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Witness Name:	**Wendell R. Hubbs**
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Missouri Public Service Commission

Utility Operations Division

Water & Sewer Department

Surrebuttal Testimony

of

Wendell R. Hubbs

Case No. WR-2003-0500 & WC-2004-0168

Missouri-American Water Company

Jefferson City, Missouri
December 2003

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the General Rate Increase for Water and Sewer Service Provided by Missouri-American Water Company	)))	Case No. WR-2003-0500
Staff of the Missouri Public Service Commission, Complainant, v. Missouri-American Water Company, Respondent	)))	Case No. WC-2004-0168

AFFIDAVIT OF WENDELL R. HUBBS

STATE OF MISSOURI)
) **ss**
COUNTY OF COLE)

Wendell R. Hubbs, of lawful age, on his oath states: that he has participated in the preparation of the foregoing testimony in question and answer form, consisting of 50 pages of testimony to be presented in the above case, that the answers in the foregoing testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.

Wendell R. Hubbs

Subscribed and sworn to before me this 5th day of December, 2003.

Notary Public

DAWN L. HAKE
Notary Public – State of Missouri
County of Cole
My Commission Expires Jan 9, 2005

My commission expires

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Surrebuttal Testimony
of
Wendell R. Hubbs

Case No. WR-2003-0500
Missouri-American Water Company

Q. Please state your name and business address.

A. My name is Wendell R. Hubbs and my business address is Governor Office Building, Suite 500, 200 Madison Street, Jefferson City, Missouri 65101.

Q. Are you the same Wendell R. Hubbs who filed direct and rebuttal testimony in this case on behalf of the Missouri Public Service Commission Staff (Staff)?

A. Yes, I am.

Q. What is the purpose of this surrebuttal testimony?

A. This testimony is presented to rebut the rebuttal testimony of the following witnesses: Missouri-American Water Company (Company) witness Paul R. Herbert; Company witness James M. Jenkins; Missouri Energy Group (MEG) witness Billie LaConte; Missouri Industrial Energy Consumers (MIEC) witness Michael Gorman; City of Riverside and AG Processing's (Riverside/AGP) witness Donald E. Johnstone; Office of the Public Counsel (OPC) witness Barbara A. Meisenheimer; and the St. Joseph Water Rate Coalition (SJWRC) witness M. Dianne Drainer. This testimony also is presented to correct portions of my rebuttal testimony with regard to an issue in the direct testimony of Empire District Electric Company (Empire) witness Dennis M. Kalbarczyk.

CLASS COST OF SERVICE STUDY – COMPANY WITNESS HERBERT

Q. Did Company witness Herbert address any of the major differences in your class cost-of-service study and his?

A. Yes, he did. He brought up one of the major differences in our studies. This difference affects the St. Louis County, Joplin and St. Joseph Districts. The difference has to do with the allocation of what Mr. Herbert calls "distribution" mains. This difference is explained in detail in my rebuttal testimony from page 2, line 13, to page 12, line 20. I incorporate my responses explained in my rebuttal testimony to rebut Mr. Herbert's "distribution main" arguments.

Q. On page 6, lines 8 through 11, of his rebuttal testimony, Mr. Herbert explains that his study reflects that many large users are served primarily from large transmission mains (generally larger than 10-inch). Please respond to this statement.

A. I agree that many larger users may be served directly off of transmission and distribution (T&D) mains of 10" or larger, and that these larger users may have service characteristics that show that they should not be assigned costs related to smaller sizes of T&D mains. But when such service characteristics are taken into account, other related characteristics, such as the length of "transmission mains" serving the class in relationship to the average system length implicit in the base-extra capacity allocation method, should also be considered. When such service characteristics exist, a differentiated service class should be created and directly allocated the costs related to its service characteristics.

RATE DESIGN – COMPANY WITNESS HERBERT

Q. On page 10, lines 2 through 7, of his rebuttal testimony, Company witness Herbert explains that the Company strongly opposes your suggestion that the Company absorb any shortfall in the Brunswick District and that this suggestion is contrary to the notion that ratepayers should pay for all of the prudently incurred costs necessary to provide service to them. Please respond to this.

A. The Company appears to be criticizing my suggestion that the Company or the ratepayers in other districts should be responsible for any cost recovery shortfall in Brunswick District's cost-of-service, because such suggestion is contrary to the notion that ratepayers should pay for all of the prudently incurred costs necessary to provide service to them. This is interesting, considering that the Company proposed no increase to this district's cost-of-service and proposed in its COS study to make customers in another district subsidize the Brunswick District's cost-of-service of $418,754 by $213,779. By stating: "The Company does not necessarily object to other reasonable cost shifting efforts to mitigate the rate impact on the Brunswick District.", the Company is saying that subsidization is acceptable to it as long as someone other than the Company is paying the subsidization. To bring Brunswick up to its full cost of service would yield a commodity rate of $8.30+ per Mgallon for residential service. This full cost-of-service commodity rate would be approximately 2.86 times as large as the St. Joseph's proposed Residential rate and 7.66 times as large as the St. Louis proposed Residential rate. This begs the question of why so much investment and costs were incurred to serve the Brunswick District. Since the Company's last rate case, the Joplin District has subsidized the Brunswick District. In this case, the Company has proposed that St. Louis County

District customers subsidize the Brunswick District customers by paying for approximately 50% of the Brunswick District's cost-of-service. The Company has proposed no increase in the recovery of cost-of-service for the Brunswick District. This means that the Company has not proposed any movement toward its determined cost-of-service for the Brunswick District.

Q. On pages 10, lines 8 through 21, of Mr. Herbert's rebuttal testimony he rebuts your position and explains the Company's proposal for the determination of the monthly customer charge. Please respond to this testimony.

A. Mr. Herbert states that the Company is proposing a uniform schedule of customer charges for all districts excluding St. Louis County and St. Charles, in which the Company is proposing different customer charges. As its backup for this position, Mr. Herbert states that a uniform schedule of customer charges makes sense, since every customer is metered, has a similar service line, has his meter read in a similar manner, and has his bill prepared at a central location. The Company's position ignores the fact that both the Company and Staff developed customer charge-related costs that are different for each district, and that when you design these costs to be recovered from the customers in each district; the resulting customer charges (cost recovery responsibility) are dramatically different. Using one uniform schedule of customer charges ignores the results of the cost of service and shifts cost responsibility between customers within each district. Customers in each district should be responsible for the recovery of their district specific-allocated customer charge costs from the COS study that the Commission approves. This means that the customer rate will and should be different for each district, including the St. Charles District and St. Louis District.

Q. Does Mr. Herbert modify the Company's position as stated in his direct testimony regarding the implementation of customer charges?

A. Yes, he does. Mr. Herbert states: "For these reasons and for administrative ease and understanding the Company would prefer to have two sets of customer charges – one for St. Louis and St. Charles and one for the remaining districts, but **would not object to district specific customer charges if all other parties support it**." (**Emphasis added**) I disagree that administrative ease and understanding are valid reasons to ignore the cost of service study results related to customer charge cost assignment, and am relieved to hear that the Company does not object to using the district-specific customer charges developed by the cost study approved by the Commission.

Q. On page 10, starting on line 21, through page 11, line 11, of Mr. Herbert's rebuttal testimony, he rebuts your position and explains the Company's proposal for the determination of the commodity charges. Please respond to this testimony.

A. Mr. Herbert states that the Company and I are in agreement with regard to having only one block for the Residential class. He also states that for all districts except St. Louis and St. Charles, the Company is proposing two to four declining block structures for each non-residential class. Staff has proposed a single commodity rate for all classes in all districts, consistent with what the Company is proposing for the St. Charles and St. Louis Districts. I am of the opinion that all commodity charges for each cost of service should be set as they are for the vast majority of the Company's ratepayers in the St. Louis District. The Company has proposed to change commodity charge design

for the St. Charles District from a four-tier declining block design to a single block design. This same design being proposed by the Company for the St. Louis and St. Charles Districts is what I am proposing for the other districts.

As an argument for the Company's position, Mr. Herbert states that large-use customers should benefit from declining block rates. I agree with Mr. Herbert that with the use of declining block rates larger customers will benefit. They will benefit by paying dramatically less for water service than smaller customers in the same class pay.

As an example of the inequity caused by using a declining block tier, small customers can have more favorable load factors than large customers can. Looking at the proposed commodity rates generated by Mr. Herbert's rate block determinations for commercial customers in the Mexico District, the first block is set at $4.0140 per Mgallon for the first 100 Mgallons. The second block is set at $1.5000 per Mgallon for all usage over 100 Mgallons. This rate results in a small commercial customer with a better-than-average load factor being exposed to paying twice as much per unit of water than the volumetric rate of a large commercial customer with a worse-than-average load factor. This declining block rate tier design does not represent an equitable recovery of the costs related to the load factor affected inside of the class. The use of uniform commodity rates (a single commodity rate for each class of customer) is more equitable, because customers pay the same unit price for water service as other members of the defined class do. There is no equity in allocating costs by class in the study, and then designing rates that make smaller customers in that class pay up to twice what larger customers in that class pay for the same gallon of water.

Q. Are Mr. Herbert's non-residential customer class proposals for the St. Louis County District and the St. Charles District consistent with the declining block commodity charge rate design he is proposing for the other districts?

A. No, they are not.

Q. Please discuss the reasons that Mr. Herbert gives for retaining the declining block rate design for some of the districts.

A. Mr. Herbert states that having single-block rates for each class benefits the small users at the expense of the large users (page 11, line 5, Herbert's Rebuttal Testimony.) First, I would point out that Mr. Herbert has proposed that the majority of the Company's customers continue to use a single-block rate, and has proposed that the St. Charles District move to a single-block rate. At this point in his rebuttal testimony he is, for some reason, attempting to state that my rate design proposal to move to single-block rates for the other districts is not appropriate, when he is proposing to retain such use for the majority of the Company's customers.

Under the single-block rates for each class, the only benefit to smaller customers is that they will be charged the same cost on a per-unit basis as all other customers in their defined class and won't be responsible for subsidization of costs related to serving the large customer. By approving the single-block rates for all districts and classes, the smaller customers in each affected class will be afforded the same rate applicability that the Company is proposing for the St. Louis County District and St. Charles District customers, for the majority of the Company's customers.

The benefit to smaller customers by using a single-block rate is that the small customers would no longer be paying up to twice as much per gallon of water purchased

as the large customer in the same class would pay. The declining block rate design causes small users in a customer class to pay much more of the costs to provide their water than large customers pay. The commodity-related class costs of service allocated to the individual classes have been allocated on the usage characteristics and demands of the class, and should thus be recovered from each customer in the class on that same basis.

On page 11, starting at line 4, of his Rebuttal Testimony, Mr. Herbert states that the Company believes that larger-use customers should benefit from declining block rates. Larger customers do benefit from declining block rates. When you design rates using a declining block rate design it will shift costs from large customers to small customers in the same class for no defined reason.

Mr. Herbert then states: "The Company needs to retain large users on the system so that they will share in the fixed costs of the system which benefits all users including residential users. Higher single-block rates may encourage large users to seek or develop alternative supplies to the detriment of the remaining customer base who would have to replace the lost revenue". What Mr. Herbert is saying in effect is that the smaller customers of a class need to subsidize the cost-of-service of larger customers in the same class, by paying up to twice per gallon what the larger customer pays. Mr. Herbert appears to be of the opinion that if these small customers don't subsidize the rates of the larger customers, the larger customers will leave the Company for their water needs, and if they leave the system the rest of the customers will suffer by paying higher rates. I am of the opinion that it is inequitable to have smaller customers in the class fund dramatically higher rates to retain a larger customer of that class. I am of the opinion that

the results of the cost-of-service study should be assigned to each class, and that commodity recovery should be affected on a per unit basis equitably from large and small customers of that class, without the small customers of that class paying as much as twice as much as the large customer pays, so that the large customer will not leave the system. If larger customers need economic incentive to stay on the system, I recommend that they seek special service contracts to lower their rates from the cost-of-service, so that all customers will end up subsidizing this customer, not just the smaller customers in his class.

Again, I note that Mr. Herbert has proposed a single-block rate for the St. Louis County District, and is proposing to change the St. Charles District to a single-block rate as well. I recommend that the Commission approve the single-block rate for all classes in all districts to recover the cost-of-service consistently and fairly throughout the Company.

Q. On page 11, starting on line 12, through page 12, ending on line 6, Mr. Herbert rebuts your recovery design for public fire service costs. Please address this testimony.

A. Mr. Herbert states that the Company strongly opposes my allocation of public fire protection costs back to non-fire, non-resale classes, to be recovered in the consumption rates. He states that the Company believes that such costs should be recovered on a per-customer basis, as proposed in the tariffs, or recovered through fixed customer charges. I disagree with the recovery of public fire protection cost on a per-customer basis as proposed by Mr. Herbert. It is my opinion that recovery of the public fire protection costs should be recovered based upon the benefit received by the Company's customers. As a result, it does not seem to me that a flat, per-customer

charge is appropriate, since the benefit of fire protection obviously varies from customer to customer. I am of the opinion that a customer using 2,000,000 gallons of water a month most likely has facilities that are more valuable than a customer using 5,000 gallons per month does. Because of this, I am of the opinion that a usage charge is a more appropriate recovery mechanism than recovery on an equal-per-customer basis as proposed by the Company. I used the AWWA M1 Manual, Chapter 30, *Rates for Fire Protection Service,* as the authoritative support to recommend that the Company maintain the Commission-approved method of recovery of public fire protection costs through the Company's commodity charge. The AWWA M1 Manual addresses the Company's proposal of equal recovery based on a per-customer basis no matter what size the customer, but states that this method does not recognize any differences in the level of fire protection service provided.[1] The creation of hydrant charges, as the Company has proposed, is discussed, but only in the context of billing municipalities for the service, not individual customers. Municipalities then recover this charge along with all other general fund expenses - - typically by assessing *ad valorem* taxes. Such a method of recovering costs is believed to be generally equitable in that individual property owners pay for fire protection service based on the value of their property - - a measure of the benefit they receive for fire protection.[2] I have no problem keeping a hydrant charge for any governmental or quasi-governmental entity that pays for public fire service alone.

Current tariffed rates for public fire service in every district but the St. Louis County District are recovered on a per-sales-unit basis such as I am proposing. The

[1] AWWA M1 Manual, Chapter 30 Rates For Fire Protection Service, Page 227
[2] AWWA M1 Manual, Chapter 30 - Rates For Fire Protection Service, page 225 Direct Public Protection Charges

recovery of public fire service costs is done with the automatic adjustment clause on a per-customer basis.

I have recommended that the St. Louis County District public fire protection costs be recovered consistent with the current recovery of the other districts, on a per-sales-unit basis.

Pursuant to the Company's proposed tariff language for the districts, this uniform charge will be made to all residential, commercial, industrial and public authority customers on a per-customer basis. The existing St. Louis County District language, and the other districts proposed tariff language contains an automatic adjustment clause, which can increase or decrease the billed cost of fire service to a customer's bill based on the change in the total number of hydrants in service and/or the total number of customers. The per-hydrant charge for public fire service shown on the proposed tariff sheet is not actually the charge a customer will pay for the public fire service. The actual rate to be charged has to be computed based on the number of hydrants in service and the total number of customers being served. I am of the opinion that it is necessary and appropriate to set the actual rate that each class of customer is responsible to pay for this service in the context of a general rate case. Mr. Herbert's proposal does not do such. If the customers' rates need to be changed, such should be accomplished pursuant to a rate case before the Commission. This is the first automatic adjustment clause whereby customer rates (the rates the customers are ultimately charged) can be changed without specific Commission approval. The Company's proposed tariff sheet does not set a specific rate for customers, and in fact it allows for the modification of the rate for this

service based on the variables of the number of fire hydrants in service and/or the number of customers at different dates in the future.

Q. On page 11, starting on line 17, through line 23, Mr. Herbert rebuts your recovery design for public fire service costs regarding recovering a fixed cost through a usage charge. Please address this testimony.

A. Mr. Herbert states that the Company believes that the costs to provide fire service are fixed in nature. Mr. Herbert says that fire service costs include investment and maintenance of larger-sized mains, storage facilities and fire hydrants themselves, in order to provide instantaneous fire suppression when called upon. He states that they do not vary with water usage at all, and yet I am proposing to recover such costs through consumption rates, resulting in customers who use more water paying for more fire protection.

First, the majority of all costs-of-service that Mr. Herbert refers to as fixed in nature are recovered on a commodity basis. Only the customer charge costs of meter-related costs, service-related costs and billing and collection costs are recovered on a per-customer basis (based on my full customer charge rate design proposal, not his non-cost based district customer charges.) The majority of the "fixed" costs of the Company are recovered on a commodity basis. The majority of these "fixed" costs do not vary with water usage at all, but are still recovered on a commodity basis. My proposal to recover these public fire service costs through the commodity charge is the same method of recovery as is used for the vast majority of all fixed costs. The recovery of these fixed costs by the use of a commodity charge is more equitable than recovery on a per-customer basis. In fact, Mr. Herbert's cost-of-service study also proposes using the

commodity charge to recover the majority of these fixed costs. His argument that I am not recovering fixed type of costs based on customers is not valid, since the majority of fixed costs - even in his study - are recovered through a commodity charge.

What is important is the basis for allocation of these costs to customers. Mr. Herbert is of the opinion that each customer - the apartment dweller and the industrial customer alike - who have access to public fire protection, should pay the same cost for this protection. He takes exception to my method of allocating of fire costs to the classes and then recovering such costs on a commodity basis, in an attempt to recognize difference in the value of service between the apartment dweller and the industrial customer. Mr. Herbert says that recovering the fire protection costs unfairly shifts a disproportionate share of these costs to large users. Comparing my recovery mechanism to his proposal, I believe that almost anyone will conclude that having an apartment dweller pay the same amount for public fire service as an industrial customer pays is much more of an unfair shift of a disproportionate share of the public fire service cost to the small user, than my attempt to allocate the cost to customers based on the value of fire service received.

Q. On page 12, starting on line 1 through line 8, Mr. Herbert rebuts your recovery design for public fire service costs stating that large users often provide their own fire protection by paying for a private fire line. Please address this testimony.

A. Mr. Herbert continues by stating that having a private fire line connected to a sprinkler system will often eliminate the need for public fire protection for large users. He states that by including public fire costs in their consumption rate, these

customers are, in essence, being double-billed for fire protection. I am of the opinion that many large users of water seek additional private fire protection in addition to the public fire protection. Public fire protection is required in most municipalities; the Company is required to provide it to its customers. All such customers are provided with public fire protection. The private fire protection customers do not provide their own fire protection; they contract with the Company to provide this additional fire service. Since the Company is required to provide this service to its customers, the customers should pay the costs associated with this service. Contrary to Mr. Herbert's arguments about customers being double-billed under my proposal, the Company's proposed tariff has the proposal to bill large customers for both public and private fire service under Mr. Herbert's public fire service proposals. Documentation that supports this conclusion is found on the tariff sheets that contain the recovery of public fire costs from all customers and also provides for the recovery of private fire service costs through separate tariff charges.

On a related topic, I would like to bring out one correction to my direct testimony brought up by witness Michael Gorman in his surrebuttal testimony, regarding the allocation of public fire costs in the St. Louis County District. My direct testimony, as filed, would allocate public fire cost to Sale-for-Resale customers. This assignment was performed in error and if the Commission adopts my study, my study should be modified to exclude the allocation of public fire costs for Rate B and Rate D customers.

CLASS COST-OF-SERVICE STUDY & RATE DESIGN – COMPANY WITNESS JENKINS

Q. Did Company witness Jenkins address an area of class cost of service and rate design that is not contained in the Company's cost-of-service study?

A. Yes, he did. Mr. Jenkins addresses Mr. Kalbarczyk's direct testimony, where Empire District Electric Company (Empire) has proposed that it receive an interruptible rate. Mr. Jenkins states that he does not oppose the concept of the interruptible rate, but does oppose Mr. Kalbarczyk's recommendation of a reduced rate after Empire's annual revenues that are specified in the Contract between the Company and Empire.

I stated in my rebuttal testimony that what surprised me the most is that the Company and Empire have entered into a "contract" to provide a type of service that the Commission has not approved. I stated that I did not find in the Commission-approved service tariff sheets for the Joplin area where the Company is authorized to require Empire to enter into a service agreement that includes a minimum annual revenue charge and that provides for "liquidation of damages" if Empire terminates the service agreement. I need to modify my previous testimony, because I have now found a tariffed provision that covers the Empire main extension contract. The tariffed provision is contained on Sheet 37 of the Company's Joplin District tariff.

I would state that Empire and all other customers of the Company are receiving interruptible service. The Company's Joplin District tariff contains Rule 14. CUSTOMERS REQUIRING UNINTERRUPTED SUPPLY, which reads as follows:

> "The Company will endeavor to give reasonable service, but does not guarantee a sufficient or uniform pressure, or an interrupted supply of water, the Customers are cautioned to provide sufficient storage of water where an absolutely uninterrupted supply must be assured, such as for steam boiler, hot water heating systems, gas engines, etc."

As can be seen in this language, all customers are provided interruptible service and; therefore, all rates are for interruptible service. The tariffed rates for the industrial service are for interruptible service. A reduced rate for being interruptible is not appropriate. The rates that are designed now are for interruptible service with no guarantee for sufficient or uniform pressures for any customer.

On page 20, line 12, of his rebuttal testimony, Mr. Jenkins states that the Company a tariff should be tailored specifically for Empire Electric. Staff concurs with Mr. Jenkins in that if Empire is seeking special treatment, the Company and Empire should tailor such tariff and propose a tariff that contains the justification and details of why the special treatment is needed. I do not consider Empire being interruptible, the same as all other customers are, to be a valid reason to lower their cost-of-service-designed rates.

CLASS COST-OF-SERVICE STUDY & RATE DESIGN – EMIPIRE WITNESS KALBARCZYK

Q. Do you have a correction to your rebuttal testimony regarding the direct testimony of Empire witness Kalbarczyk?

A. Yes, I do. As I mentioned on the previous page, I found the tariffed authority for the Company to enter into the contract with Empire. Additionally, I found tariff language that explains that Empire and all other customers are receiving interruptible service. As I stated above, all customers are provided interruptible service

and all rates are for interruptible service. The tariffed rates for the industrial service are for interruptible service. A reduced rate for being interruptible is not appropriate. All customer rates are now designed for interruptible service, with no guarantee for sufficient or uniform pressures for any customer.

If Empire wants special rate treatment, the Company and Empire should tailor a tariff and propose a tariff that contains the justification and details of why the special treatment is needed. I do not consider Empire being interruptible, the same as all other customers are, a valid reason to lower their cost-of-service-determined rates.

CLASS COST-OF-SERVICE STUDY & RATE DESIGN – MEG WITNESS LACONTE

Q. Did MEG witness LaConte address an area of class cost-of-service in her rebuttal testimony that you would like to rebut?

A. Yes, she did. Ms. LaConte rebuts my direct testimony with regard to the computation of "Factor 4" for the St. Louis County District. On page 2 of her rebuttal testimony, Ms. LaConte first explains the Company's method of allocation of T&D mains to the functions and classes of the St. Louis County District. I address the inappropriateness of the Company's "Factor 4" in my rebuttal testimony, pages 2 through 19. I refer readers to that testimony for the explanation as to why the Company's study is flawed and inappropriate.

Ms. LaConte then explains that the Staff's method for calculating "Factor 4" allocates the costs using 100% of the Sales-for-Resale and the Rate J average hourly consumption. Ms. LaConte then states that my method does not recognize the Company's point that most of these large users are connected directly to transmission

mains and that the amount of distribution mains they use is very small. Again, in my rebuttal testimony I address the reasons why my "Factor 4" method is more appropriate than that filed by the Company.

Allocation of the cost of T&D mains under the base-extra capacity method of cost allocation includes the allocation to function and to class. The base-extra capacity method develops allocations based on average use and on demand of the system as a total.

If a party to the cost-of-service allocations wants to add a service characteristic allocator related to the portion of the system that some customers in a defined class have, but others do not, then a separate class should first be created. After an appropriate class has been redefined, every aspect of the use of this class's system use must then be analyzed for appropriate allocation of all mains to that class - not only "distribution mains" but also "transmission mains." For instance, in addressing Sales-for-Resale customers who are not being served directly by "distribution mains", the actual use of the "transmission mains" must also be analyzed.

If you are going to analyze a customer class's system responsibility based on something other than use and demand, as contained in the base-extra capacity method of cost allocation, then every aspect of the redefined class's use of T&D mains must be taken into account in allocating costs. The "other aspect" which neither the Company nor Ms. LaConte has considered is that most of these sale-for-resale customers are using a larger length of "transmission main" than is allocated per the base-extra capacity method. This is because these customers are taking water at points that are farther away from the treatment facility or purchased water delivery point than the average distance that is imputed by the base-extra capacity allocation methodology.

Not only would it be necessary to determining the embedded length regarding more length of larger mains "transmission main" as other customers, but this analysis should also give weight to the fact that these customers are causing larger mains to be built for longer distances and at an installation cost for the "larger mains" that is up to 10 times the cost per foot of the "smaller mains." Allocating costs based on a specific different service characteristic of how much a class of customer uses T&D mains must consider all uses of the entire system - both "large mains" and "smaller mains" - to be valid. The proposal of the Company does neither the redefinition of a class based on the service characteristic nor a complete analysis of the use of T&D mains.

Ms. LaConte then states, on page three of her testimony, that my method allocates to large customers costs of the "distribution mains" that they do not use, and that it produces rates that are not based on cost incurrence or responsibility. The Staff's rates are based upon the base-extra capacity method, which allocates costs to all classes based on average and extra use of the system as a whole. Neither the Staff, nor the Company has a defined class called "large users."

The Staff did not alter base-extra capacity method of allocation by omitting costs to some classes based on their use of the T&D mains, because such allocation does not recognize that there could be incremental use of another part of the T&D mains, the "transmission mains", by these classes. Any proper allocation based on the size of T&D mains that serves a customer class directly should include a complete analysis of the T&D mains, including the incremental costs associated with the customer class's use of "distribution mains."

Again, if this service criterion of assigning costs by the size of pipe that connects directly to a customer is valid, the one who proposes this criteria should develop rates for every defined class and allocate costs and develop rates for every class of service based on the size of main they are connected to. Defining a proper class using this service characteristic would result in a customer who is served directly off a 30" main having different main allocations and rates that a customer who is served from a 24" main, and a customer who is served directly off a 20" main having a different cost allocation and rate than a customer who is served directly off a 16" main, and a customer who is directly served off a 12" main having a different rate than a customer who is served directly off a 10" main. Also, a customer who is directly connected to a 4" main should have a rate different than a customer who is connected to an 8" main. If such a cost allocator is valid for the treatment of some customers, it should be applied to all customers as a valid service characteristic for which to assign T&D costs.

Neither the Company nor Ms. LaConte has proposed T&D allocators that afford all customers treatment of what they consider a valid basis for cost allocations related to their stated service characteristic.

Contrary to what Ms. LaConte states, the rates that the system average allocation methodology of the base-extra capacity allocation method produces are based on the cost incurrence and responsibility of the system as a whole. This is determined using the bases for the base-extra capacity method - the allocation of costs for the defined classes by the service characteristics of average use and extra capacity.

Q. Mr. Hubbs, Ms. LaConte provides two examples of how other Commissions have dealt with this issue on page 3 of her rebuttal testimony. Please address these examples?

A. For her first example, Ms. LaConte provides a quote, purportedly from some Kentucky Public Service Commission docket, where that Commission found that "…costs associated with mains smaller than 10 inches should not be allocated to the wholesale class." Without knowing all the facts of that case, one cannot tell whether that Commission also appropriately assigned a greater share of cost of 10" and larger mains to the wholesale class, thereby considering the greater use of the larger mains over an average of T&D main allocation to this class. If that Commission did not consider the wholesale rate class's greater-than-average use of the larger mains, then the other residential, commercial and industrial customers were allocated more T&D costs and pay higher rates than they should.

The fact that the Kentucky Public Service Commission may have erred in one of its cases does not mean this Commission should make a similar mistake. This issue should be decided on the merits of the arguments presented in this case, and not on errors of a commission in another state.

The second example Ms. LaConte uses appears to be a quote from some document related to a water case in Illinois. Ms. LaConte states that this quote is from the staff of the Illinois Commerce Commission. This quote states: "In allocating the costs of smaller mains, Staff assigned costs associated with distribution recovered in the first two usage blocks. In Staff's view, this allocation is appropriate because it recognizes that many industrial customers, though connected to the grid distribution

system, do not use the smaller mains and are only slightly dependent on the grid distribution of smaller mains for pressure requirements."

The first problem with this quote is that – unlike Illinois - St. Louis County has a single-block rate, and that is all that has been proposed in this proceeding. With the single-block rate, there can be no "appropriate" cost recovery difference between the different classes of industrial customers who are identified in the quote as being inappropriately lumped into one class.

Secondly, the Illinois Commission staff erred in not creating two or three classes, per the service characteristics that they state are appropriate for the different allocations. Their modified industrial customer classes should be: 1) customers who are greatly dependent on the distribution grid's smaller mains, 2) customers who are only slightly dependent on the grid distribution of smaller mains and, 3) those customer who don't use the smaller mains.

Third, without knowing all the facts of that case, one cannot know whether the Illinois staff appropriately assigned a greater portion of costs associated with any extra use of the larger mains in setting the industrial rates, thereby considering the greater-than-average use of the larger mains to this class. If they did not consider the industrial rate class's greater-than-average use of the larger mains, then the other classes of customers would be allocated more T&D costs and pay higher rates than they should. Again, as I stated in my previous testimonies, segregation into separate classes and allocation of smaller main costs away from some customers can be a valid ratemaking. That has not occurred in this Illinois case.

Lastly, the fact that the Illinois Commerce Commission may have approved an erroneous cost allocation method recommended by its staff does not mean that this Commission should also approve such an erroneous cost allocation method. Again, this issue should be decided on the merits of the arguments in this proceeding.

Ms. LaConte states at the bottom of page 4 of her rebuttal testimony that the Commission should approve the Company's method for allocating the costs of "distribution mains", since it is fair and results in rates that are more representative of how the system is used. This statement is incorrect, since she has not redefined the customer classes consistent with the service characteristics chosen to differentiate treatment between all classes, and she has not recognized greater-than-average use of the larger mains by customers on the outskirts of the Company's distribution system.

Q. Does the rebuttal testimony of Ms. LaConte contain a rate design proposal that you would like to address?

A. Yes, it does. Ms. LaConte is proposing that eligible customers with several locations consolidate their usage on a single bill. She states that where the consolidated usage is sufficient, that the consolidated usage of the several locations could then qualify for billing under the manufacturing and large use customers tariff. The cost-of-service for metered take points is to be developed by the cost to serve each metered take point. The current tariff for manufacturing and large use customers is premised on an individual premise's delivery, and I see no reason to afford entities who may be a customer at different take points to qualify for a rate lower than the those generated by the cost of service study approved by the Commission.

Ms. LaConte states that, from a fairness standpoint, consolidated billing reflects the cost of service for eligible customers. Such is not true; billing all customers the rates developed per metered delivery point is more fair than allowing recovery of revenues that are less than the cost to serve entities with multiple metering points.

Ms. LaConte also states that such a customer could install new pipes to achieve the same effect as a consolidated bill would achieve, but that it would be more cost effective if MAWC were to consolidate the customer's usage. If such a customer can modify its piping to take water at one point, then I recommend that it do so, as it will then properly have the chance to qualify for the manufacturer and large user rates, without shifting allocated costs to other customers.

COST-OF-SERVICE – MIEC WITNESS GORMAN'S REBUTTAL TESTIMONY

Q. Please respond to MIEC witness Gorman's rebuttal testimony filed October 10, 2003.

A. On page 5 of his rebuttal testimony, Mr. Gorman states five recommendations for this proceeding. The following will address three of these recommendations.

Q. Please respond to Mr. Gorman's first recommendation.

A. Mr. Gorman's first recommendation reads: "MAWC's rates must be competitive to attract and retain high volume customers. As such, MAWC's service quality and competitive pricing are key factors to the MAWC service area's business infrastructure and economic development". Mr. Gorman is stating that rates should be set on something other than the cost-of-service. He is stating that they should be set on whatever it takes to attract and retain high volume customers. Mr. Gorman is stating that

either smaller customers or the Company should subsidize the cost-of-service for larger customers, so that the Company can attract and retain customers for economic development or retention for its service territories. I am of the opinion that rates should be set at the cost of service for the customer and that if any economic development or retention issues develop with a customer, that the Company and the customer should apply for special treatment for that customer.

Q. Please respond to Mr. Gorman's second recommendation.

A. Mr. Gorman's second recommendation reads: "To keep MAWC's rates competitive, it must minimize its revenue requirement through assertive and aggressive cost management, and must allocate its cost of service among its customers in accordance with how it incurs costs for providing service to each customer. Efficiency in cost management and cost allocation and rate design will help ensure that MAWC's prices are competitive and that it is able to successfully contribute to the economic development of its service territory."

I agree that the Company should be efficient in its cost management. I agree that rates should be set through allocations to its customers in accordance with how it incurs costs for providing service to each customer (cost-of-service ratemaking). I do not understand Mr. Gorman's statement about how the Company should be efficient in cost allocation and rate design. Although cost-based rates will occur pursuant to cost-of-service ratemaking, as alluded to in Mr. Gorman's second recommendation, such statement is contrary to his first statement, where he states that rates should be set to attract and retain high-volume customers for economic development and retention. Rates to the classes should be based on cost of service.

Q. Please respond to Mr. Gorman's third recommendation.

A. Mr. Gorman's third recommendation reads: "MAWC's cost of service appears to be generally reasonable, but I am recommending several adjustments to more accurately assign MAWC's cost of purchased power, to credit contract revenue among its customer classes, and to eliminate the proposed St. Louis District's revenue contribution to MAWC's other districts". The following highlighted areas address this recommendation:

PURCHASED POWER COST ALLOCATIONS (GORMAN REBUTTAL PAGES 4 THROUGH 7)

Mr. Gorman proposes an adjustment to the purchased power cost allocation factor used in Mr. Herbert's study. Mr. Gorman is proposing to use the maximum-hour consumption factor, "Factor 5", instead of "average use" allocation factor, "Factor 1", for allocation of the purchased power costs.

Purchased power bills are billed on a customer charge basis, a demand charge basis and an energy charge basis. Mr. Gorman argues that the demand costs related to the purchased power bill should be allocated to the Company's customer classes on something other than annual usage. Purchased power demand charges are not directly tied to water demand in the base-extra capacity allocation method. Purchased power demand charges are charged for whatever load factor the water utility incurs. Base costs in the base-extra capacity allocation method are the costs associated with providing average usage. Base costs should include demand costs that will be incurred to provide the base level of usage and should be allocated on the base usage allocator of "Factor 1." Any portion of a purchased power demand charge that may be applicable to extra-capacity allocation would be limited to the incremental amount of billed demand over the

base-related demand that must be supplied over the base usage amount. Contrary to Mr. Gorman's assertion that "the maximum hour demand drives the purchased power demand billing units, and the average flow drives purchased power energy consumption," the average flow drives average purchased power demand and average energy consumption. Absent purchased power billing demand data needed to allocate the incremental demand (extra capacity) over base capacity, I used the "Factor 1" allocator for all purchased power costs.

Additionally, any valid allocation of purchased power costs based on actual demand and energy figures should not include an allocation of actual usage costs to private and public fire service classifications. "Factor 5" has a large allocation to public and private fire based on potential demands, not actual demands and energy usage. Purchased power costs are based on actual demands and energy uses, not potential demands and energy uses. Because of such misallocations, Mr. Gorman's proposed use of "Factor 5" is entirely inappropriate.

Mr. Gorman states that "Factor 5" is appropriate to use, since Mr. Herbert uses "Factor 6" to allocate pumping equipment. "Factor 6" allocates pumping expenses based on the function of each pump. Mr. Gorman says that "Factor 6" is appropriate to use because pumping costs are allocated for maximum-hour demands. This is not true, pumping costs are not sized, they are what they are. Pumps have specific functions and costs associated with them. In truth, in Mr. Herbert's study for the St. Louis County district, he does not allocate any costs to the maximum-hour function, because all pumps are related to maximum-day functions.

CONTRACT REVENUE (GORMAN REBUTTAL PAGES 7 THROUGH 8)

On page 7 of his rebuttal testimony, Mr. Gorman addresses why Mr. Herbert's use of "Factor 19" is not appropriate to eliminate the costs of a special contract from the rates of customers. Mr. Gorman states that "Factor 2" be used to eliminate costs from the other classes. I am of the opinion that neither factor is a great fix for the allocation of the special contract. Their values per class are close in value; the difference between them should not affect a material shift in cost between the classes. Pursuant to the Company's study, the impact of Mr. Gorman's recommendation for the sales-for-resale customers and the "manufactures and large users" is to increase their direct cost allocations.

REVENUE CONTRIBUTION: (GORMAN REBUTTAL, PAGE 8)

On page 8 of his rebuttal testimony Mr. Gorman recommends that the Company's proposal for a revenue contribution from the St. Louis District be rejected. I agree with Mr. Gorman's recommendation about collecting costs from the districts causing the costs, but if the Commission decides the Brunswick District needs such a subsidy, the negative impact of shifting the costs to the St. Louis County District would be less than shifting costs to other districts because of the relatively inexpensive water costs in the St. Louis County District and the economies of scale related to the level of revenues collected from the St. Louis County District.

COST-OF-SERVICE – MIEC WITNESS GORMAN'S SURREBUTTAL TESTIMONY

Q. Please respond to Mr. Gorman's surrebuttal testimony filed November 10, 2003, with regard to cost-of-service.

A. On page 2 of his surrebuttal testimony, Mr. Gorman provides five summaries to his testimony, two of which are related to my direct testimony.

The first is in regard to the removal of "distribution mains" costs from allocations to Rate B (sales for resale) customers and Rate J (manufacturers and large users). This issue has been addressed in my rebuttal testimony. Mr. Gorman brings up one of the major differences in Mr. Herbert's and my studies. This difference affects the St. Louis County, Joplin and St. Joseph Districts. The difference has to do with the allocation of what Mr. Herbert calls "distribution" mains. This difference is explained in detail in my rebuttal testimony from page 2, line 13, to page 12, line 20, and I incorporate that portion of my rebuttal testimony here as rebuttal to Mr. Gorman's similar arguments.

In his first summary, he states an additional reason to reject my study claiming that it is a sharp departure from the Commission's practice for setting water rates for St. Louis County in the Company's past rate cases. Although mistakes may have been made in cost allocations and rate design in past St. Louis County rate cases, that certainly does not justify continuing the practice. Judging the merits of the arguments, it is timely to implement changes, if the Commission determines such are valid.

On page 3 of his surrebuttal testimony he states: "The class cost of service studies offered by the Company and by me in my Direct Testimony…" I can find no direct testimony filed by Mr. Gorman in this proceeding.

On page 3 and 4 of Mr. Gorman's surrebuttal testimony, he refers to a diagram of what he calls "…a simple hypothetical water utility system which is attached as Schedule 1 to his surrebuttal testimony." This diagram (map) is misleading and does not contain a true picture of the Company's St. Louis County District distribution grid.

Although the map shows no Rate J customers served from "distribution" mains, almost 48 percent of Rate J customers are located off the "Distribution Mains" (small mains) of the Company. Also contrary to Mr. Gorman's diagram, one needs to envision the "sales for resale" customers being located at the extreme other end of the "distribution system" (on the far right of Mr. Gorman's diagram). This location would require considerably longer lengths of much more expensive large transmission main to serve the "sales for resale" customers than that of other customers on average. Looking at the service characteristics of what mains serve what customers, as proposed by Mr. Herbert and Mr. Gorman, would require looking at the greater allocation of larger mains costs to the "sales for resale" class.

Mr. Gorman points out that the Commission set rates for St. Louis County District in past rate cases, recognizing the cost causative factors that Mr. Gorman outlines at the bottom of page 4 of his surrebuttal testimony, and that my study is not consistent with these past determinations. This is true, but I am of the opinion that decisions in past cases should not be used as the reason for accepting or rejecting a different position in the future, as mistakes would thus never be able to be corrected.

Mr. Gorman, on page 5 of his surrebuttal testimony, states that he is citing authority for distinguishing between transmission and distribution costs of mains in the preparation of a cost-of-service study. Mr. Gorman says that the AWWA's M1 Manual states that a utility may consider service characteristics and demand patterns in establishing customer classes. Mr. Gorman's and the Company's proposals do not consider service characteristics in the establishment of customers classes. If they did such, they would have at least two classes. One would be "manufacturers and large users

served directly from 12" and larger mains" and the other would be "manufacturers and large users served directly from 10" and smaller mains". Mr. Gorman continues by stating that the Manual M1 provides: "In particular, utilities may recognize that large industrial customers, wholesale customer and other large users tend to be served directly from major treated water transmission mains, while smaller users are served by both large and small mains". Although M1 states that utilities may recognize such treatment, it does not state that they shall recognize such treatment. First, the Company and Mr. Gorman did not appropriately establish their classes consistent with the service characteristics upon which they have proposed to allocate costs. Also, any valid use of this method to assign costs – using or not using small T&D main sizes – must also consider the assignment of the costs of the use of large T&D main sizes. Without such consideration, the service characteristics can skew applicable costs from larger customers to smaller customers.

On page 5 of his surrebuttal testimony, Mr. Gorman states that the Commission should reject my study as the basis for apportioning costs among customer classes in St. Louis County because it ignores common cost allocation practices in the industry. As can be seen by referring to the M1 Manual, my cost study is consistent with the manual. The manual additionally states that a utility may consider recognizing that individuals served directly off of large lines do not use small mains. I have no problem with this concept, as long as the customers are put in appropriate classes and as long as the large customers' use of the large mains is analyzed at the same time. I do not agree with the studies of the Company and Mr. Gorman, which not only do not appropriately classify customers, but also fail to take into consideration all aspects of the assignment of costs

for the use of all sizes of mains rather than just one size of mains. If the "common cost allocation practice" is like Mr. Gorman's study, which does not properly put the customers served directly off the larger lines in a separate class based on their service characteristic without also analyzing the use of the larger T&D mains, then the Commission should not approve Mr. Gorman's "common" practice. Rather, it should correct the error by adopting my study.

RATE DESIGN – MIEC WITNESS GORMAN'S SURREBUTTAL TESTIMONY

Q. Please respond to Mr. Gorman's surrebuttal testimony filed November 10, 2003, with regard to your rate design proposal for public fire protection costs.

A. Mr. Gorman states that I recommend recovery of Public Fire Protection Costs to be recovered in the volumetric charges for each customer class and that such costs are fixed in nature and do not vary with the volume of water consumed. He states that this would overcharge high volume customers. These issues have been addressed in my rebuttal testimony; starting at page 28, line 18, through page 30, line 15. These issues have also been addressed in more detail in this surrebuttal testimony, starting on page 11, line 15, through page 17, line 2. These differences are explained in detail in my rebuttal testimony from page 2, line 13, to page 12, line 20, and I incorporate that portion of my testimony here as rebuttal to Mr. Gorman's similar arguments.

On page 6 of his surrebuttal testimony, Mr. Gorman says that it is not clear from my testimony whether I recognize the distinction between public and private fire protection costs. This comes from a typographical error contained on line 13 of page 7 of my direct testimony, which reads "private" and should read "public".

Mr. Gorman does bring up one point that is correct. My direct testimony as filed would allocate public fire cost to sale-for-resale customers. This assignment was performed in error and if the Commission adopts my study, my study should be modified to exclude the allocation of public fire costs to Rate B and Rate D customers in the St. Louis District.

CLASS COST OF SERVICE AND RATE DESIGN – RIVERSIDE/AGP WITNESS JOHNSTONE

Q. Mr. Hubbs, please address the rebuttal testimony of Riverside/AGP witness Johnstone with regard to the use of what he refers to as "recently created customer classes."

A. On page 2 of his rebuttal testimony, Mr. Johnstone states that AGP and Riverside oppose important aspects of the rate design submitted by MAWC (Company) and myself. Mr. Johnstone states that his clients are quite concerned with the use of the recently created rate classes (i.e. Residential, Commercial, Industrial, Public Authority and Sales for Resale.) Rates were determined for these traditional general rate classes and were implemented pursuant to the AWWA M1 Manual in the Company's last rate case a few years ago. Mr. Johnstone states that the definitions of what it takes to be in these classes are not defined in the tariff. Staff has no problem with including definitions in the tariff sheets for these traditional rate classes. Contained in *Chapter 8: Distributing Costs to Customer Classes*, of the AWWA's M1 Manual, is a discussion of general and special classes.

Q. Mr. Hubbs, please address Mr. Johnstone's statement that the Company and the Staff do not have the statistical data to support the cost studies without extrapolating from areas as far away as Pennsylvania.

A. On page 2 of his rebuttal testimony, Mr. Johnstone states that large, and potentially unwarranted, differences in rates are being created for customers that have every appearance of being similarly situated based on meter size and usage, as the consequence of the Company and the Staff not having statistical data to support the cost studies without such extrapolation. I agree that I have not performed detailed studies of the demand factors for the customer classes for each of the districts. I generally accepted Mr. Herbert's experience-based numbers, except in a couple of instances where I proposed reducing the allocation of costs for the industrial class over that proposed by Mr. Herbert and proposed to increase the allocation of costs to the sale-for-resale class. I found Mr. Herbert's customer class demand factors to be in a reasonable range. I do, however, recommend that the Commission order demand studies be performed at least for the St. Louis County District, the St. Charles District, the Joplin District and the St. Joseph District before the Company's next general rate case. These studies should include the Residential, Commercial, Small Industrial, Large Industrial, Small Sales-for-Resale and Large Sales-for-Resale customer classes.

With regard to Mr. Johnstone's statement that large, and potentially unwarranted, differences in rates are being created for customers that have every appearance of being similarly situated based on meter size and usage, large difference in rates are not being created. This would be true except for the fact that meter size cost differentials are taken into account in both the Company's and my studies. This leaves the only difference

stated by Mr. Johnstone as to similarly-situated customers as being that of usage. Having large usage only, however, is not a valid service differential to create differences in customer classes and customer rates. Mr. Johnstone presents no quantification of any relationships as to why large users should be charged less for the water delivered through their meters. Also, Mr. Johnstone does not state who these customers are that have every appearance of being similarly situated. He does not recognize that the rates that the Company and I create do recognize the differences in usage demands for the different classes. Usage demands are usage characteristics recognized in the Company's and my study.

The Company's cost to produce and deliver water is a fixed figure per test year based on annualized and normalized costs of service. Without quantitative and justifiable reasons to provide one customer a price break over another customer, all customers that are similarly situated should pay the same charge for 1,000 gallons of water. The Company's and my cost-of-service studies assign different costs based on the customer classes set out in the AWWA's M1 Manual and the Company's existing tariff sheets.

Q. On page 3, lines 1 and 2, of Mr. Johnstone's rebuttal testimony he states that his clients oppose the elimination of the declining block structure as you have proposed. Please respond to this testimony.

A. If Mr. Johnstone's clients are large users, they should oppose my proposal of the elimination of the declining block rate structure from an economic standpoint. In the past, larger customers in a class have had other, smaller customers in their class playing up to twice as much per 1000 gallons of water as the larger customers have been paying. Because of this inequity, which is caused by declining block rates, I have

proposed the elimination of declining block rates and movement to a single rate block like that used in the St. Louis County District and proposed in the St. Charles County District.

Mr. Johnstone then states that his clients strongly oppose such large changes to the applicable rates, without a proper consideration of the impact of the changes. He further states that many customers were severely impacted as a result of the rates approved in Case No. WR-2000-281. As proof of the large changes, he shows the impact of each rate (customer charges and commodity charges), including the ones that I have proposed to eliminate.

The following are the true impacts of my study on the classes of customers:

	St. Joseph District	Parkville District
Residential	1.53% decrease	1.65% decrease
Commercial	13.36% decrease	10.16% decrease
Industrial	13.39% decrease	3.05% decrease
Other Water Utilities (Sales-for-Resale)	19.22% decrease	7.85% decrease

Mr. Johnstone's customers may experience an increase in their annual bills even with these large revenue decreases for their classes, but such increases are the result of the smaller customers in their class having been dramatically over-billed using the existing declining block structure. If I were one of Mr. Johnstone's clients, I would like to maintain the existing system, which can result in small users with similar demand characteristics paying almost twice as much per 1000 gallons of water as the large users pay.

In discussing MAWC's rate design proposal for the St. Joseph and Parkville Districts, Mr. Johnstone, on the bottom of page 3 and the top of page 4 of his rebuttal testimony, explains that he has been advised by his counsel that laws forbids any

differences in charges that are not based upon differences in service, and that even when based upon differences in service the differences in the charges must have some reasonable relationship to the amount of difference in service.

Mr. Johnstone has not, however, proposed any rate design for water service that is based upon valid differences in service; and, if such differences would be valid, the rates he has proposed do not bear any reasonable relationship to the amount of such differences. Absent justification and quantification of rate differentials pursuant to his recommendation, the only rates that would be valid would be the per-meter-size customer charge and a single commodity rate that is the same for every customer.

The following are the true impacts of the Company's study on the classes of customers:

	St. Joseph District	Parkville District
Residential	11.31% increase	8.18% increase
Commercial	5.92% increase	1.56% increase
Industrial	2.83% decrease	6.12% increase
Other Water Utilities (Sales-for-Resale)	9.15% decrease	11.67% decrease

Mr. Johnstone explains: "In the Platte County District Public Authority and Sales for Resale usage charges increased by 107% and 170% respectively. In the St. Joseph District there are similarly large percentage impacts in usage charges: the Industrial classes usage charges went up 177%, the Public authority Class usage charges went up 103% and the Sales for Resale class usage charges went up 239%! Very large increases are now being proposed for customers that have already just endured rate changes that more than doubled due to the last rate case."

I note that the customers Mr. Johnstone refers to above were paying a very small portion of their Commission determined cost-of-service before the last rate case. Absent

the Commission making them responsible for these determined costs of service in the last rate case, customers in other classes would have continued to dramatically subsidize them. Since major "class to class" subsidization was removed from rates with the Commission's decisions in the last rate proceeding, Mr. Johnstone is really complaining about his clients no longer being subsidized by the Residential, Commercial and Other Public Authority customers.

Also, although Mr. Johnstone states that very large increases are now being proposed for the customers that have just endured rates changes that more than doubled due to the last rate case, the fact is that the Staff has proposed a decrease of 13.39% for the St. Joseph Industrial class and the Company has proposed a decrease of 2.83%. For the "Platte County" (Parkville) District Sales-for-Resale class the Staff has proposed a decrease of 7.85% and the Company has proposed a decrease of 11.67%. At least one of Mr. Johnstone's clients may receive an increase in its cost of water, which would result from the elimination of the 4-tier rate blocks and the implementation of the single block rate. Again, however, my proposal to establish a single-block commodity rate is intended to eliminate small customers paying a disproportionate share of the costs assigned to the defined classes. There is no need for them to subsidize the larger user's cost of service.

DEFINING CUSTOMER CLASSES

Mr. Johnstone, on page 5 of his rebuttal testimony, rebuts my use of the customer classes that the Commission approved in the Company's last rate proceeding. On lines 6 through 20, of page 5 of his rebuttal testimony, he appears to be implying, without definitively stating, that the classes of Residential, Commercial, Industrial, Other Public Authority and Sales-for-Resale are classes where *…there is no material difference in*

usage characteristics that leads to different costs and therefore a need for different rates. Most water utilities have the three general class of Residential, Commercial and Industrial.[3] Wholesale service, the Sales-for-Resale class, is also a special class with recognizable service characteristics that are valid for creating a separate class.[4] Most water utilities have recognized that general service characteristics, demand characteristics, and location with regard to city limits are generally considerations in customer classifications. The Residential, Commercial, Industrial and Sales-for-Resale classes are made up of customers similar to those located in other areas of the country, like Pennsylvania.

CUSTOMER CHARGE CHANGE

On page 6, line 21, through 7, line 3, of his rebuttal testimony, Mr. Johnstone appears to oppose the reduction of customer charges to match the cost-of-service results of my study, because doing so would increase the usage charges, which increased by over 100% in the Company's last rate case. Cost-based customer charge rates should be implemented to assure recovery of billing costs, collection costs, meter costs and service costs from the appropriate customers. The usage charges that increased in the last rate case were increased to help eliminate the subsidy that Mr. Johnstone's clients were receiving at that time. Continued movement to cost of service – including interclass movement to the single commodity rate for each class – should be put into place.

SINGLE COMMODITY RATE

Starting on page 6, line 4 through page 7 line 7, of his rebuttal testimony, Mr. Johnstone addresses my proposal to eliminate the undue discrimination created by the use

[3] AWWA M1 Manual, Chapter 8 Distributing Costs to Customer Classes, Page 64

of declining block rates. Mr. Johnstone appears to believe that movement to a single commodity rate for each class creates large disparate impacts among various customers. In an attempt to prove this, he does an analysis of his client's districts for the Staff's proposed rates and Company's proposed rates, by comparing the customer charges and usage charges for the existing rates with the rates that were in effect prior to the Commission's decision in the Company's last general rate case. He determines, by his analysis, that my rates create rate impact considerations with double- and triple-digit percentage changes in specific rates. To show how such an analysis is not valid, it should be noted that the Industrial class in the St. Joseph District would experience a decrease of 13.39% under my rates. I proposed the single-block usage rate to eliminate the unjustified discrimination that is provided to large customers through the 4-tier declining block usage rates. Any impact caused to a customer by moving to the single commodity rate will eliminate such existing discrimination. Mr. Johnstone does not quantify the impact of the industrial rate decrease on his clients; instead he just looks at the impacts on usage rate blocks, including those that I have proposed to eliminate. His argument is that the impact on the block rates is the manner in which to determine whether a "serious impact problem" exists as a result of my single-block rate proposal. Actual customer class impacts, rather the than effects on block rates that I am proposing to eliminate, should support any such "serious impact problem." My actual customer class impacts show that his analysis of the effects of the block rates (Schedules 2 and 3 to his rebuttal testimony) does not support his claim that there is a serious impact problem for the class.

With regard to Mr. Johnstone's analysis of my proposed rates, when compared to the rates that were in effect before the last general rate case, Case No. WR-200-281, his

[4] AWWA M1 Manual, Chapter 8 Distributing Costs to Customer Classes, Page 64

analysis is untimely. By approving the current rates in the last general rate case, the Commission effectively eliminated the unjust discrimination that his clients enjoyed under the previously effective rate structure. In the last rate case, the Commission approved a rate structure that helped eliminate the subsidization of the Industrial and Sale-for-Resale customer classes by the other classes. The next step toward valid ratemaking is to eliminate the subsidies within the rate classes by moving to cost-based customer charges and a single commodity rate for each class. The fact that Mr. Johnstone's clients may have been negatively impacted by the Commission's decision to correct the major infirmities that existed in the previous rate structures is not a legitimate reason to not correct discriminatory rates that still exist, by approving a single commodity rate for each rate class.

Later in his rebuttal testimony, on page 8, lines 3 through 6, Mr. Johnstone explains that the Staff is proposing to completely eliminate the declining block structure in apparent disregard of the MAWC studies showing increasing economies with size of customer, and with no study of load factor effects related to increasing size. I agree with Mr. Johnstone, but only to the extent that I have not seen any Company studies showing increasing economies with size of customer. Additionally, neither the Company nor Mr. Johnstone have provided or filed any such studies in this proceeding. I do not know what "economies" Mr. Johnstone is referring to, but the economies for size that I that I referred to are analogous to the situation where you pull up to a gasoline station and fill up your 18-wheeler and I fill up my diesel pick-up truck: we are both going to pay the same rate.

With regard to the load factor effects related to increasing size, I have seen no studies that show that larger industrial users have a better load factor than smaller

industrial users. In fact, just the opposite can be true: small industrial customers can have better load factors than large industrial customers.

Load factor has been used as the basis for allocations of costs to the different customer classes in both the Company's study and my study, and the rate differentials between the classes incorporate these quantified usage differences. If Mr. Johnstone feels that larger industrial users have different load usage characteristics than smaller industrial users, then he should propose that two different industrial classes be created to measure and allocate costs pursuant to such characteristics. However, a single commodity rate should then be developed for each of the newly created classes. Mr. Johnstone, by proposing the continuance of declining block rates, is proposing to charge smaller customers up to twice the rate that larger customers pay. Additionally, the Company must not feel too strongly about any "economies" studies that it has done, since it is not recommending the use of a 4-tier declining block for the industrial customers in its largest service territory. Instead, the Company proposes to continue charging a single commodity rate to the majority of its customers, the St. Louis County District customers.

WHOLLY INADEQUATE CONSIDERATION OF CUSTOMER IMPACTS

It is interesting that Mr. Johnstone, on page 8 of his rebuttal testimony, lines 12 through 14, states that my analysis of the impact of the proposed rate changes on classes of customers, and individual customers, has been wholly inadequate. While I have quantified and filed the cost impact on every class of customer, Mr. Johnstone's study does not quantify the impact on customer classes or individual customers. Instead, he does an analysis of the impact past rates.

With regard to Mr. Johnstone's next statement in his rebuttal testimony, page 8, lines 15 through 17, that there has been wholly inadequate consideration of the potential cumulative impact of proposed rate changes in light of the recent doubling of some customers bills, I know that customer impacts were of great concern to the Commission when it approved the currently effective rates, and that the Commission considered such impacts during the Company's last rate case. I am also confident that the Commission will consider the impact of the Staff's proposed decrease for customers in the Industrial class in this case, when determining what rates to approve. It is my understanding that the Commission has been moving toward having customers pay their allocated cost-of-service in their rates. I know of no requirement that the Commission must consider the impacts of past rate cases in its attempt to move toward cost-based rates. Also, Mr. Johnstone has not provided the Commission with any quantified evidence as to the impact of the proposed rate changes on the customer classes, nor on individual customers and not even for his own clients. Obviously, it is difficult for the Commission to consider customer class or individual customer impact information when no such information is provided.

RATE DESIGN PROPOSALS

Q. Please address Mr. Johnstone's specific recommendations with regard to rate design in this proceeding, as presented on pages 11 and 12 of his rebuttal testimony.

A. Mr. Johnstone's **first "rate design proposal"**, explained on page 12, lines 2 through 18, of his rebuttal testimony, contains the recommendation to start setting the rates by using the Company's study. The Company study that he is proposing to use,

however, breaks customers into the classes that Mr. Johnstone says should not even exist. He says they should not exist because there has been no proof that there are distinctions between these classes. Mr. Johnstone then proposes to adjust the Company's rate elements on a pro rata basis to recover the allowed district cost-of-service. After Mr. Johnstone's rates are determined pursuant to the Company's rate design proposals, Mr. Johnstone then recommends that those results be compared to the 1997 rates and that increases to specific classes be limited to a 100% increase over the 1997 rates. This proposal would have the effect of reducing rates from the current levels and shifting the cost recovery responsibility caused by the shortfall of revenues from larger customers of the Industrial and Sale-for-Resale classes to the Residential, Commercial, and the Other Public Authority classes. Mr. Johnstone's first rate design proposal would shift rates dramatically back toward the rates that were approved in 1997, undoing the Commission-approved cost allocation shift that was effected in the last rate case. This proposal would also continue the rate discrimination that is caused by the use of declining block rates within each customer class.

Mr. Johnstone's **second "rate design proposal**", contained on page 12 of his rebuttal testimony, is to go back to the 1997 rates and increase those rates on a pro rata basis. This would also have the effect of eliminating the existing Commission-approved rate classes and shifting large amounts of costs to customers in the Residential, Commercial, and Other Public Authority classes. Going back and using the "1997 rates" as the basis for pro rata increased new rates would implement different rates for what Mr. Johnstone has stated are similarly-situated customers without definitive class distinctions. Following this logic, it appears that the only way to make sure that all such similarly

situated customers are charged the same rate for service would be to implement a single commodity rate for all customers, which is exactly what I have proposed.

Mr. Johnstone's second rate design proposal would also have the effect of completely eliminating the rate design determinations that the Commission made during the last rate case. This proposal would also continue the rate discrimination that is caused by the use of declining block rates within each class. Since Mr. Johnstone did not file a rate design proposal with his direct testimony, and does not quantify or show the actual development of rates using anyone's cost of service, I cannot determine the actual impacts of his proposals.

Q. Mr. Hubbs, starting on page 8, line 18, of his rebuttal testimony, Mr. Johnstone explains how his clients oppose the continued use of the existing Commission approved rate classes. Please address this testimony.

A. Mr. Johnstone states that unless there is a demonstrated need based on Platte County and St. Joseph District customers, that his clients oppose the continued use of such customer classes. These existing classes were created to allocate cost-of-service differentials to customers so that rates could be developed on justifiable differences in the customers' demand and usage characteristics. Additionally, these are customer classes that most water utilities typically have.

Mr. Johnstone states that the principal question is really whether there are measured differences in usage characteristics that in turn create a need for distinct rates. Absent distinct rates for each defined class, all customers would be in the same class. Pursuant to Mr. Johnstone's argument that there should be no class distinctions in the districts, all customers should pay the same rate. However, the 1997 rates are not the

same for all customers. The 1997 rates have customer charges based on the size of meters and a declining block commodity recovery method. Customers are thus charged different rates for their water, which effectively distinguishes them on a class-like basis. The cost of water for a small manufacturing customer with a better load factor than a large manufacturing customer could be twice that of the large customer, for no definitive and measurable differences other than that the large customer purchases more water. The existing class rates are based on studies that were implemented to correct the entirely inappropriate rates that were being charged customers before they were implemented. If one rate were to be charged for similarly situated customers of the class, that rate would consist of customer charges based on meter size and a single commodity charge for all usage. Absent such a single commodity rate, the customers would be charged different rates for their water.

Under the AWWA's M1 Manual on the base-extra capacity allocation method, the typical classes used by most water utilities are allocated costs based on their average usage and their imputed usage over average usage. Under the base-extra capacity allocation method, rates are developed to recover the costs allocated to each class as the result of the loading differentials of each class. Although Mr. Johnstone and his clients may believe that these classes of customers are not needed, most water utilities disagree. If Mr. Johnstone's and his clients' arguments are that there is no need for class distinctions, and that one class will suffice to cover all customers, then these arguments are contrary to what most other utilities have discovered. Most other utilities have discovered that there is no appropriate correlation to show that bigger customers have better load factors, nor is there any finding that larger customers should be given price

breaks just because they use more water. This is apparent because most other utilities have implemented customer class rates that are consistent with those that the Company and I have proposed. Most other utilities have discovered that the functional classification of end users into classes such as residential, commercial, industrial and sales-for-resale results in measurable load patterns that assist in the allocation of costs to the customers causing the costs. Most other utilities do not use the scenario of rate design contained in the 1997 rates: that of using just one class of customer. Rather, they strive to further break down cost responsibility based on the demand characteristics of the functional use of the end users.

What other utilities have discovered is that there is a correlation in load factors based on the end-use of the customers. They have discovered that domestic use customers have extremely poor load factors that are homogenous enough to segregate them from other customers. They have discovered that manufacturing and processing customers, no matter what their usage levels, have very good load factors and as such have usage characteristics homogeneous enough to classify them into separate classes. The end-use customers of the Company's St. Joseph and Parkville Districts are similar to residential, commercial and industrial customers of other water utilities, and it is thus logical to use the established customer classes for determining rates.

RATE DESIGN – OPC WITNESS MEISENHEIMER

Q. Mr. Hubbs, please address the rebuttal testimony of OPC witness Meisenheimer with regard to rate design issues.

A. On page 9 of her rebuttal testimony, Ms Meisenheimer discusses that mitigating potential rate shock needs to be considered in addition to movement toward

cost-of-service. She states that if the Commission adopts revenue requirements higher than those the Staff proposes, then the Staff's current recommendation that takes rates other than Brunswick's to full cost-of-service could produce unacceptable rate increases. It is my opinion that the main goal of the Commission should be that any increase or decrease in rates resulting from this case should move to eliminate subsidies in the current rate design. Based on what increase or decrease occurs, the Commission will need to request that updated cost of service studies be provided to ascertain the actual impact on each class of customer.

On page 9 of her rebuttal testimony, Ms. Meisenheimer states that she does not propose to move the customer charges to be equal to the cost-of-service determined in this case. This recommendation ignores the results of the cost-of-service studies and will result in the recovery of determined customer charge costs from higher usage customers instead of from the lower usage customers.

On page 10 of her rebuttal testimony, Ms. Meisenheimer recommends the continued use of the existing block rates. I simply do not understand this recommendation since the use of the existing block rates would force small residential users to continue to subsidize large residential users by up to 80% on a per 1,000 gallon basis. Again, as presented throughout my testimony, these similarly situated customers should pay the same rate for service.

Ms. Meisenheimer continues that OPC's rate design recommendations can be implemented without creating "winners and losers" within a district. By not creating "winners and losers" within a district, one is not correcting the existing subsidies shown to exist by the class cost-of-service studies. I believe it is imperative to remove the

subsidies (i.e. – to create "winners and losers") while moving rates to the appropriate cost-of-service for the customers.

RATE DESIGN – SJWRC WITNESS DRAINER

Q. Mr. Hubbs, please address the rebuttal testimony of SJWRC witness M. Dianne Drainer with regard to rate design issues.

A. On page 7 of her rebuttal testimony, lines 2 through 6, Ms. Drainer explains that my rate design proposals result in customers receiving substantially different rate treatment in their monthly commodity charge depending on usage, even through they are in the same class. This is not true. My single-commodity rate, rate design gives customers in the same class exactly the same monthly commodity charge rate.

Later on in her testimony, on page 7, lines 9 thru 18, Ms. Drainer explains that although Staff has proposed decreases to these classes, that the elimination of the block rates will have significant changes in customers' monthly commodity costs depending on their usage. This is exactly the impact that I intended. This will eliminate the subsidization of large use customers in a class by smaller use customers in the same class. My proposal for a single commodity rate for these similarly situated customers provides them the same rate for similar service. The schedules attached to Ms. Drainer's rebuttal testimony provide an excellent example of the subsidization that occurs through the existing 4-tier block rates. This 4-tier block rate subsidization is to the benefit of larger use customers and to the detriment of smaller use customers, even though they are all in the same class.

On page 9, lines 8 through 11, of her rebuttal testimony, Ms. Drainer states that to change the rates within each block disproportionately, or to eliminate the blocks, without regard for the resulting rate impacts would result in additional rate shock to customers in the Commercial and OPA classes. Ms. Drainer is correct in that the Commission needs to evaluate the rate shock that occurs within the classes caused by my rate design proposal. If the Commission determines that movement to cost-of-service is too severe at one time, then it will need to modify my recommendation and continue having smaller users dramatically subsidize large users in the same class.

Ms. Drainer states on page 9, lines 15 though 19, of her rebuttal testimony that my proposal would deprive Industrial class customers of the benefits of the substantial reductions sought by Staff. This is not true. The exact rate reduction amounts will still be afforded the Industrial class, pursuant to my recommendations. The larger use customers in the class will just not experience all of the reductions since they are being greatly subsidized by the smaller use customers under the existing block rates.

Ms. Drainer is proposing to keep the existing block structure, and changing the blocks based on the percentage impact on their monthly commodity charge. Ms. Drainer's proposal will have the affect of maintaining the gross overpayment for water service by the small users in a class and thus the continued subsidization of the large users in that class by such small users. I oppose maintaining such subsidies.

Q. Does this conclude your pre-filed surrebuttal testimony in this case?

A. Yes, it does.