

BEFORE THE STATE OF NEW HAMPSHIRE

PUBLIC UTILITIES COMMISSION

ORIGINAL	
N.H.P.U.C. Case No.	DW 10-091
Exhibit No.	# 9
Witness	Panel 2
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In the matters of:

Pennichuck Water Works, Inc.)
DW 10-091)
Permanent Rate Case)

Pennichuck Water Works, Inc.)
DW 11-014)
Petition for Approval of Special Contract with)
Anheuser-Busch, Inc.)

Direct Prefiled Testimony

Of

Scott J. Rubin
On behalf of the Office of the Consumer Advocate

Dated: March 31, 2011

Introduction

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Q. Please state your name and business address.

A. My name is Scott J. Rubin. My business address is 333 Oak Lane, Bloomsburg, PA.

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

A. I am an independent consultant and an attorney. My practice is limited to matters affecting the public utility industry.

Q. What is the purpose of your testimony in this case?

A. I have been asked by the New Hampshire Office of the Consumer Advocate (“OCA”) to review the cost of service study and proposed rate design filed by Pennichuck Water Works, Inc. (“PWW” or “Company”). In addition, I have been asked to review the Fourth Contract for Water Service Between Anheuser-Busch, Inc. (“A-B”) and PWW.

Q. What are your qualifications to provide this testimony in this case?

A. I have testified as an expert witness before utility commissions or courts in the District of Columbia and in the states of Arizona, California, Connecticut, Delaware, Kentucky, Illinois, Maine, Maryland, New Jersey, New York, Ohio, Pennsylvania, and West Virginia. I also have testified as an expert witness before two committees of the U.S. House of Representatives and one committee of the Pennsylvania House of Representatives. I also have served as a consultant to the staffs of the Connecticut Department of Public Utility Control and the Delaware Public Service Commission, as well as to several national utility trade associations, and state and local governments throughout the country. Prior to establishing my own consulting and law practice, I was

1 employed by the Pennsylvania Office of Consumer Advocate from 1983 through January
2 1994 in increasingly responsible positions. From 1990 until I left state government, I was
3 one of two senior attorneys in that Office. Among my other responsibilities in that
4 position, I had a major role in setting its policy positions on water and electric matters. In
5 addition, I was responsible for supervising the technical staff of that Office. I also
6 testified as an expert witness for that Office on rate design and cost of service issues.

7 Throughout my career, I developed substantial expertise in matters relating to the
8 economic regulation of public utilities. I have published articles, contributed to books,
9 written speeches, and delivered numerous presentations, on both the national and state
10 level, relating to regulatory issues. I have attended numerous continuing education
11 courses involving the utility industry. I also periodically participate as a faculty member
12 in utility-related educational programs for the Institute for Public Utilities at Michigan
13 State University, the American Water Works Association, and the Pennsylvania Bar
14 Institute. Attachment SJR-1 to this testimony is my curriculum vitae.

15 **Q. Do you have any experience that is particularly relevant to the issues in this case?**

16 A. Yes, I do. I have testified on numerous occasions as a rate design and cost of service
17 expert in water rate cases. I also have worked as a consultant to local government entities
18 on rate design issues – both to assist government-owned utilities in designing rates and to
19 help government agencies obtain reasonable rates from their utility. I also served on the
20 editorial committee for the preparation of the major rate design manual for the water
21 utility industry, the American Water Works Association’s Manual M1: *Principles of*
22 *Water Rates, Fees, and Charges*, published in 2000. In addition, during 2004 I provided

1 technical assistance, training, and analysis for the staff of the Connecticut Department of
2 Public Utility Control on rate design, cost allocation, and related issues in a major water
3 utility rate case. From September 2009 through August 2010, I also served as the part-
4 time director of the water research program for the National Regulatory Research
5 Institute.

6 I also have experience dealing with issues related to water contracts. I have
7 served as an arbitrator in a water contract dispute in Michigan. In addition, I worked on a
8 project team evaluating regional solutions to the provision of water supply where my
9 research included (among other things) reviewing approximately 50 water supply
10 agreements from throughout the United States. I developed checklists and
11 recommendations that water utilities should use in considering or developing such
12 agreements. That research was published in *Regional Solutions to Water Supply*
13 *Provision, Second Edition* (2008) by the American Water Works Association Research
14 Foundation (now known as the Water Research Foundation). I also have worked on
15 projects evaluating the potential for regional water solutions in two locations. Those
16 projects included my review and evaluation of existing water supply contracts.

17 Summary

18 **Q. What is the primary focus of your direct testimony?**

19 A. My testimony focuses on two areas: (1) the reasonableness of the rates and other terms
20 and conditions of PWW's contract with A-B; and (2) PWW's proposed rate design for
21 general service customers.

1 **Q. Did you review the testimony and exhibits of any Company witnesses?**

2 A. Yes. I reviewed the testimony and exhibits of John Palko and Donald Ware, as well as
3 the A-B contract and the testimony and pleadings that accompanied that filing. I also
4 reviewed other exhibits that are part of the filings and numerous responses to discovery
5 requests that were provided by Mr. Palko, Mr. Ware, and other witnesses.

6 **Q. Please summarize your conclusions.**

7 A. My conclusions can be summarized as follows:

- 8 • I am not proposing any changes to the main part of the Company's cost-
9 of-service study ("COSS").
- 10 • I find that the contract between PWW and A-B is reasonable with two
11 exceptions: (1) the contract refers to daily meter reading that does not exist
12 and is not currently enforceable by PWW; and (2) the volumetric rate
13 should be increased by \$0.1537 per 100 cubic feet ("ccf") under the
14 Company's proposed revenue requirement to reflect a proper allocation to
15 A-B of property taxes and payroll taxes.
- 16 • The Commission should reject the Company's proposed "adjustments" in
17 the allocation of administrative and general ("A&G") expenses,
18 transmission and distribution ("T&D") expenses, depreciation,
19 amortization, and property taxes.

20 **Q. Before you begin your review of the Company's proposals, do you have any
21 preliminary matters to address?**

22 A. Yes. I want to make clear at the outset that my testimony and analysis are based on
23 PWW's proposed revenue requirement. This is a standard practice because it allows
24 different parties' cost-of-service and rate design recommendations to be compared on an
25 "apples-to-apples" basis. This should not be taken, however, as an endorsement of the
26 Company's proposed revenue requirement.

Principles of Rate Design

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Q. Are you familiar with the basic principles and goals of rate design?

A. Yes, I am. I recently wrote a paper on water rate design for the National Regulatory Research Institute, a copy of which is attached as Attachment SJR-2. In that paper, I review the basic principles of properly designed water rates.

Q. Please summarize those basic principles.

A. As I explain in Attachment SJR-2, utility rates should be designed with a goal of meeting the following principles:

- Practicality, including simplicity, understandability, ability to implement, and public acceptability;
- Clarity in its interpretation;
- Effectiveness in yielding the total revenue requirement;
- Stability in revenues from year to year;
- Continuity of rates, including the concept of gradualism;
- Fairness in relation to the cost of serving different types of customers;
- Avoidance of undue discrimination among similarly situated customers; and
- Encouragement of efficient consumption practices.

It may not be possible in every case to meet all of these principles, but a rate analyst or regulator should evaluate the rate design against these principles. Where a principle cannot be met or where two principles are in conflict, the issue should be recognized and a valid basis should be given for the analyst's or regulator's decision. An

1 accurate cost-of-service study provides important information that should be used to
2 evaluate several of these rate-design principles.

3 **PWW's Cost-of-Service Study ("COSS")**

4 **Q. Did you review PWW's COSS dated April 2010?**

5 A. Yes, I did; however, PWW provided a revised COSS and rate design in February 2011
6 that reflects the final terms of the new contract with A-B. For consistency with the
7 Company's presentation, my discussion of costs, rates, and rate design will use the
8 February 2011 filing as representing the Company's proposal in this case.

9 **Q. Do you have any concerns with the methodology used in that study?**

10 A. No, the main part of the Company's COSS (Schedules 1 through 7) was prepared using
11 the base-extra capacity method that is a recognized standard in the water industry. While
12 my judgment may differ from Mr. Palko's in a few areas, the net effect of any changes I
13 would propose in the COSS would be quite minor. In order to simplify the issues in this
14 case, therefore, I am not proposing any changes in the main part of the COSS.

15 **Anheuser-Busch Contract**

16 **Q. Have you reviewed the contract with A-B?**

17 A. Yes, I have.

18 **Q. Do you have any concerns with that contract?**

19 A. Yes, I have two concerns with the contract. The first is a concern with the limitation on
20 maximum daily consumption by A-B. The second is a concern with the calculation of
21 one of the rate elements set forth in the contract.

1 **Maximum Daily Consumption Limits**

2 **Q. What is your concern with the contract provision relating to maximum daily**
3 **demand by A-B?**

4 A. One of the critically important provisions of the contract is paragraph 5 (Maximum Water
5 Take) that restricts the amount of water A-B can draw from PWW's system. This
6 restriction on water purchases is then used in PWW's revised COSS to allocate
7 significantly less cost to A-B than would have been allocated under the previous contract
8 between A-B and PWW. Specifically, this paragraph restricts A-B to taking no more
9 than 1.5 million gallons of water in any day.

10 The contract contemplates that PWW will have the capability to read A-B's water
11 meters each day so that this provision can be enforced. Specifically, paragraph 7
12 (Definitions) states: "Where the words 'day,' 'daily,' or '24 hours' are used in this
13 Fourth Contract, they shall refer to the 24-hour period between the daily meter readings."

14 PWW, however, does not read A-B's meters each day and has not installed meters
15 that are capable of recording daily consumption. See PWW's responses to OCA 6-9 and
16 OCA 6-10, provided as Attachments SJR-3 and SJR-4, respectively. Thus, as it stands
17 now, PWW has no means by which it can enforce this provision of the contract. Further,
18 there is no penalty (or other increased cost) to A-B if it exceeds the limit on daily
19 consumption. Attachment SJR-3.

20 **Q. Why is this important?**

1 A. This is important for two reasons. First, PWW should not enter into a contract that it
2 cannot administer and enforce. Second, PWW used the new contract with A-B to
3 significantly reduce the amount of costs allocated to A-B. Those costs were not absorbed
4 by PWW, but were allocated to other water customers. It is unfair to those other water
5 customers for PWW to use the contract limits for cost allocation purposes, but to then fail
6 to enforce the contract limits. In effect, A-B would be given a free ride – it would have
7 the ability to use more capacity at no additional cost.

8 **Q. Have you quantified the effect of this problem?**

9 A. Yes. PWW states that it has physically restricted the ability of A-B to take more water on
10 an hourly basis than the hourly contract limit, equivalent to 2.0 million gallons per day
11 (“mgd”). Attachment SJR-3. But there is no physical restriction that would prohibit A-B
12 from taking that amount of water for an entire 24-hour period. Thus, the physical limit
13 on A-B’s use of the system is 2.0 mgd, while the contract limit is 1.5 mgd. PWW has
14 prepared its revised COSS based on the contract limit of 1.5 mgd. Under this assumed
15 maximum daily demand, PWW has determined that the volumetric charge to A-B would
16 be \$0.9099 per ccf, and total annual revenues from A-B would be \$900,513.

17 If, however, A-B’s maximum daily demand were 2.0 mgd, the volumetric rate
18 using PWW’s COSS model would need to be \$0.9551 per ccf and total annual revenues
19 from A-B would need to be \$925,437.¹ In other words, each 0.1 mgd (100,000 gallons
20 per day) increase in A-B’s maximum daily demand would increase the annual cost to

¹ These figures are calculated by changing the maximum day demand for A-B to 2.0 on the Volume tab of the revised COSS model. The model calculates A-B’s rate per ccf and the total annual revenues from A-B on the PropRevCalc tab.

1 serve A-B by approximately \$5,000. That is, for each 1,000 gallons by which A-B's
2 daily demand exceeds 1.5 million gallons, the cost to serve A-B would increase (and the
3 cost to serve other customers would decrease) by approximately \$50 on an annual basis.

4 **Q. Is there a significant risk that A-B could use more than 1.5 mgd?**

5 A. Yes, there is. According to Attachment SJR-3, A-B experienced usage that averaged
6 more than 1.5 mgd for an entire month in August 2008. It is likely that there were peak
7 days during that month that were substantially higher than 1.5 mgd. Further, according to
8 the confidential A-B usage data provided by PWW in response to A-B 2-2, A-B also had
9 a monthly peak of just below 1.5 mgd in September 2008. Again, it is very likely that
10 there were individual days during the month that exceeded 1.5 mgd. Further, the
11 confidential data from A-B 2-2 show that during the past two years, there were several
12 months when A-B's average daily usage for the month was between 1.1 and 1.2 mgd. It
13 would not be difficult to imagine that there were individual days during those months that
14 might have been more than 1.5 mgd. Thus, I consider there to be a significant risk that
15 A-B could exceed 1.5 mgd on one or more days during the year.

16 **Q. Is it possible for PWW to read A-B's meters on a daily basis?**

17 A. Yes, it is. In Attachment SJR-4, PWW states that it could modify A-B's meters so that
18 they could be read electronically each day for an annual cost of approximately \$4,800.
19 This is equivalent to a cost of \$200 per month for each of A-B's two, six-inch meters.

20 **Q. What do you recommend?**

1 A. I recommend that PWW should be required to electronically read A-B's meters each day
2 and that the meter charge for each of A-B's meters should be increased by \$200 per
3 month to recover that cost. In addition, I recommend that the contract should be
4 amended to impose an additional charge on A-B of \$50 for each 1,000 gallons by which
5 its maximum daily demand during a year exceeds 1.5 million gallons.

6 In the alternative, if the Commission determines that these changes are not
7 appropriate, then I recommend that the COSS should be revised to reflect a maximum
8 daily demand to A-B of 2.0 mgd, which is the physical limit on deliveries through
9 PWW's facilities serving A-B. Using the Company's proposed revenue requirement, this
10 would increase the volumetric rate to A-B to \$0.9551 per ccf (instead of \$0.9099 per ccf),
11 resulting in increased annual charges to A-B of approximately \$24,924 per year.

12 I would emphasize that without daily metering and a cost-based charge for
13 exceeding the contract maximum, other customers would be forced to subsidize service
14 to A-B. That should not be permitted. Either PWW needs to begin daily meter reading,
15 coupled with a cost-based charge to enforce the contract maximum, or the COSS needs to
16 be revised to remove the possibility of a subsidy from other customers to A-B. I prefer
17 the former approach because it is consistent with the intention of PWW and A-B in
18 negotiating the contract; but either approach would provide reasonable protection for
19 PWW's other customers.

20 ***Allocation to A-B of Property Taxes and Payroll Taxes***

21 **Q. Please describe your understanding of the rates PWW proposes to charge to A-B.**

1 A. The general approach used by PWW is to develop the rate in three components. The first
2 component, known as the Base Monthly Fixed Fee, is to recover fixed costs associated
3 with the treatment plant, source of supply, and the Fifield storage tanks. The
4 methodology for determining this charge is set forth in the Appendix to PWW's original
5 COSS (filed in April 2010). The calculation has been updated to reflect the new water
6 consumption and peaking requirements in the revised contract. The components of this
7 charge are return on investment grossed up for income taxes, depreciation expense, and
8 property taxes associated with these facilities.

9 The second component of the rate is the monthly metering charge. As I discussed
10 above, I recommend that this metering charge should be \$200 per month per meter higher
11 than the charge for a typical six-inch meter, so that PWW can recover the cost of daily,
12 electronic meter reading.

13 The third component of the rate is the Volume (or consumption) charge which
14 PWW calculates in two parts. The first part of the charge is the production cost
15 calculated on Schedule 13, page 1, of PWW's revised COSS. The second part of the
16 variable charge is to allocate Administrative and General ("A&G") expenses to A-B.
17 This calculation is shown on Schedule 13, page 3, of the revised COSS.

18 **Q. Do you have any concerns with the calculation of the rates to be paid by A-B under**
19 **PWW's revised COSS and rate design model?**

20 A. Yes, I do. The general concept of PWW's approach to determining the rates for A-B is
21 reasonable, but the calculation of these three rate components fails to include two

1 important costs that should be allocated, in part, to A-B. Specifically, the allocation of
2 A&G expenses to A-B fails to include two expenses that are indistinguishable from
3 A&G, but are accounted for in a separate category: (1) payroll taxes; and (2) the non-
4 production portion of property taxes.

5 **Q. How did you determine that these costs are not being allocated to A-B?**

6 A. On Schedule 13, page 3, of the revised COSS, PWW shows the base cost and extra
7 capacity costs for A&G that it is allocating to A-B. These costs are taken directly from
8 Schedule 2, page 2, of the COSS, on the “Total Admin. and Gen’l Expenses” line. That
9 line on Schedule 2, page 2, includes the sum of the items above it (accounts 920 through
10 950). On Schedule 2, page 3, however, the COSS separately shows lines for \$520,118 in
11 payroll taxes and \$2,844,093 in property taxes. These lines were not included in A&G on
12 Schedule 2, page 2, and they are not included in the A&G allocation to A-B on Schedule
13 13, page 3.

14 **Q. Why should payroll taxes be allocated in part to A-B?**

15 A. Payroll taxes include such items as the employer’s share of Social Security and Medicare
16 taxes, as well as workers’ compensation and unemployment compensation taxes. These
17 costs really are no different than other employee benefits, except they are paid to the
18 government instead of to private companies. The A&G allocation to A-B properly
19 includes the allocation of employee benefits (account 926) because PWW’s employees
20 make it possible for PWW to provide service to A-B. Those employees maintain the
21 facilities, treat the water, send the bills, and so on. The taxes on those employees’

1 salaries and wages should be allocated to A-B, just like the salaries and wages themselves
2 and other employee benefits are allocated in part to A-B.

3 **Q. You said earlier that property taxes on some facilities already were allocated to A-B.
4 Are there more property taxes that should be allocated in part to A-B?**

5 A. Yes, there are additional property taxes that should be allocated to A-B. The allocation
6 of property taxes in the Base Monthly Fixed Fee is limited to the taxes on certain
7 production and storage facilities. PWW also pays property taxes on water mains and
8 other facilities that enable PWW to serve A-B. All other customers pay these property
9 taxes through their rates, and A-B should be no exception.

10 **Q. Have you calculated the amount of payroll taxes and additional property taxes that
11 should be allocated to A-B?**

12 A. Yes. On Attachment SJR-5, I show the calculation of these amounts. Specifically, I
13 show that A-B should be responsible for \$25,873 in payroll taxes and a total of \$147,108
14 in property taxes. The Base Monthly Fixed Fee and meter charge already recover
15 \$88,220 and \$38, respectively, in property and payroll taxes, so there remains \$84,723 to
16 be recovered in taxes through the Volume charge. As shown on that attachment, I
17 calculate that this would increase the Volume charge by \$0.1537 per ccf. This would
18 result in increasing the Volume charge under PWW's proposed revenue requirement and
19 rate design from \$0.9099 as PWW proposed on Schedule 13, page 3, to \$1.0636 per ccf.

1 **Rate Design: General Service Customers**

2 ***Reallocation of Expenses***

3 **Q. Do you have any concerns about the Company's rate design proposal and**
4 **methodology?**

5 A. Yes. Rather than using the results of its COSS as a guide to designing rates, PWW first
6 makes three unwarranted adjustments to the results of the study. In particular, PWW
7 reallocates a portion of A&G expenses, transmission and distribution ("T&D") expenses,
8 and what it terms "base fixed costs" (that is, the base component of depreciation expense,
9 amortization expense, and property taxes) out of their initial functions (base, maximum
10 day, or maximum hour) and into the customer function. Presumably the Company does
11 this so it can justify an increase in the customer charge. PWW, however, does not
12 provide any justification for this radical departure from the COSS, other than to express
13 its desire to have a higher customer charge.

14 **Q. What specifically did the Company do in making these unjustified adjustments?**

15 A. On Schedule P10, page 3, the Company begins with the customer costs from its COSS, or
16 \$4,339,328. This should be the maximum amount the Company recovers from its
17 customer charges.

18 PWW then adds to that amount 75% of A&G expenses that had been properly
19 allocated to the other functions, plus 40% of T&D expenses that had been properly
20 allocated to the other functions, plus 75% of the base portion of depreciation,
21 amortization, and property taxes. The Company thereby improperly inflates its so-called

1 customer-related costs by more than \$5.1 million. That is, these reallocations more than
2 double PWW's customer-related costs.

3 **Q. Is the Company's reallocation of A&G expenses reasonable?**

4 A. No. The Company's arbitrary reallocation of A&G expenses from the base, maximum
5 day, and maximum hour functions to the customer function is not reasonable.

6 The Company's total A&G expenses are \$5,023,804. Of that amount, the COSS
7 already allocates \$1,023,000 to the customer functions (commercial, meters, and
8 services). Importantly, essentially all of this A&G expense is for A&G salaries and
9 employee pensions and benefits. Both of these items should be allocated among all of the
10 functions performed by the utility.

11 Administrators are involved in managing infrastructure (deciding when to repair
12 or replace water mains, for example), operational and engineering decisions, and so on.
13 Similarly office personnel support all functions of the utility, including engineering,
14 operations, maintenance, and so on. There is no reason to assume that these people
15 perform functions primarily related to the customer service functions; in fact, they
16 support all functions within the Company. PWW's original COSS allocation properly
17 recognizes this fact, and there is no reason to reallocate these costs to the customer
18 function.

19 Employee pensions and benefits, of course, apply to all employees and should be
20 allocated in proportion to how direct payroll expense is allocated. This is precisely what
21 PWW did in the main part of its study. There is no reason to reallocate these costs

1 primarily to the customer function when, in fact, they support all aspects of the
2 Company's operations.

3 **Q. You testified that the Company also reallocated its T&D expenses. Is the**
4 **Company's reallocation of T&D expenses reasonable?**

5 A. No. The Company has \$1,634,228 in T&D expenses. Its COSS already allocates more
6 than half this amount (\$898,706) to the customer functions. These are costs associated
7 with maintaining meters and service lines. The remaining costs in these accounts are
8 related to maintaining water mains and miscellaneous equipment. There is no reason to
9 change the allocation of these amounts or to simply assume (incorrectly) that they are
10 somehow related to the customer functions.

11 **Q. The Company also reallocated the base portion of depreciation, amortization, and**
12 **property taxes to the customer functions. Is that reallocation reasonable?**

13 A. No, it is not. Depreciation, amortization, and property taxes should be allocated in
14 precisely the same manner as the plant with which they are associated. The Company's
15 COSS contains a detailed schedule (Schedule 2, page 3) showing the allocation of these
16 expenses. All of them are allocated in the same manner as the underlying plant
17 investment.² By reallocating these expenses, PWW is proposing to remove the inherent
18 linkage between the property and the expenses to support the property.

² The plant investment is allocated on Schedule 1, pages 1-2. PWW correctly uses the same factors to allocate each plant account on these pages and the corresponding depreciation expense on Schedule 2, page 3.

1 **Q. What do you conclude about the Company’s proposed reallocation of A&G**
2 **expenses, T&D expenses, depreciation, amortization, and property taxes into the**
3 **customer function?**

4 A. I conclude that the Company’s proposed reallocation of these costs is not consistent with
5 its own COSS. Simply, the reallocation does not reflect the reasons why those costs are
6 incurred. Further, the reallocation is inconsistent with standard industry practice in
7 preparing a water COSS. The purpose of a COSS is to get an accurate depiction of the
8 costs of providing service to different functions or different types of customers; it is not
9 to reflect a utility’s judgment about public policy or the importance to the utility of rate
10 stability. I recommend, therefore, that the Company’s proposed reallocation of these
11 expenses should be rejected.

Rate Design

13 **Q. How does the cost of service compare to the revenues the Company receives under**
14 **existing rates?**

15 A. Table 1 compares the cost of service from PWW’s revised COSS to the pro forma
16 revenues PWW receives under present rates (from Schedule 10 of PWW’s COSS).

Table 1: Comparison of PWW’s Revised Cost of Service with Pro Forma Revenues Under Present Rates			
	Revised COSS	Present Revenues	Difference
Volume and demand costs	\$ 19,687,453	\$12,696,537	(\$6,990,916)
Customer costs	4,339,328	6,751,420	2,412,092
Private fire costs	1,053,318	1,005,371	(47,947)
Public fire costs	3,131,999	2,690,258	(441,741)
Total cost of service	\$28,212,098	\$23,143,586	(\$ 5,068,512)

1 Table 1 shows that PWW's existing customer charges are more than sufficient to recover
2 all of PWW's customer-related costs under PWW's proposed revenue requirement.
3 Specifically, PWW is currently collecting \$6,751,420 from customer charges, but its
4 customer-related cost under proposed rates is only \$4,339,328. In other words, if the cost
5 of service were the only consideration, PWW's customer charges should be reduced by
6 more than 30%. Certainly, there is no cost justification for increasing PWW's customer
7 charges in this case. Any rate increase from general service customers (that is, non-fire
8 customers) should be recovered through an increase in the consumption charge. Even if
9 that were done, PWW's revenues from customer charges still would exceed the
10 customer-related cost of service.

11 **Q. Are there other rate design considerations in addition to the cost of service?**

12 A. Yes, there are valid public policy considerations other than the cost of service that should
13 be evaluated when designing utility rates. Among these are the impacts on customers,
14 encouraging the efficient use of the utility service, the stability of the utility's revenues,
15 and the avoidance of dramatic changes in the rate design.

16 **Q. How has the Company proposed to balance these various rate design**
17 **considerations?**

18 A. The Company has placed tremendous weight on the stability of its revenues while
19 ignoring the other factors, including the cost of service. Thus, the Company proposes to
20 recover nearly all of its rate increase through increases in fixed charges. Specifically,
21 PWW proposes a 41.15% increase in its customer charges, but a 6.4% increase in its
22 general-service consumption charges. In my opinion, this is an extreme – and

1 unwarranted – position. The Company has elevated revenue stability above all other
2 considerations and it has crafted a rate design proposal that is neither reasonable nor
3 reflective of the cost of serving different types of customers.

4 **Q. Does the Company’s revenue history exhibit the type of instability that would justify**
5 **such an extreme rate design proposal?**

6 A. No, it does not. According to the Company’s data, its revenues have been relatively
7 constant in recent years. In 2007 and 2008, the Company’s revenues from retail sales
8 were almost identical, increasing slightly from \$21,312,996 in 2007 to \$21,724,120 in
9 2008. Schedule 1 to PWW’s rate filing. PWW had a rate increase during 2009, so its
10 revenues for the year increased significantly on a pro forma basis, to more than \$24
11 million.

12 While it is true that the Company’s sales of water may have declined, that tells us
13 little about the overall stability of its revenues. Under present rates, approximately 44%
14 of the Company’s revenues come from fixed charges that are not affected by the amount
15 of water sold. Specifically, PWW has pro forma revenues under present rates of
16 \$24,100,074. Of that amount, \$10,578,864 (43.9%) comes from fixed charges (customer
17 charges, fixed contract charges, and fire charges).

18 **Q. How does the percentage of revenues PWW receives from fixed charges compare to**
19 **other water utilities with which you are familiar?**

20 A. PWW recovers more of its revenues through fixed charges than almost any other water
21 utility with which I am familiar. Most of the water utility rate cases I have worked on

1 result in the utility recovering less than 30% of its revenue requirement from fixed
2 charges. Indeed, as part of its statewide water conservation policy, the California Urban
3 Water Conservation Council recommends that water utilities recover no more than 30%
4 of their revenues from fixed charges. This is consistent with my experience with water
5 utilities throughout the United States.

6 For example, last year I worked on a rate case involving Illinois-American Water
7 Company which has service areas of different sizes spread throughout that state. In total,
8 that utility's pro forma revenues under present rates for 2009 were \$58.7 million.
9 Approximately \$6.2 million of that amount (10.5%) was recovered through fixed charges.
10 That is, almost 90% of its revenues came from consumption-related charges. Similarly,
11 last year I also reviewed a rate case filed by Kentucky-American Water Company. In
12 that case, the utility proposed a revenue requirement of \$88.1 million, of which \$22.1
13 million (25%) would be recovered from fixed charges.

14 Even in my experience with smaller utilities, I cannot recall a case where the
15 utility received more than half of its revenues from fixed charges. For example, last year
16 I worked on a rate case by Shorelands Water Company in New Jersey. That utility has
17 approximately 11,000 customers, and the utility made similar arguments about the need
18 to improve the stability of its revenues. The settlement in that case provided for the
19 utility to recover approximately \$3.9 million of its total revenue requirement of \$10.5
20 million through fixed charges, or about 37% of its revenues.

1 These cases represent just a few of the many water rate cases on which I have
2 worked. Simply, in my experience it is very unusual to have a water utility recover 44%
3 of its revenues from fixed charges. PWW's percentage of fixed-charge revenues already
4 are at a level that exceeds the percentage recovered by most water utilities with which I
5 am familiar.

6 **Q. What do you conclude about the stability of PWW's revenues?**

7 A. I conclude that the existing rate structure, through which almost 44% of PWW's revenues
8 are from fixed charges, ensures a relatively stable revenue stream for PWW. In my
9 opinion, there is no need to deviate significantly from the cost of service, or to ignore
10 other important public policy goals, in order to provide PWW with an unusually high
11 level of revenue stability. In fact, in light of my experience with many other water
12 utilities' rate cases, the Commission could even reduce the percentage of revenues PWW
13 recovers through fixed charges and still have rates that promote revenue stability.

14 **Q. What do you recommend?**

15 A. My preferred approach to setting rates for PWW would be to have no increase in PWW's
16 customer charges. Those charges already recover \$6,751,420 in revenues, even though
17 the customer-related cost of service under PWW's proposed revenue requirement is only
18 \$4,339,328. Thus, I do not see a justification – either because of the cost of service or for
19 revenue-stability reasons – to increase the customer charges. For example, if the
20 customer charges do not increase and if PWW's revenue requirement were granted in
21 full, PWW would recover \$11,764,174 in revenues from fixed charges (customer
22 charges, fixed contract charges, and fire protection charges), out of a total revenue

1 requirement of approximately \$28,124,900. This represents 41.8% of revenues
2 recovered through fixed charges which, as I discussed above, is high for a water utility.
3 In my opinion, therefore, keeping customer charges at their existing level would be
4 consistent with the cost of providing service and would not impose an undue burden on
5 the stability of the Company's revenues.

6 **Q. Have you prepared rates that would implement your proposal?**

7 A. Yes. On Attachment SJR-6, I show the rates, and a proof of revenues, that would collect
8 the Company's proposed revenue requirement using my rate design proposal. This
9 attachment also shows how I developed the totals and percentages I referred to in the
10 previous answer.

11 **Q. If the Commission were to authorize a smaller rate increase than the Company**
12 **requested, how would you recommend that rates should be designed?**

13 A. If the Commission authorized a lower rate increase than PWW requested, I would
14 continue to hold customer charges at their existing level. The rate increases in fire
15 charges and consumption charges should be scaled back proportionately to produce the
16 authorized level of revenues. On Attachment SJR-7, I illustrate this using a hypothetical
17 revenue requirement of \$26,681,759 (the revenues that are produced using the
18 Company's updated billing determinants and the rates authorized by the Commission as
19 temporary rates on October 8, 2010).

1 It should be noted that the rates on Attachment SJR-7 recover 43.4% of revenues
2 from fixed charges – almost the same percentage as recovered under present rates without
3 having to increase customer charges at all.

4 **Q. You said that this is your primary recommendation. If the Commission rejects your**
5 **proposal to keep customer charges at their existing level, do you have any other**
6 **recommendations?**

7 A. Yes, if the Commission rejects my proposal to keep customer charges at their current
8 levels, I would urge the Commission to not permit PWW to increase the proportion of
9 total revenues that the Company recovers through fixed charges. As I stated above, that
10 percentage is 43.9%. I consider that percentage to be very high for a water utility
11 already, so I would urge the Commission not to authorize any greater recover of revenues
12 through fixed charges. If the Commission were to increase fixed-cost recovery beyond
13 43.9%, PWW's rates would move even further from the cost of service than they are at
14 present.

15 **Q. Have you calculated what your alternative recommendation, to limit the percentage**
16 **of revenues recovered through fixed charges to 43.9%, would mean for PWW's**
17 **customer charges?**

18 A. Yes. Under PWW's proposed revenue requirement, the maximum customer charge
19 revenue would be approximately \$7,326,000, which when added to fire revenues and
20 fixed contract revenues would bring the percentage of fixed-charge revenues to 43.9% of
21 the approximate \$28,124,900 revenue requirement proposed by the Company.

1 Attachment SJR-8 shows the customer charges and consumption charge that would
2 provide PWW with 43.9% of its revenues from fixed charges.

3 I also prepared Attachment SJR-9 to show what this limitation (43.9% of
4 revenues from fixed charges) would mean if the final revenue requirement were set equal
5 to the temporary rate increase previously authorized by the Commission. This
6 attachment shows that the maximum customer-charge revenues under this revenue
7 requirement should be approximately \$6,867,000.

8 **Conclusion**

9 **Q. Please summarize your recommendations regarding the contract between PWW
10 and Anheuser-Busch.**

11 A. I recommend that the Commission should approve the Fourth Contract for Water Service
12 between A-B and PWW, and the rates set out in PWW's revised COSS, with the
13 following changes: (1) the meter charge should be increased by \$200 per month for each
14 meter to recover the cost of daily meter reading; (2) A-B should be charged \$50 for each
15 1,000 gallons that its annual maximum day demand exceeds 1,500,000 gallons; and
16 (3) the volumetric rate should be increased to \$1.0636 per ccf to recover a reasonable
17 allocation of property taxes and payroll taxes.

18 **Q. Please summarize your rate design recommendations for General Metered
19 customers.**

1 A. Table 2 summarizes the rates I recommend, and my alternative recommendation, and the
 2 resulting annual bill for a typical residential customer under the hypothetical situation
 3 where the Commission authorizes the full revenue requirement requested by PWW.

Table 2: Typical Residential Bill Under Different Rate Design Options Using PWW's Requested Revenue Requirement				
	Present	PWW Proposed	Recommended: No Customer Charge Increase	Alternative: Retain Same Proportion of Fixed Charges
5/8" meter charge	\$18.18	\$25.66	\$18.18	\$19.78
Rate per ccf	\$2.9000	\$3.0660	\$3.6800	\$3.5439
Typical bill: 6 ccf	\$35.58	\$44.06	\$40.26	\$41.04
% increase		23.8%	13.2%	15.3%

4 Table 3 shows the same type of summary under the hypothetical situation where the
 5 Commission authorizes a revenue requirement equal to the amount it authorized as a
 6 temporary rate increase on October 8, 2010.

Table 3: Typical Residential Bill Under Different Rate Design Options Using Temporary Rate Revenue Requirement				
	Present	Authorized Temporary Rates	Recommended: No Customer Charge Increase	Alternative: Retain Same Proportion of Fixed Charges
5/8" meter charge	\$18.18	\$20.15	\$18.18	\$18.54
Rate per ccf	\$2.9000	\$3.2100	\$3.3905	\$3.3595
Monthly bill: 6 ccf	\$35.58	\$39.41	\$38.52	\$38.70
% increase		10.8%	8.3%	8.8%

7 **Q. Does this conclude your direct testimony?**

8 A. Yes, it does.