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IDAHO PUBLIC
UTILITIES COMMISSION

Attorneys for Applicant

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION
OF UNITED WATER IDAHO INC. FOR
AUTHORITY TO INCREASE ITS RATES
AND CHARGES FOR WATER SERVICE IN
THE STATE OF IDAHO

Case No. UWI-W-04-04

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

REBUTTAL TESTIMONY OF DENNIS PESEAU

1 Q. Please state your name and business address.

2 A. My name is Dennis E. Peseau. My business address is Suite 250, 1500
3 Liberty Street, S.E., Salem, Oregon 97302.

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

5 A. I am President of Utility Resources, Inc. My firm consults on a
6 number of economic, financial and engineering matters for various
7 private and public entities.

8 Q. On whose behalf are you testifying in this proceeding?

9 A. I am testifying on behalf of United Water Idaho Inc.

10 Q. Are you the same Dennis E. Peseau who prefiled direct testimony in
11 these proceedings?

12 A. Yes.

13 Q. What is the purpose of your testimony?

14 A. As a follow-up to my direct testimony, I will address rate design issues
15 discussed by Staff witness Sterling and Idaho Rivers United Witness
16 Wojcik. Additionally, United Water has asked me to analyze and
17 critique Staff's proposal to employ a 13-month average rate base. I
18 will discuss the rate base issue first, followed by a discussion of rate
19 design issues.

20 Q. Please describe the Staff proposal to employ a 13-month average rate
21 base, as you understand it.

22 A. Staff calculates a rate base by averaging the monthly balances from
23 July 31, 2003 through July 31, 2004 for Plant in Service, Customer

1 Advances and Contributions in Aid of Construction. Except for
2 investment associated with the Columbia Water Treatment Plant
3 (CWTP) post-test year investments, through December 31, 2004, are
4 treated as if it occurred in the last month of the test year, and in
5 consequence, that investment is included in rate base at 1/13 of the
6 amount actually invested. (See Harms, Di. Pg 6).

7 Q. In contrast, how did the Company calculate its proposed rate base?

8 A. The Company employed an end of period or year end rate base using
9 the twelve-month period ended July 31, 2004. Normalizing and
10 annualizing adjustments were made to the test period and known and
11 measurable adjustments to revenue, operating expense and rate base
12 through May 31, 2005. (See Healy, Di. Pg 2). In addition, as
13 described in the testimony of Company Witness Wyatt at pp. 10-13, an
14 adjustment was made to reflect the impact on revenue and expense of
15 post test year plant additions, and to match revenue, expense and rate
16 base, in accordance with the policy stated by the Commission in Idaho
17 Power.

18 Q. Is the year end methodology proposed by the Company consistent with
19 prior Commission orders with respect to United Water and its
20 predecessor, Boise Water Corporation?

21 A. Yes. I have reviewed the previous four rate orders for United
22 Water/Boise Water, commencing in 1993 with Case No. BOI-W-93-1,
23 Order No. 25062. (See also, Case Nos. BOI-W-93-3, Order No.

1 25640; UWI-W-97-6, Order No. 27617 and Case No. UWI-W-00-1,
2 Order No. 28585). The year-end with pro-forma adjustments method
3 proposed by the Company in this case is identical, in all material
4 respects, to the method proposed by the Company, and accepted by the
5 Commission in these previous cases.

6 Q. Is the effect of Staff's proposed change in rate making methodology
7 material?

8 A. Very much so. According to Staff witness Harms, the 13-Month
9 Average rate base is approximately \$12 million lower than the Rate
10 Base filed by the Company. Solely due to the difference in rate base,
11 Staff's revenue requirement is approximately \$2 million lower than the
12 Company's. A \$12 million reduction in rate base, compared to the
13 Company's total rate base of \$140 million represents a 9% reduction,
14 solely from a change in rate making methodology.

15 Q. What conclusions have you reached with regard to Staff's position to
16 change from the policy of an end of period rate base to a thirteen-
17 month average rate base for the Company in these proceedings?

18 A. I conclude that:

- 19 1. Staff has erred in its conclusion that United Water Idaho
20 did not normalize revenues completely to May 31, 2005
21 and so did not cause a "mismatch of expenses and
22 revenues" as Staff alleges.
- 23 2. The Company's rate base, expense and revenues treatment
24 in its filing are consistent, while Staff's are not;
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3. There is a fundamental test used below that the Commission can use to distinguish between when to apply the thirteen month average rate base method it uses for the electric utilities, and the year end rate base method it has used for some time for the more capital intensive United Water Idaho.

4. Because Staff's case is so inconsistent, and unless the Commission continues with the methodology it used in the four previous United Water Idaho rate cases, there will result an absolute inability for United Water Idaho to earn its allowed rate of return, and shareholder property will be confiscated.

United Water Idaho Matches, but Staff Mismatches Revenues and Expenses

Q. What is the issue with respect to the matching of revenues and expenses in this case?

A. Staff alleges in this case that the Company's filing, although entirely consistent with and nearly identical in method to its previous three rate case filings, does not match normalized revenues with normalized expenses. The issue here is whether or not it is necessary in the case of United Water to change from its established end of period rate base method to a thirteen-month average method proposed by Staff in order to match revenues and expenses.

I argue that in at least two respects, the year-end or end-of-period rate base method is more appropriate for a water utility with the Company's characteristics. I say this knowing that for some time the Commission has endorsed and approved the thirteen-month average rate base period for the electrics Idaho Power and Avista, which it regulates.

1 Q. What is the first reason it is appropriate to allow United Water to
2 establish rates based upon an end-of-period rate base?

3 A. The first reason is for accuracy and ease of application. For a water
4 utility that has its investment, and therefore rate base growing as
5 quickly as the Company, it is far easier to annualize revenues to end of
6 period, than to reverse the numerous expense and rate base entries. In
7 the recent Idaho Power rate case No. IPC-E-03-13, I testified:

8 Q. How should this mismatch be corrected?

9 A. There are basically two alternative remedies available. The
10 first would be to reverse the annualizing entries and
11 properly match test year averages on both sides of the
12 ledger. The second alternative is to annualize revenues in
13 the same manner as rate base and expenses.

14 Q. Do you have a preference between these two alternatives?

15 A. On the whole, I think annualizing revenues to 2003 year-
16 end levels is the preferable course for two reasons. First, it
17 is much simpler to annualize revenues than to back out
18 Idaho Power's annualizing adjustments from numerous cost
19 and rate base categories. Moreover, annualizing revenues
20 produces a more forward-looking result than reversing the
21 expense and rate base annualizations.

22 I recognize, however, that when faced with a similar
23 mismatch problem in the last Idaho Power rate case, the
24 Commission ordered a reversal of the improper
25 annualization of expenses. Order No. 25880, pp. 3-4. In
26 theory this course of action is equally acceptable, but it
27 poses a greater risk of computational errors just because of
28 the number of adjustments required. Consequently, I
29 continue to recommend annualizing earnings instead.
30 (Peseau direct, Case No. IPC-E-03-13, Pages 5-6)

31 Q. Has, in fact, Staff failed to properly match its proposed thirteen-month
32 expense and rate base estimates with corresponding revenues?

33 A. Yes. This can be demonstrated by determining that Staff used
34 essentially the same level of annualized revenues, those for the period

1 ending May 31, 2005 that are contained in the Company's filing. In
2 following its suggestion to use the thirteen-month average rate base,
3 Staff should also have reduced the May 31, 2005¹ annualized revenues
4 in the Company's filing back to the actual test year revenues centered
5 at January, 2004. But Staff did not. The test year revenues used by
6 Staff are actually the very same test year revenues developed by the
7 Company for its end of period method, with one very small exception.
8 On Company Exhibit 8, Page 2 of 2, proposed test year revenues are
9 \$31,534,832. To verify that Staff's case calculates annualized
10 revenues identically to the end of period May 31, 2005 calculated by
11 the Company, I refer to Staff Exhibit 126. On this exhibit (column (6),
12 line (12)) appears the same annualized revenue levels of \$31,
13 534,832.² In other words, Staff mismatches rate base and expenses on
14 a thirteen-month average basis, with a higher level of revenues
15 calculated on a forward annualized period May 31, 2005. Thus there
16 is a gross mismatch.

17 Contrastingly, the Company's filing is consistent, in that it
18 matches the higher level of end of period May 31, 2005 revenues with
19 its end of period expenses and rate base. Staff, on the other hand,
20 mismatches these components by using the smaller than actual rate
21 base, its thirteen month average, with the higher level of end of period

¹These May 31, 2005 annualized revenues are derived by adjusting twelve-month ending July 31, 2004 revenues for South County, weather normalization and growth through May 31, 2005.

²This figure is adjusted by \$5,628 for Carriage Hill on Staff Exhibit 111, Page 2 of 2.

1 revenues. This is a mismatch that eventually guarantees an under
2 recovery of revenues sufficient to earn the allowed rate of return.
3 Again, in my opinion, the most appropriate means by which to most
4 accurately match the Company's expenses and revenues is to use the
5 end of period rate base.

6 Q. For purposes of consistency between the rate base treatment of the
7 local electrics, and United Water should the Commission require
8 United Water to use a thirteen-month average rate base?

9 A. No, there are significant and peculiar differences here that, in my
10 opinion, argue strongly for allowing United Water to continue with its
11 end of period rate base method. This second reason is argued below.

12 Q. Does not Staff argue that the Commission has recently changed
13 policies regarding rate base treatment?

14 A. Yes. Staff Witness Mr. Lobb, on Pages 6-9, suggests that because the
15 Commission approved the thirteen-month average rate base methods
16 filed by Idaho Power and Avista, that consistency requires this policy
17 be extended to United Water.

18 Q. Did the Commission orders in those cases mandate use of an average
19 test year for all utilities?

20 A. Not as I understand them. Order Numbers 29505 (IPCo) and 29602
21 (AVU) advised utilities that when proposing post-test year additions to
22 rate base a corresponding revenue and expense adjustment should be
23 made. United Water has attempted to comply with that directive in

1 this case. Neither order, however, advised utilities that an average test
2 year must be presented.

3 Q. Have Order Numbers 29505 and 29602 created some level of
4 uncertainty among companies regulated by the Idaho Commission.

5 A. I believe so. Neither Order identified the calculations used to produce
6 the proxy adjustment and the IPCo Order indicated that the proxy was
7 not intended as precedent for use in future cases.

8 Q. Are the Idaho Power and Avista cases distinguishable in other ways?

9 A. Yes. In each case the utility, as part of its initial Application, proposed
10 use of an average test year, which was, with some modifications,
11 accepted without dispute in each case. In both cases the question of
12 average versus year-end test year was not a debated issue. Neither
13 case reflects a conscious policy decision to require an average test year
14 in all cases for all utilities.

15 Q. Are there examples of instances in which the Commission has
16 simultaneously used an average rate base for some companies and a
17 year-end rate base for others, depending on the circumstances of each
18 company?

19 A. Yes. In Case BOI-W-93-3, filed in December of 1993 and decided in
20 August of 1994, the Commission employed a year-end test year for
21 Boise Water. At about the same time the Commission in Case No.
22 IPC-94-5 (filed in June of 1994, decided in February of 1995)
23 employed an average rate base for Idaho Power Company.

1 Q. Do you agree that requiring United Water to use a thirteen-month
2 average rate base in setting rates would place the Company in a
3 position consistent with Idaho Power and Avista?

4 A. No. First let me acknowledge that in some if not many circumstances
5 normalizing and annualizing accounting adjustments can be made that
6 make the thirteen-month average rate base and year-end rate base
7 nearly financially equivalent. But such is not the case for United
8 Water.

9 Q. Why?

10 A. The key determinants of whether use of a thirteen-month average rate
11 base and a year-end rate base will produce rates that generate revenues
12 sufficient to keep the utility financially whole for the first year or so
13 after those rates go in effect are 1) capital intensity and 2) growth in
14 rate base per customer.

15 That is, once rates are set in these proceedings, for
16 example, if each new customer added to the system requires greater
17 (less) than the average investment per customer then rates charged
18 each new customer will cause a return shortfall (excess) on average
19 investment. In the 1990s, many electric utilities, including Idaho
20 Power, were able to freeze and even reduce existing rates despite
21 significant annual rates of customer and rate base growth, with no
22 adverse financial consequences. In fact, some utilities were able to
23 earn returns in excess of allowed returns and agreed to share these

1 excess returns with ratepayers. The reason that this was possible was
2 because new customers were able to be served with incremental
3 investment or rate base of less than system average rate base per
4 customer. At fixed rates therefore, these new customers cost less than
5 system average rate base cost to serve and provide higher than average
6 revenue margins than set in the prior rate case.³

7 In such cases where the rate base additions to serve a
8 growing customer base is below or equal to average cost, the
9 application of either a thirteen month average or year-end rate base
10 should be nearly financially equivalent. But for capital intensive
11 utilities that incur above average rate base costs to serve new
12 customers, the thirteen-month average rate base is far less likely to
13 produce rates that generate revenues necessary to produce the allowed
14 returns. This is true simply because a thirteen-month rate base is not
15 as current or “forward-looking” as the year-end rate base adjusted for
16 rate base additions.

17 Q. Under what such capital intensive and growth category does United
18 Water service fall?

19 A. The Company definitely qualifies as a capital intensive utility that
20 must make higher than average cost incremental rate base additions to
21 meet its growing load.

³The technical term is that the marginal cost to service new customers is less than the average cost to serve, and existing rates are matched to average, not marginal costs.

1 Q. Do you have evidence that recent customer and usage growth
2 experienced by the Company has been met with higher than average
3 rate base costs per customer?

4 A. Yes. This is shown in the following table. This table simply
5 calculates the percentage changes in rate base costs per customer (in
6 two different ways). As shown, rate base cost per customer has grown
7 recently by over 20%, while customer or usage growth has been
8 approximately 2% or less.

9 Q. Do the high rates of growth in rate base cost per customer reflect the
10 large cost increment resulting from the Columbia plant addition?

11 A. Yes, and Staff has, in my opinion acted responsibly in incorporating
12 the Columbia plant in rate base for the entire test year. But my point
13 here is that the recent large rate base additions, and those planned in
14 the coming years will be at incremental costs higher than rates in
15 place. Under these circumstances, a forward looking end of period
16 rate base calculation will do much more to reduce (but will not
17 eliminate) the Company's earnings attrition than will a thirteen-month
18 average rate base calculation.

19 Q. Are there other factual circumstances that United Water faces that
20 compound this earnings attrition and revenue shortfall?

21 A. Yes. Not only is the Company experiencing incremental investment
22 that is higher than average, it also is adding customers whose revenues
23 or bills are below system average. I understand that this decrease in

1 revenue per new or growth customer is due largely to a high
 2 percentage of such customers taking service in areas where alternative
 3 sources of irrigation water are available and thus only use United
 4 Water service for domestic purposes. This phenomenon only
 5 accentuates revenue shortfall between rate cases.

United Water Idaho
 Change in Rate Base per Billing Unit

Item	Test Year Ending July 31,2004 Adjusted	Pro Forma Year Ending May 31, 20005	Percent Change
Rate Base(1)	\$113,575,180	\$140,148,149	23.40%
Commodity Use (CCF) (2)	20,407,679	20,671,823	1.29%
Rate Base per CCF	\$5.57	\$6.78	21.72%
Bills Rendered (3)	440,686	450,336	2.19%
Rate Base Per Bill Rendered	\$257.72	\$311.21	20.76%

Source:

- (1) Exhibit No. 1, Page 1 of 9. (revised)
- (2) Exhibit 6, Schedule 3, Pages 7, 13 and 22.
- (3) Exhibit 6, Schedule 3, Pages 9 and 22.

6

7 Q. What conclusions do you draw from this?

8 A. I conclude that Commission consistency does not and should not
 9 require the same rate base evaluation methods between the electric and
 10 water utilities that it regulates.

11 In fact, I conclude that consistency, defined as equal
 12 opportunities to earn the allowed rates of return granted, actually
 13 requires maintaining the long-time end of period method used for

1 United Water. I am not at all persuaded by Staff's proposal to make
2 all utilities fit into a thirteen-month average rate base valuation.

3 Q. Has the Commission in the past relied on analysis similar to yours, as
4 discussed above?

5 A. Yes, in 1993, when the Commission abandoned use of an average test
6 year in Order No. 25640 the Commission said:

7 According to Staff, Boise Water's rate base would be \$1,163,281
8 lower if calculated based on a 13-month average as opposed to
9 year end. While it might be advantageous to ratepayers to have a
10 lower rate base, no party challenges Boise Water's proposal to
11 utilize a year end rate base. Boise Water's customer base and its
12 investment in plant are both growing rapidly. A year-end
13 calculation of rate base for a utility experiencing rapid growth is, in
14 this case, a more accurate reflection of that utility's investment in
15 plant. In light of the foregoing and the absence of objection, we
16 find that a year-end calculation of rate base for Boise Water is fair,
17 just and reasonable.
18

19 Q. Will the use of Staff's thirteen-month average rate base cause United
20 Water to suffer rates of return attrition from the very first year rates are
21 in effect?

22 A. Yes.⁴ This earnings attrition or rate of return shortfall is shown in my
23 rebuttal Exhibit 17.

24 Q. What does Exhibit 17 show?
25

⁴This conclusion is reached even assuming that Staff corrects its revenue mismatch by deducting \$752,289 from its normalized revenue estimate.

1 A. Exhibit 17 compares the actual or realized rates of return under Staff's
2 proposed thirteen month average rate base to the fair or allowed rate of
3 return that it proposes. The right-most column of the exhibit
4 summarizes the total rate of return on equity and overall rate of return
5 that result from Staff's changing from the present year-end method to
6 the thirteen-month average rate base method. Staff's proposal ensures
7 an overall rate of return shortfall of 88 basis points, the difference
8 between the proposed 8.10% overall rate of return and the 7.22% rate
9 of return that results solely from not including the ending rate base
10 investment.

11 Thus, according to this exhibit, Staff's proposal, and the
12 high marginal cost of serving new customers virtually assures that
13 United Water will suffer earnings deficiencies from the time that new
14 rates go into effect.

15 Q. In your opinion would such an earnings shortfall constitute a denial of
16 shareholders of an opportunity to earn a fair rate of return
17 commensurate with investments with commensurate risks?

18 A. Yes. In my efforts over the years to estimate fair rates of return for
19 utilities, I have relied upon the financial interpretations of certain key
20 court decisions in evaluating the reasonableness of rate making
21 adjustments. Three key decisions are the Bluefield [*Bluefield Water*
22 *Works v. Public Serv. Comm'n*, 2672 U.S. (1922)], Hope [*Federal Power*
23 *Commission v. Hope Natural Gas*, 320 U.S. 591 (1944)] and more recent

1 Duquesne [*Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989)]cases,
2 My interpretation has always been that irrespective of the method or
3 actual estimate for the fair rate of return, a check of reasonableness is
4 always that the sum of the rate case decisions allow for, or even ensure
5 the opportunity for the utility to earn the fair rate of return determined
6 in the case.

7 Q. In your opinion does Staff's proposed thirteen-month average rate base
8 method allow United Water the opportunity to earn its allowed return?

9 A. No, as I have explained, Exhibit 17 shows that Staff's thirteen-month
10 average rate base causes actual returns to be below the fair or allowed
11 return. This in my opinion results in a denial of fair earnings and a
12 confiscation of shareholder property

13 Q. Turning now to the Staff recommendation to allow in rate base 1/13 of
14 post test year investment, what is the practical effect of this proposal?

15 A. It means, obviously, that the Company is denied a return on up to 92%
16 of post test year investment in plant that is devoted to public service
17 during the rate period.

18 Q. To the extent the proposal is aimed at solving a perceived problem of
19 mis-matched revenue and expense, does it make sense?

20 A. It does not. It cannot conceivably be true that the revenue producing
21 or expense reducing effects of new investment are of such a magnitude
22 that 92% of the investment should be disallowed.

1 Q. Is the end result of the Staff proposal out of proportion with the end
2 result of adjustments recently made by the Commission in other cases
3 to take into account revenue producing, expense reducing effects?

4 A. Yes it is. In the recently concluded Avista rate case, the Commission,
5 with some reluctance, employed a variant of a proxy approach
6 developed in the preceding Idaho Power Company rate case. (*See*
7 Order No. 29602, pgs 16—17). This resulted in approximately 12% of
8 post test year investment being excluded. Without debating the merits
9 of the adjustment methodology in *Avista* it is obvious that Staff's
10 proposal in this case produces an end result totally disproportionate to
11 the end result believed to be reasonable by the Commission in *Avista*.

12 Rate Design and Cost of Service Issues

13 Q. Are there numerous differences in the cost of service and rate design
14 issues proposed by you and by Staff witness Sterling?

15 A. No. In fact, there is really only one significant difference between the
16 rate design proposal I offer on behalf of United Water Idaho and that
17 proposed by Mr. Sterling. That difference is in the level at which to
18 set the bimonthly customer charge. I propose a bimonthly customer
19 charge of \$19.86 while Mr. Sterling proposes to keep in place the
20 present bimonthly customer charge of \$14.57. I argue this issue
21 below.

1 Q. Is there a significant difference in your cost of service analysis on
2 seasonal commodity cost differences and the seasonal rate design
3 proposed by you and Mr. Sterling?

4 A. No, in fact there is no difference that I can determine. In my direct
5 testimony, I explained that for the first time we were able in this case
6 to incorporate an actual seasonal cost of service study to set
7 parameters for seasonal rate differences. That is, the seasonal rate
8 design I propose and Mr. Sterling endorses is based on seasonal cost
9 differences. In this regard Mr. Sterling indicates:

10 Q. Do you believe that the 25 percent summer/winter rate
11 differential should be maintained?

12 A. Yes, I do. By having a commodity rate that is 25 percent
13 higher in the summer than in the winter, customer are sent a strong
14 conservation signal that helps to lessen United Water's peak
15 summertime demands. Furthermore, I agree with United Water
16 witness Peseau's conclusion from his cost of service study that
17 there is a substantial difference in commodity costs of service
18 between the winter and summer.

19 Q. Do you believe that the summer/winter commodity rate
20 differential should be increased to more than 25 percent?

21 A. No, I do not

22 (Sterling, Direct, Page 58, Lines 12-25)

23
24 I point out the agreement between Staff and Company on the seasonal
25 rate design issue because both Mr. Sterling and Idaho Rivers United
26 (IRU) witness Mr. Wojcik go on to discuss possible inverted rate
27 alternatives to the present seasonal rate design structure. And, while I
28 strongly believe that, given the initial consumption block design
29 agreed to between Company and Community Action Partnership
30 Association of Idaho (CAPAI), and the discussion in rebuttal by Mr.

1 Wyatt agreeing to Staff's proposal to move toward monthly billing,
2 additional rate inversion should be avoided. Additionally, I do not see
3 the need at this time to follow Mr. Sterling's proposal to begin a
4 separate docket to review other rate designs until such time as the
5 present one is evaluated. Any consideration of new, alternative rate
6 design proposals, perhaps including inverted rates, could be postponed
7 to a the next general rate case, provided parties express their interests
8 and undertake discovery early in the process. Inverted rates should not
9 be attempted in the present proceedings.

10 Level of Customer Charges

11 Q. In light of the potential move to a monthly billing cycle, what is your
12 recommendation with regard to the appropriate level of customer
13 charges?

14 A. I disagree with Mr. Sterling's suggestion that there is any economic
15 justification for limiting or restraining customer costs to the narrow
16 definition of "direct costs" of meter reading and billing. The only
17 other cost categories included in my customer cost of service study are
18 the direct costs of meters and services. I cannot think of any cost more
19 directly related to individual customers than those of their own meter
20 and service line. These two items can serve the individual and only
21 the individual customer and are the most direct cost imaginable.

22 Placing these direct and individual customer costs on the
23 commodity rate in the name of conservation only ensures that these

1 fixed costs will not be recovered by the Company between rate cases,
2 and will be made to be subsidized by customers whose consumption
3 cannot be shifted (have “inelastic” demand) after subsequent rate cases
4 attempt to distribute these revenue shortfalls.

5 Q. What is the problem you see in keeping customer charges far below
6 actual costs of service?

7 A. While I do not favor moving customer charges to full cost of service at
8 this time, I nevertheless recommend that they be raised to some degree
9 in every rate case. Absent this, United Water Idaho and the
10 Commission will be facing significant revenue shortfall and rate equity
11 problems.

12 Q. Please explain the revenue shortfall problem.

13 A. Both the Staff and IRU discuss keeping customer charges below costs
14 in order to facilitate conservation. I am absolutely in support of
15 facilitating any and all conservation that results from rate design based
16 on costs. This is precisely how so-called “economic efficiency” and
17 responsible consumption are promoted.

18 The problem is that collecting the capital costs of physical,
19 fixed customer meters and service lines outside a customer charge by
20 spreading it as if they were volumetric or commodity costs cannot be
21 argued to promote economic levels of conservation. This is best done
22 within the seasonalization of the commodity costs that is contained in
23 my cost of service study.

1 involve higher administrative costs for the Company, the Commission
2 and others, but are likely to result in more inequitable rates among
3 customers, over time.

4 Q. Why does significant under-recovery of customer charges cause
5 inequities among rates of customers?

6 A. The costs of meters and service lines benefit none other than the
7 specific customer for whom the meter and service is installed. Staff's
8 limiting of customer charges reflective only of meter reading, billing
9 and customer accounting results in 65% of customer-specific costs
10 being shifted to the usage-sensitive commodity rate. Consequently,
11 those in a position to invest in devices to reduce water consumption
12 avoid paying their reasonable share of their own meters and service
13 lines.

14 Q. Isn't this type of pricing good for conservation?

15 A. No. As valuable and socially responsible that the conserving of our
16 water is, equitable pricing requires that conservation be induced
17 primarily through rates that reflect costs, in this case commodity costs.
18 My seasonal commodity rate differentiation accomplishes this.
19 Further and additional adding on of fixed customer costs to commodity
20 rates is merely punitive to some degree.

21 Q. Does the raising of monthly or bimonthly customer charges closer to
22 actual costs "blunt price signals"?

1 A. No. All the economic benefits attained through pricing are based on
2 the theory that rates bring about optimal levels of consumption of a
3 commodity, water or otherwise, by pricing according to costs. The
4 seasonal rates I propose are based primarily on seasonal commodity
5 cost differences and are adequate for inducing conservation.

6 Q. Do the seasonal commodity rates proposed by you in Exhibit 14
7 already contain a considerable amount of customer costs not collected
8 by the \$19.86 proposed bimonthly customer charge?

9 A. Yes. In my direct testimony and my Exhibit No. 14, Schedule 1, Page
10 1 of 2, the implied full cost of service charge would be approximately
11 \$22.00, which I do not propose.

12 Q. Would the enactment of monthly rather than bimonthly billing of
13 customers provide an opportunity to raise the current customer charge?

14 A. I believe that it would. Obviously, the commodity portion of a
15 monthly bill will be approximately one-half of the bimonthly amount.
16 While the annual amount billed should be same, movement to monthly
17 billing should make the customer charge more acceptable. The
18 monthly customer charge under my rate design would be
19 approximately \$9.93.

20 Q. Please summarize your position on the appropriate level of customer
21 charge to set in these proceedings.

22 A. An increase in the existing customer charge is necessary to maintain
23 some level of revenue stability for the capital intensive nature of the

1 Company's water service. A monthly customer charge of \$9.93, while
2 significantly below the monthly fixed costs of serving customer, is a
3 move in the right direction.

4 Furthermore, this level of customer charge would lessen the
5 inequities of cross subsidies in rates for customers who do not pay a
6 fair portion of their specific meter and service line costs.

7 Alternative Inverted Rates

8 Q. What is the purpose of your discussing the issue here of an inverted
9 block rate design?

10 A. As I referred to in the introduction, while Staff Witness Sterling agrees
11 with the level and seasonal design of my proposed rates, he does go on
12 to indicate that, while not recommending an inverted block rate design
13 in this case, he offers discussion on same in the event that the
14 Commission should wish to consider it (Direct, Page 62, Lines 2-11).

15 Q. Do you believe that an inverted rate design for United Water is
16 preferable to your proposed seasonal rate design?

17 A. No. Before I could endorse an inverted block rate design for United
18 Water I would need to have the benefit of considerable consumption,
19 elasticity, billing and other information upon which to base inverted
20 block rates. This information is not available at this time.

21 Secondly, implementing multi-block inverted rates may
22 add considerable confusion for customers. I agree with Mr. Sterling's
23 assessment (Direct, Page 58, Lines 2-10) that:

1 Any time a new rate design is implemented,
2 however, there is a period – sometimes a very lengthy one
3 – during which customers must learn and become aware of
4 the new rate design. Moreover, even more time is required
5 for customers to adjust their usage patterns before the
6 objectives of a new rate design can be achieved. I believe
7 the decision of whether to implement a new rate design
8 should be based on an evaluation of whether the advantages
9 of a new rate design outweigh the tradeoffs.

10
11 Q. With study, can new rate designs be adequately evaluated at some
12 point?

13 A. Yes, although the process can be involved. Given the lack of specific
14 proposals that could be evaluated in these proceeding, and the cost of
15 administering proceedings on inverted blocks, I recommend that any
16 such interest be expressed early in the next general rate case.

17 Q. Do you have comments on the testimony of Mr. Wojcik who testifies
18 on behalf of Idaho Rivers United?

19 A. Only briefly. Mr. Wojcik proposes significant rate design changes,
20 including multiple block inverted rates. However, the justification for
21 most of the proposals contains no Company or Idaho-specific data.
22 For the reasons cited by Mr. Sterling and me, these general rate design
23 suggestions referred to by Mr. Wojcik should be studied thoroughly
24 for applicability to the Company and its customers before being given
25 any serious consideration.

1 Q. Do you agree with Mr. Wojcik's suggestion that the initial summer
2 block be increased by approximately three times the proposed 3CCF
3 bimonthly quantity? (Wojcik, pg. 7, lines 16-17)?

4 A. No. This proposal is intended to discount usage of water equal to the
5 average indoor consumption per customer. In my opinion this is an
6 excessive discount and has no cost or rate design benefit over the
7 smaller proposed 3 CCF discount. A more prudent policy would be to
8 begin with the smaller initial block, study customer responses and
9 assess the acceptability at a later date.

10 Q. Does the larger initial block proposed by Mr. Wojcik blunt an
11 appropriate summer price signal?

12 A. Yes. This larger initial summer block in effect shields the customer
13 from facing the consequences of the higher cost summer consumption.
14 After all, all consumption in the summer contributes to summer peak
15 and the need for additional supply at higher marginal costs, regardless
16 of whether the consumption is for inside or outside uses.

17 Q. Has Company Witness Mr. Wyatt agreed to a higher than 3 CCF initial
18 minimum block in his rebuttal testimony?

19 A. Yes. It is my understanding that in agreeing to transition to a monthly
20 billing cycle, Mr. Wyatt accepts as a monthly minimum block a 2CCF
21 quantity. This has the effect of increasing the original bimonthly block
22 by 33%, from 3 CCF to 4 CCF.

1

A. Yes.

**FIRST YEAR EARNINGS SHORTFALL FROM STAFF'S
RATE BASE CALCULATIONS**

	[1] Staff At Proposed Rates [a]	[2] Adjust PIS to 7/31/04 Actual Amount	[1]+[2]=[3] Staff At Proposed Rates-Adjusted	[4] Adjust PIS to 12/31/04 Actual Amount	[3]+[4]=[5] Staff At Proposed Rates-Adjusted
Operating Revenues	32,111,297		32,111,297		32,111,297
O&M Expenses	11,438,385		11,438,385		11,438,385
Depreciation Expense	5,854,518		5,854,518		5,854,518
Taxes Other Than Income	1,906,789		1,906,789		1,906,789
Income Taxes	2,825,164		2,825,164		2,825,164
Net Operating Income	10,086,441		10,086,441		10,086,441
Rate Base	124,524,407	6,345,676 [b]	130,870,083	8,791,833 [c]	139,661,916
Rate of Return - Overall	8.10%		7.71%		7.22%
Rate of Return on Equity	10.01%		9.16%		8.12%

[a] Rate Base amount is 13 month average
[b] Difference between recorded amount and Staff 13 mo. Avg.
Source is Staff Exhibit 112, P. Harms
[c] Difference between amount recorded at 5/31/05 and effect
of 13 month average recommended by Staff
Source is Healey analysis attached