Exhibit No.:	
Issues:	*Rates, expenses, tariff rules*
Witness:	*Merciel*
Type of Exhibit:	*Direct Testimony*
Sponsoring Party:	*MO PSC Staff*
Case No.:	*WA-97-510*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY OPERATIONS DIVISION

George Hoesch

CASE NO. WA-97-510

REBUTTAL TESTIMONY

of

JAMES A. MERCIEL, JR., P. E.

Jefferson City, Missouri
November 30, 1998

REBUTTAL TESTIMONY

Of

James A. Merciel, Jr.

George Hoesch

CASE NO. WA-97-510

Q. Please state your name and address.

A. James A. Merciel, Jr., P. O. Box 360, Jefferson City, Missouri, 65102.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission (Commission or PSC) as Assistant Manager-Engineering, in the Water and Sewer Department (Department).

Q. Please describe your education and experience.

A. I graduated from the University of Missouri at Rolla in 1976 with a Bachelor of Science degree in Civil Engineering. I am a Registered Professional Engineer in the State of Missouri. I worked for a construction company in 1976 as an engineer and surveyor, and have worked for the Commission in this Department since 1977.

Q. What is the purpose of this testimony?

A. The purpose of this testimony is to recommend that a Certificate of Convenience and Necessity (Certificate) be granted to George Hoesch (Company), to provide some background information about the water system operated by the Company, and to present the

Staff's water rate design, including estimated water usage for each class of customers.

Q. Please briefly describe the water system.

A. The water system is a single-well "subdivision size" water system located in Gascony Village subdivision (GV). I observed approximately 47 gallons per minute (gpm) pumped from the well, and there is a 5,000 gallon pressure tank in the well house. Information in the Direct Testimony of Company witness George Hoesch in this case indicates there are 180 customers connected to the water system. This includes twenty (20) full time residential customers, a swimming pool and bathhouse, a small building housing kitchen facilities, and some additional spigots located at boat launch ramps. The remainder of the customers, approximately 158, are part-time residential customers. The part time customers use the lots for recreation. The appearance of GV is of a recreational development, rather than of a residential subdivision, the existence of full-time customers notwithstanding. Some customers have constructed cabins, or moved mobile homes to their lots. Others park camping trailers, or bring tents. There are no water meters except a master meter located at the well. According to Direct Testimony submitted by Mr. George Hoesch, some lot owners currently are being charged an "availability charge" even though they are not water customers.

Q. When was the water system, and GV constructed?

A. GV dates to the mid 1970's, but apparently the water system that exists today was constructed beginning in 1980.

Q. What rates are you recommending?

A. The rates that I am recommending are shown on Schedule 1. Calculations for those rates are shown on Schedule 2. In calculating rates, the water utility expenses were added to calculate a "customer charge" and a "commodity charge," as if metered rates were being designed. These charges were calculated in the usual manner by using the number of customers, and a figure for total water sold. Since there are no water meters on customer service lines I used a figure for total water sold by subtracting a 10% unaccounted-for amount of water from well production as indicated by the master meter. I assumed 10% because it is consistent with the approximately 10% to 15% observed at many water utilities. I then made a number of assumptions about customer water usage to develop flat rates for the customer classes. I made an assumption for water sold to permanent residential customers of 12,000 gallons per quarter per customer, which is based on my experience with recreational developments, and calculated an estimate for swimming pool/bathhouse use which is shown on Schedule 2. The remainder of the total water sold is assigned to part-time customers and low-use commercial customers such as the kitchen and spigots at boat ramps. This amount is slightly less than 2,000 gallons per quarter per customer. The customer charge and

commodity charge were then applied using these water use figures to develop quarterly flat rates.

Q. Is there any rate base associated with this water system?

A. No. At this time, the Staff takes the position that there is no rate base. The reason is that the Company has not been able to show any capitalization of water system components. Further detail regarding this matter is contained in the Rebuttal Testimony of Staff witness James Russo.

Q. If the Commission does not agree with the Staff on the rate base issue, and allows rate base treatment on any water plant as the Company requests, do you have any recommendations on how to determine the rate base level?

A. Yes. First, whether or not depreciation has been collected from customers in the past, a depreciation reserve should be calculated based on the age of the various plant components and the Staff's recommended depreciation rates as outlined in Staff witness Guy Gilbert's Rebuttal Testimony. The Staff regularly calculates a depreciation reserve when a new certificate is granted for operation of existing utility plant, because current customers should not pay for depreciation that was or should have been taken in past years.

Also, I would strongly recommend that the transmission and distribution plant such as water mains and service lines remain excluded from any rate base treatment, regardless of how that plant

was booked in the past. The reason for this is that water utilities customarily invest money in the source and storage plant (wells and tanks). Transmission and distribution plant is contributed by developers or customers requesting service. Thus, rates that most water utility customers are accustomed to paying does not include return on transmission and distribution plant. There are very few exceptions to this. Had the Company become regulated when it began operation as should have been done, the Staff would have recommended water main construction and extensions be paid by the developer with the cost to be recovered in lot sales, or be funded by potential customers requesting service. I do not believe the customers should pay any premium in water bills because this Company operated outside of PSC regulation and did not set up its operation similar to the normal ways of regulated utilities. For distribution plant (water mains) constructed in the future to serve future customers, I recommend this Company file a tariff that includes a water main extension rule so that future main extensions are paid by either customers requesting the service or by the developer. Such water main extension rules are common among regulated utilities.

Q. Does the Company have plans to operate a sewer system?

A. Yes. Mr. Hoesch is under a directive from the Missouri Department of Natural Resources to construct a sewer system. The Company has made a filing, Case No. SA-97-357, which

seeks a certificate to construct and operate a sewer system. No central sewer system exists in the subdivision at present.

Q. Would construction of a sewer system along with granting of a certificate have any impact on the Staff's recommended water rates?

A. Yes, there could be an impact in the future. When utilities operate both water and sewer systems, then a number of common costs can be shared and allocated between water and sewer rates. Examples of such costs are billing when both services are included on a single bill; office expense when one office handles both services; and operations personnel and transportation when an operator works on both systems in a single trip.

Q. Are any of the expenses included in the Staff's proposed quarterly water rates in this case allocated to sewer rates?

A. No. At this point in time it is questionable in my opinion whether or not Case No. SA-97-357 will actually result in the Company operating a sewer system because of apparent infeasibility. For this reason the Staff's recommended quarterly water rates do not include any allocation to sewer rates.

Q. Would there be any impact on the expenses if the Company is granted a certificate to provide sewer service in SA-97-357, or some subsequent case, and begins operating a sewer system?

A. Yes, at least there could be some impact in the future. If a certificate for sewer service is granted after water

rates are set in this case, then my recommendation would be to set sewer rates based on the incremental expenses over and above those incurred in providing water service. This means that water rates would subsidize the sewer operation, which is not particularly desirable. However, for practical purposes it is safe to assume that all sewer customers will be water customers, so the subsidization would not cause any negative impact on customers, and I think this is the best way to deal with the uncertainty of the sewer system issue. Expenses could be properly allocated in a future rate case.

Q. On page 3 of his Direct Testimony, Mr. George Hoesch discusses several items that are now purportedly owned by Gascony Realty Co., but proposes ownership by the Company. Do you agree it is reasonable for the Company to own these items?

A. To a great extent, it is a management decision regarding who or what entity owns these items. Regarding the office trailer, the Staff did not include it as rate base, but the Staff did include office rent. The Company could choose to own its office and furnishings in lieu of renting it if it is economical to do so. Regarding the trencher, my opinion is that present customers have little or no benefit from this piece of equipment. This item is used primarily for construction of new water mains and service lines, the cost of which is not incurred by current customers; rather new customers or developers pay for main extensions. If the Company owned the trencher, and it is "used

exclusively by the Company" as stated in the testimony, then the Company would need to bill the entity causing the cost to be incurred, and there should be enough revenue from main extensions to justify the Company's ownership. This means return on investment does not need to be in quarterly water rates. To the extent it is used for repairs, the allocated cost or rental of this equipment is properly included in water rates; and the Staff has included money for repairs.

Q. On the same page in his Direct Testimony, Mr. Hoesch proposes that the Company install shut-off valves at each water service line. Do you agree this is necessary?

A. Shut-off valves are important and I would recommend they be required for new construction, along with an appropriate connection charge if the Company incurs cost to make the connection. I don't think it is economical to go to each existing service connection and install a valve. Because of the time involved in locating service lines this would be quite expensive relative to bills customers are currently paying. I do think that the Company should have rules in its tariff providing for the installation of, and payment for, shutoff valves for customers who have to be disconnected for any reason such as non-payment of bills. A few other regulated water companies have such rules and charges. Approved charges for those companies are in the range of $400 to $600. While such a charge for the Company could be within

this range, the charge would be based on actual costs and could be outside the range.

Q. On page 4 of his Direct Testimony, Mr. Hoesch states that his existing charges for residential water service are determined at least in part by whether or not the customer has electric service. Do you believe this is reasonable?

A. No, I do not. It may be true that some customers with electric service tend to use more water than some customers without electric service, but there has been no basis for quantifying the difference as applicable to a customer class. There are also other factors that affect individual customer water use. I don't think it is practical to try to set different rates for one class of customers based on individual circumstances. I recommend setting residential rates based on part-time or full-time status, which can be determined by mailing address. This method works for other regulated water utilities that have part-time customers.

Q. On page 5 of his Direct Testimony, Mr. Hoesch discusses an "availability charge," which applies to customers who do not have water service. Do you support such a charge?

A. No. Some developments have such charges, but they are created by subdivision restrictions, to which lot purchasers agree in the context of the lot sale. In these cases the utilities are assigned funds collected from such a charge. In reviewing lot sales contracts, I have seen no evidence to indicate such a charge

was included. I do not support creation of such a charge by the Company because it really is not a charge for utility service.

Q. Do you agree with all the expenses included in the Direct Testimony of the Company's witness Mr. Earnest Harwig?

A. No. I have included some expenses in the Staff's proposed water rates that are different than those in Mr. Harwig's Direct Testimony.

Q. Would you please describe expenses for which there is significant disagreement?

A. Yes. Expenses may be compared by referring to my Schedule 2-1, and Mr. Harwig's Schedule 2.

I have included an all-inclusive maintenance expense of $1,500 as opposed to the Company's $500 "well maintenance" to reflect costs normally associated with a system of this size.

I have included a $4,000 annual expense for a 5-year amortization of start up costs. Mr. Harwig included a total of $20,750 in annual "rate case expense" for legal, consulting, and accounting, which I am sure is actually intended to represent expenses for the Certificate case. In my opinion the amortization is a more realistic way to address the one-time start up expenses. Considering the size of the operation, and the fact that the PSC has an informal rate procedure for small water companies, there is no reason to include a large annual rate case expense. The amortization is the Staff's estimate based on the Company's proposal. I recognize that Mr. Hoesch may have incurred much more

additional legal expense related to the proposed sewer system, since there has been a controversy between Mr. Hoesch and the Missouri Department of Natural Resources. This amortization is intended to pertain only to the water system.

I have included $12,000 for salaries and benefits, as opposed to the Company's proposed $19,767 for supervision, clerical, and benefits. The expense I have included is in the mid-range of some other small water utilities of similar size. Some such water utilities incur less expense for salaries because the operation is relatively simple, and others incur more because they have more staff to operate systems serving full time residential customers, for reading water meters, and billing monthly. I think this Company would fall into the category of a relatively simple operation. The Staff has provided Mr. Hoesch with forms to record and document vehicle mileage, personnel time, and other operational items, and advised that records should be kept. The Staff could reconsider salaries and benefits expenses in the future after reviewing genuine documentation recorded by the Company.

I have included a total $1,200 for miscellaneous expense, on-hand materials and supplies, and contingency, as opposed to the Company's $500 expense for miscellaneous.

The Company's proposed operating expenses are about twice what the Staff is proposing.

Q. Do you agree with the rate design, and quarterly rates calculated by Mr. Harwig?

A. No. Mr. Harwig has calculated a rate that includes an availability charge for lot owners, which as discussed I do not think is appropriate. His rate design does not distinguish part-time and full-time water utility customers. It appears to me that he also used only a commodity charge to determine flat rates. Mr. Harwig's expenses and rate design result in a charge for residential customers of about twice what I am proposing, and a rate for the Swimming Pool/Bathhouse that is about five (5) times what I am proposing. I think these rates are unrealistically high. The risk of designing rates that customers think are too high is that many customers, being part-time recreational customers unlike full-time residential customers, are in a position to permanently disconnect from the water system.

Q. Do you recommend water meters be installed?

A. Similar to shut-off valves, I think water meters are important, but not always economical. In this case, I do not recommend a water meter installation program for residential customers because of the cost involved. Water meters installed on existing service lines could cost from $350 to $600 each or more. I do think a properly sized water meter should be installed at the swimming pool/bathhouse. It may also be desirable to install a water meter at other commercial locations such as the kitchen and other locations. It is possible that at some time in the future a meter installation program could be initiated for full-time residential customers, then for part-time customers. I still

recommend flat rates be implemented in this case. After any meters are installed, actual water usage may be studied and incorporated in rate design in future rate cases.

Q. Is the water system being operated presently in a manner that requires a Certificate from Public Service Commission?

A. In my opinion, yes, the water system should already be regulated, because the owner is presently charging for service to the public, and has been doing so for a number of years. It appears the water system should have been regulated since operation began in the 1980s or before.

Q. Do you recommend the Commission seek penalties against the Company for operating without a Certificate?

A. No, I am not making any such recommendation. The Commission could decide to seek penalties anyway, of course. There could be a substantial impact on the Company or its owner if the Commission took such action. The Staff sometimes considers using penalty action as a compliance tool, if there is no cooperation from a utility, but this Company submitted a Certificate case filing at the Staff's request, and the case is moving ahead.

Q. Do you recommend the Commission grant a Certificate to the Company?

A. Yes. My recommendation is based on the fact that the system exists and customers are connected, making the need for service obvious. Mr. Hoesch has been operating the system for a number of years, and it appears to me after observing the system

and meeting with Mr. Hoesch and his agents that he has reasonable technical, management and financial capability to continue operation as a regulated utility. In addition to being granted a Certificate, I also recommend the company submit a tariff that is similar to the Water and Sewer Department's example tariff for small water companies. The tariff should include a reconnection charge that reflects the cost of installing a shut-off valve, and a water main extension rule.

Q. Do you have any other recommendations about this case?

A. Yes. The case was filed on behalf of George Hoesch, Mr. Hoesch personally proposed to be the regulated utility. However, Mr. Hoesch has indicated in information submitted to the Staff, and in his Direct Testimony, the existence of a corporation he formed, Gascony Water Company, Inc. A filing was recently made by the Company seeking that the Certificate be issued to Gascony Water Company, Inc. (GWC). I do not object to the concept of GWC being the regulated utility, and any recommendations I have made applicable to the Company would also be applicable to GWC if it indeed becomes the regulated utility.

Q. Would you please summarize your testimony?

A. Yes. I recommend:

⇒ That George Hoesch (or GWC) be issued a Certificate of Convenience and Necessity to provide water service;

⇒ That rates as outlined herein be approved;

- ⇒ That the Company file a tariff that contains rates as recommended herein, a connection charge and a reconnection charge that includes a shutoff valve on customer service lines, and rules and regulations for providing water service including a water main extension rule;
- ⇒ That the Company not initiate a service line valve installation program, in consideration of rules for new connections and reconnections requiring valves;
- ⇒ That water meters be installed at the pool/bathhouse, and any other commercial customers considered to be high water use customers;
- ⇒ That no penalty action be sought.

Q. Does this conclude your Rebuttal Testimony?

A. Yes.

George Hoesch
WA-97-510

11/25/98

Quarterly rates		Annual
Pool/Bathhouse	**$ 139.67**	$ 558.68
Full-Time residential	**$ 65.38**	$ 261.52
Part-time residential and other commercial	**$ 32.82**	$ 131.28

Schedule 1

George Hoesch
WA-97-510

11/25/98

WATER RATE DESIGN

Quarterly billing

180 customers
20 Full time customers
1 Commercial (pool)
2577 Thousand Gallons total annual pumped water
10% Assumed unaccounted for water

2319 Annual Water Use

Expenses	**Total**	**customer**	**commodity**
Electric	500	-	500
Mgt -oper-clerical	12,000	8,000	4,000
maintenance	1,500	-	1,500
vehicle	2,829	1,414	1,415
testing	500	500	-
rent	1,500	1,500	-
office equip - suppl	200	200	-
telephone	600	600	-
postage	250	250	-
insurance	-	-	-
taxes	70	-	70
Startup costs (amortized)	4,000	4,000	-
Legal, accounting	1,000	1,000	-
Misc, contingency, M & S,	1,200	1,200	-
	-	-	-
	-	-	-
PSC Asess	500	500	-
Design Revenue	**26,649**	**19,164**	**7,485**

QUARTERLY RATES	**Customer charge**		**Commodity charge**
(for flat rate calculation)	**$ 26.62**	**$ 3.23**	**/1,000 gal**

Schedule 2-1

George Hoesch
WA-97-510

11/25/98

DEVELOPMENT OF FLAT RATES

All plant contributed

Assume full time customers use , gallons per quarter 12,000
Common property except swimming pool considered part time

Swimming pool est	5	months activity			
		dimension:	60	40	
		fill vol	5	feet	90000 gallons/yr
		evaporatio	5	inches/mo	7500 gallons/mo
		shower	100	people	
			6	weekend days	
			4	gal	2400 gallons/mo

Customer	Annual use			QUARTERLY FLAT RATES	annual
Pool	140	Thousand Gal		**139.67**	558.68
Full time	960	Thousand Gal		**65.38**	261.52
Part time	1,219	Thousand Gal		**32.82**	131.28
	1,920	gal per quarter per customer			

REVENUE CHECK

		Quarterly rates		Annual Revenue
1	Commercial (pool)	$ 139.67		$ 558.68
20	Full time customers	$ 65.38		$ 5,230.40
159	Part time customers	$ 32.82		$ 20,873.52
			Total	**$ 26,662.60**
			Design rev	**$ 26,649.00**
			difference	$ 13.60

Schedule 2-2

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of George Hoesch, for a Certificate of Convenience and Necessity Authorizing Him to Own, Operate, and Maintain a Water System for the Public, Located in an Unincorporated Area of the County of Gasconade, Missouri.	)))))))	Case No. WA-97-510

AFFIDAVIT OF JAMES A. MERCIEL, JR.

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

James A. Merciel, Jr., of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony, in question and answer form, consisting of 15 pages, to be presented in the above case; that he has knowledge of the matters set forth in such answers; and that such answers are true to the best of his knowledge and belief.

James A. Merciel, Jr.

Subscribed and sworn to before me this 30th day of November, 1998.

Christine E Brauner
Notary Public

CHRISTINE E BRAUNER
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP JULY 22,2001

My commission expires _____