

Exhibit No.: _____
Issues: Cost Allocation/Rate Design
Witness: Paul R. Herbert
Exhibit Type: Surrebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2010-0131 & SR-2010-0135
Date: May 6, 2010

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2010-0131 & SR-2010-0135

SURREBUTTAL TESTIMONY

OF

PAUL R. HERBERT

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

JEFFERSON CITY, MISSOURI

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

IN THE MATTER OF MISSOURI-AMERICAN) WATER COMPANY FOR AUTHORITY TO) FILE TARIFFS REFLECTING INCREASED) RATES FOR WATER AND SEWER) SERVICE)	CASE NO. WR-2010-0131 CASE NO. SR-2010-0135
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AFFIDAVIT OF PAUL R. HERBERT

Paul R. Herbert, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of Paul R. Herbert"; that said testimony was prepared by him and/or under his direction and supervision; that if inquires were made as to the facts in said testimony, he would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of his knowledge.


Paul R. Herbert

**Commonwealth of Pennsylvania
County of Cumberland
SUBSCRIBED and sworn to
Before me this 4th day of May 2010.**


Notary Public

My commission expires: February 20, 2011

COMMONWEALTH OF PENNSYLVANIA
Notarial Seal
Cheryl Ann Rutter, Notary Public
East Pennsboro Twp., Cumberland County
My Commission Expires Feb. 20, 2011
Member, Pennsylvania Association of Notaries

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1 **WITNESS INTRODUCTION**

2
3 **1. Q. Please state your name and address.**

4 A. My name is Paul R. Herbert. My business address is 207 Senate Avenue,
5 Camp Hill, Pennsylvania.

6 **2. Q. By whom are you employed?**

7 A. I am employed by Gannett Fleming, Inc. as President of the Valuation and
8 Rate division.

9 **3. Q. Are you the same Paul Herbert that submitted direct and rebuttal**
10 **testimony in this proceeding?**

11 A. Yes, I am. My direct testimony and exhibits were submitted with the
12 Company's filing on October 29, 2009. My rebuttal testimony was submitted
13 on April 15, 2010.

14 **4. Q. What is the purpose of your surrebuttal testimony in this proceeding?**

15 A. The purpose of my surrebuttal testimony is to address the cost of service
16 allocation and rate design issues presented in the rebuttal testimonies of Staff
17 witness James Russo, Office of Public Counsel (OPC) witness Barbara
18 Meisenheimer, and AGP witness Donald Johnstone.

19
20 **AGP PROPOSALS**

21 **5. Q. What are the issues that you will address concerning Mr. Johnstone's**
22 **rebuttal testimony?**

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25 A. I will address his load research recommendation and his rate design
26 proposal.

1 **6. Q. What is the issue regarding load research data?**

2 A. Mr. Johnstone reiterates his complaint regarding the lack of demand data and
3 recommends that the Company conduct load research for the larger industrial
4 customers and the Sales for Resale customers in the St. Joseph District.
5 However, this would only provide a small part of the total information that
6 would be required. The residential and commercial classes have over 50% of
7 the total consumption. If these classes are not included in a load research
8 study, the results would be incomplete.

9 **7. Q. Are you suggesting that a complete load study be performed?**

10 A. No, I am not. Such a study would be very expensive and would have to be
11 performed for all the districts, not just St. Joseph. This would require
12 numerous recording devices that range in cost from as little as \$100 to as
13 much as \$2,400 a meter depending on the age and type of meter being
14 replaced. In addition, there would be costs incurred to place such devices,
15 monitor the recording process, download the data periodically and analyze
16 the data to determine the results. These costs could be significant and there
17 is no evidence that the information produced as a result of this exercise would
18 sufficiently improve the class cost of service studies. Each party has been
19 able to conduct cost of service studies without load research data and have
20 relied on estimated peak ratios to support their results.

21 **8. Q. Are load studies typically conducted for water companies?**

22 A. Generally, no. The energy industry has been conducting load studies for
23 many years because they have the sophisticated equipment and a power
24 source available to facilitate the data gathering process. Also, the commodity

1 cost for water is so much less than for energy that there hasn't been a strong
2 demand to have water load studies performed.

3 **9. Q. Can cost of service studies and declining block rates be designed**
4 **without load studies?**

5 A. Absolutely, the water industry has been doing just that for many years. There
6 have been enough studies performed to determine the general relative
7 demand factors for each classification so that meaningful cost allocation
8 results can be achieved. The AWWA Manual provides the guidance
9 necessary to conduct appropriate and reasonable cost allocation studies even
10 when specific demand data is unavailable. From these cost allocation results,
11 a declining block rate structure can be designed that is fair and equitable for
12 all classifications.

13 **10. Q. Please comment on Mr. Johnstone's rate design recommendation.**

14 A. Mr. Johnstone rejects Staff's single block rate design for non-residential
15 customers and reiterates his recommendation for an across-the-board
16 increase to the existing industrial block rates. Although I support
17 maintaining a declining block structure for non-residential classes, Mr.
18 Johnstone's across-the-board increase to the existing industrial block rates
19 only perpetuates the problems in the existing design. As I indicated in my
20 rebuttal testimony, the first block rate is 47% higher than the other classes
21 without any cost justification, and the tail-block rate is too low to recover base
22 costs. The Company's proposed rates correct these problems and should be
23 used as a basis to design the final rates in this case.

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1 CUSTOMER CHARGES

2 11. Q. Please address the issue of customer charges.

3 A. Both Mr. Russo and Ms. Meisenheimer oppose uniform customer charges
4 proposed by the Company and propose to set customer charges based on
5 their district specific costs.

6 First, as I noted in my rebuttal testimony, Ms. Meisenheimer did not follow
7 standard AWWA practice to determine the level of customer charges that she
8 recommends and therefore her customer charges are significantly deficient in
9 relation to cost. Mr. Russo did not include the reallocation of public fire costs
10 in his calculation so his customer charges are also understated, but not as
11 much so as Ms. Meisenheimer's. Second, the primary reason for their
12 opposition to uniform customer charges focuses on the notion that this would
13 be a step toward single-tariff pricing. I don't believe this is a valid reason to
14 oppose uniform customer charges. The facts to consider are that every
15 customer has a meter and service line, every customer has their meter read
16 monthly (except St. Louis Metro residential customers) and every customer
17 receives a monthly bill from a centralized facility. Since each customer
18 receives service from uniform customer facilities, it makes sense to have
19 uniform customer charges. Moreover, to the extent a uniform customer
20 charge exceeds or is below its district specific cost, the excess or deficiency
21 remains in the district to be recovered through the volumetric rates, and there
22 is no interdistrict shifting of costs or revenues.

TRIUMPH FOODS ISSUE

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12. Q. Please address the rate issue of Triumph Foods.

A. Ms. Meisenheimer suggests that revenue imputation would be appropriate for St. Joseph District to reflect the full tariff rates for Triumph rather than the Commission-approved contract rates. She also recommends that the Commission review the contract rate to determine if the discounted rate should be continued.

13. Q. What is your view?

A. I have no problem with the Commission reviewing the appropriateness of the contract, but to impute revenue above the level of the contract revenue is not appropriate. Ms. Meisenheimer states that she is concerned that the variable unit costs will exceed the contract rate at some point in the future. However, my calculation shows that the difference between the contract rate and the unit variable costs has actually increased since the last case.

14. Q. Please explain.

A. In my rebuttal testimony, I calculated that the difference between the contract rate of \$0.5013 per thousand gallons and the variable costs per thousand gallons of \$0.329 equals \$0.1723. This represents the amount per thousand gallons that Triumph contributes to fixed costs. In the last case, the Triumph contract rate was \$0.4747 and the variable costs were \$0.315 per thousand for a difference of \$0.1597. So the difference between the contract rate and the variable cost per thousand gallons has increased from \$0.1597 to \$0.1723 or about 7.9% since the last case.

1 CONCLUSION

2 **15. Q. What is your overall view of the cost of service and rate design issues**
3 **and the positions of the parties at this time?**

4 A. The Company's cost of service studies have consistently applied the cost
5 allocation principles that the parties generally agree with especially now that
6 corrections have been submitted. The Company studies have properly
7 determined the class cost responsibility within each district and have properly
8 determined the appropriate level of customer costs.

9 The Company's rate design employs uniform customer charges, continues
10 the district specific single-block structure for residential customers, and
11 continues the appropriate district specific declining block structure for non-
12 residential customers. The Company's cost of service allocation results and
13 rate design proposal should be used to determine the final revenue
14 distribution and rate structure in this case.

15 **16. Q. Does this conclude your surrebuttal testimony?**

16 A. Yes, it does.