

Exhibit No.: _____
Issues: Cost Allocation/Rate Design
Witness: Paul R. Herbert
Exhibit Type: Surrebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2007-0216
Date: July 27, 2007

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-20007-0216

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**

<u>IN THE MATTER OF MISSOURI-AMERICAN)</u>	
<u>WATER COMPANY FOR AUTHORITY TO)</u>	
<u>FILE TARIFFS REFLECTING INCREASED)</u>	CASE NO. WR-2007-0216
<u>RATES FOR WATER AND SEWER)</u>	CASE NO. SR-2007-0217
<u>SERVICE)</u>	

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 inquiries 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 27th day of July 2007.



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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WITNESS INTRODUCTION

1
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.

8 **3. Q. Are you the same Paul Herbert that submitted rebuttal testimony in this**
9 **case?**

10 A. Yes, I am.

11 **4. Q. What is the subject of your surrebuttal testimony?**

12 A. The purpose of my surrebuttal testimony is to address the rebuttal testimony
13 of AGP/Parkville witness Donald Johnstone and Staff witness James Russo.

14 15 SURREBUTTAL TO AGP/PARKVILLE TESTIMONY

16 **5. Q. Please respond to Mr. Johnstone's rebuttal testimony.**

17 A. Mr. Johnstone continues to reiterate his opposition to having "new" rate
18 classes established in the St Joseph District.

19 **6. Q. Are the classes new?**

20 A. No. Mr. Johnstone confuses rate classes with rate schedules. There have
21 always been rate classes – Residential, Commercial, Industrial, Public, Sales
22 for Resale and Fire Protection classifications – the Company has always
23 recorded revenues using these rate classes and the system of accounts
24 provides for the recording of revenues in this manner. Mr. Johnstone

opposes that each rate class has its own rate schedule rather than a single, declining-block rate schedule applicable to all classes.

7. Q. Does the Company oppose having a single, declining-block rate structure for St. Joseph district?

A. No, the Company does not oppose having a single, declining-block rate schedule applicable to all classes in St. Joseph and for other districts as well. But that does not alleviate the necessity to have rate classes. Rate classes are necessary in order to allocate costs to such classes and determine the relative cost responsibility of each class. Then a single, declining-block rate schedule can be designed to recover the allocated cost of service by class. However, in order to set the actual rates for each rate block, a class cost of service study is required as well as the consumption by block for each class. Without this information, rates would be designed in a vacuum.

A properly structured declining-block rate design will include most of the residential usage in the first block, the commercial and public usage in the first and second blocks and some in the third, and the industrial and resale usage predominantly in the third and fourth blocks. With the consumption distribution by rate block for each class and the class cost of service results, the rate analyst can determine what each rate in the single, declining-block rate structure should be in order to recover (approximately) the cost of service for each class. Without class cost of service results, the analyst would be missing an important piece of the puzzle and would have to set the block rates arbitrarily.

1 **8. Q. Mr. Johnstone suggests that you can't have classes unless you have**
2 **specific measured usage characteristics among the classes. Is this**
3 **true?**

4 A. No. If Mr. Jonestone truly believed that then why is he proposing a declining
5 block rate structure? If he says that there isn't enough evidence to distinguish
6 customers' usage characteristics, then he should propose a single, uniform
7 consumption rate for all customers, not a declining block rate structure. By
8 proposing a declining block rate structure, he's assuming that larger
9 customers have better load factors and therefore, should get progressively
10 lower rates in the second, third and fourth blocks. In effect, his declining
11 block rate structure is very similar to assigning customers to classifications.

12 **9. Q. How did the existing class block rate structure evolve?**

13 A. The Company did not initially propose the existing structure. The existing rate
14 structure was a result of the 2000 rate case when staff designed the final
15 rates which established the class-specific block rates. The Company
16 attempted to rectify the rate structure in the last case but was not completely
17 successful.

18 **10. Q. Please comment on the strict fixed-variable rate structure suggested by**
19 **Mr. Johnstone.**

20 A. The Company would support recovering more of its fixed costs in a fixed
21 charge to customers, however, Mr. Johnstone does not offer any specifics of
22 how such a rate design would be structured and how the fixed and variable
23 charges would be calculated. So, I cannot comment any further.

1 **11. Q. Mr. Johnstone expresses concern over the contract rate for Premium**
2 **Pork (Triumph). Please comment.**

3 A. The Company proposed (and the Commission approved) a contract rate to
4 Premium Pork under the Company's Economic Development Rider (EDR).
5 The variable rate is currently at \$0.453 per thousand gallons and has an
6 annual escalation clause.

7 **12. Q. Does this rate cover the company's variable costs?**

8 A. It recovers the Company's variable costs or incremental costs to produce
9 water plus a contribution toward the fixed costs of the system. The
10 Company's variable costs are approximately \$0.275 per thousand, based on
11 the cost of power, chemicals and waste disposal. These are the incremental
12 costs that the Company incurs to produce an additional unit of water. Thus,
13 the rate of \$0.453 recovers the \$0.275 of variable costs plus \$0.178 per
14 thousand gallons towards the fixed costs of the system. This fixed cost
15 contribution benefits all other customers because these fixed costs would
16 otherwise be required from all other customers. In other words, if Premium
17 Pork was not on the system, the remaining customers would have to pay for
18 the fixed costs that Premium Pork contributes.

19 **13. Q. So, is it reasonable for the Company to recover the full cost of service**
20 **from the remaining customers?**

21 A. Yes, it is. In my cost of service study, I deducted the revenue received from
22 contract customers as a credit to the cost of service and allocated this benefit
23 to all other classes based on the allocated cost of service. The reduced cost

1 of service (after the credit) is allocated and recovered from the remaining
2 customers by classification.

3
4 **SURREBUTTAL TO STAFF REBUTTAL TESTIMONY**

5 **14. Q. Do you have any comments regarding Mr. Russo's testimony?**

6 A. Since Mr. Russo submitted his direct testimony and exhibit, he made several
7 corrections to his calculations?

8 **15. Q. Did any of his corrections address the allocation of distribution mains**
9 **that you indicated did not properly reflect the cost causation by the**
10 **larger customers on the system?**

11 A. No, his corrections did not change the way he allocates distribution mains, so
12 I continue to disagree with his allocation of distribution mains as I indicated in
13 my rebuttal testimony.

14 **16. Q. Does this conclude your testimony?**

15 A. Yes, it does.