

**REBUTTAL TESTIMONY OF  
HAROLD J. SMITH, VICE PRESIDENT  
RAFTELIS FINANCIAL CONSULTANTS, INC.**

**for**

**PROVIDENCE WATER SUPPLY BOARD  
DOCKET # 3832**

**August 2007**

**INTRODUCTION**

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**Q. Please state your name and business address.**

A. My name is Harold J. Smith and my business address is, 511 East Boulevard, Charlotte, North Carolina, 28203.

**Q. Are you the same Harold Smith who submitted pre-filed direct testimony in these proceedings?**

A. Yes I am.

**Q. Please describe the purpose of your testimony.**

A. I will respond to some of the issues and conclusions contained in the pre-filed direct testimony of Division and the Kent County Water Authority, et al (the "KCWA").

**Q. Have you had an opportunity to review the pre-filed testimony submitted by the Division and the Kent County Water Authority, et al?**

A. Yes. I have reviewed the testimony submitted by Mr. Mierzwa and Mr. Catlin on behalf of the Division and the testimony submitted by Mr. Woodcock on behalf of the KCWA.

**Q. What issues will you address in this rebuttal testimony?**

A. I would like to address the following issues raised by the Division and/or the KCWA:

- Allocation of fire protection demand
- Peaking Factors
- Wholesale Fixed Charge
- Cost Allocations

1 **FIRE PROTECTION DEMAND**

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3 **Q. Why did you decide to explore alternate methods of cost recovery for fire protection**  
4 **costs from what was used by the Board in previous rate filings?**

5 A. In the Board's last rate filing, Docket # 3163, the Commission did not allow the Board to  
6 raise private fire connection rates. In subsequent abbreviated filings the Commission has  
7 continued the policy of not allowing the Board to increase the private fire connection charges.  
8 Because of that, we felt it was appropriate to explore an alternative allocation of costs that would  
9 recover the fire protection costs in an equitable manner while addressing the Commission's  
10 previous concerns over increasing private fire connection costs.

11  
12 **Q. Does the testimony filed by the Division and the KCWA prove that the reallocation of**  
13 **fire protection demand proposed by Board is unreasonable?**

14 A. I do not believe it does. The testimony provided by the Division and the KCWA provide  
15 reasons why the proposed allocation is not perfectly equitable, but it does not prove that the  
16 allocation is unreasonable. By the same token, as discussed in my pre-filed testimony, the  
17 previous methodology used was not perfectly equitable either, in particular because no public  
18 fire protection costs are recovered from the thousands of tax-exempt properties within the  
19 Board's service area. Situations often arise in the recovery of costs where there is no perfectly  
20 equitable way to recover the exact cost of providing service to each customer, as is the case with  
21 fire protection.

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23 **PEAKING FACTORS**

24

25 **Q. Mr. Woodcock indicates that he does not believe the peaking factors you used are**  
26 **reasonable, do you agree with this assessment?**

27 A. I do not agree with this assessment. I would agree that the methodology used for developing  
28 the peaking factors is not ideal, but given the constraints of the data available, I believe the  
29 estimates used provide for a reasonable allocation of costs among the retail customer classes.  
30 Mr. Woodcock has expressed concern over the peaking factor assigned to the wholesale  
31 customers and how it may be used in the future, and indicates it does not recognize that some

1 wholesale customers have storage while others do not. Because the wholesale customers do not  
2 currently share in maximum day and maximum hour costs, they are allocated costs based only on  
3 their relative share of average day capacity. They are in effect allocated a share of maximum day  
4 and maximum hour costs based on the average of the system, which is why the peaking factors  
5 shown for the wholesale customers are approximately those of the system as a whole. Also, if at  
6 any point in the future the use of storage by some wholesale customers was to be recognized, the  
7 existing methodology would have to be significantly changed since all of the wholesale  
8 customers are currently treated as a single class and to recognize such differences they would  
9 need to be allocated costs individually. We would agree that the current methodology and  
10 assumptions do not recognize such differences, and the assumptions used currently would not be  
11 appropriate for use if the methodology was updated in the future to recognize such differences.

### 12 13 **WHOLESALE FIXED CHARGE**

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15 **Q. Mr. Woodcock stated in his testimony that the proposed fixed charge for the wholesale**  
16 **customers will “only result in over and under charges,” do you agree with this statement?**

17 A. I would agree that every single proposed rate in our proposal, as well as the rates set by any  
18 utility, will ultimately result in over and under charges. They are only estimates based on  
19 projected expenses and usage, which will ultimately not exactly match the actual expenses and  
20 usage, and therefore result in every proposed rate not being exactly correct. Rate setting is not  
21 an exact allocation of actual costs, it is a reasonable allocation of expected costs.

22  
23 **Q. Mr. Woodcock points out that if wholesale customers demand more water than the**  
24 **projections used in the rate model, the Board will receive less revenue under the proposed**  
25 **structure than they would under the existing structure in which all charges are based on**  
26 **actual consumption. Is the Board comfortable with this scenario?**

27 A. Yes, the Board believes that the benefits of stabilizing wholesale revenues outweigh the  
28 possibility of slightly reduced revenues, especially since, as Mr. Woodcock points out, wholesale  
29 consumption has historically been very close to the historical average that is used as the estimate  
30 of rate year wholesale consumption.

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2 **Q. Mr. Woodcock argues against a fixed charge for wholesale customers by stating in his**  
3 **testimony that “it seems incongruous to suggest higher fixed charges to wholesale**  
4 **customers to increase revenue stability and lower fixed fire protection charges for retail**  
5 **customers,” do you agree with this arguement?**

6 A. No, I do not. While the proposed shift in some demand related fire protection charges may  
7 result in decreased revenue stability, Mr. Woodcock’s argument fails to recognize that total fire  
8 protection revenues make up approximately 6% of the Board’s revenues while total wholesale  
9 revenues make up approximately 25% of the Board’s revenues. As such, the two are not directly  
10 comparable as suggested. While not every element of our proposal works to increase revenue  
11 stability; our proposed rates result in a net increase in revenue stability for the Board. Overall a  
12 larger portion of the Board’s revenue will be derived from fixed charges than under the previous  
13 rate structure, accomplishing the goal of increased revenue stability.

14

15 **Q. Why do you believe the proposed fixed charge is a more reasonable way to recover the**  
16 **wholesale customers share of costs?**

17 A. By fixing a portion of the wholesale customers’ charges based on their projected usage, the  
18 amount that is charged the wholesale customers will have less variance than if we did not fix a  
19 portion of their charges. Given that a large portion of the Board’s costs are fixed regardless of  
20 how much water the wholesale customers use, I believe it is reasonable that we stabilize the  
21 revenue from these customers to some extent. This fixed charge represents a commitment by the  
22 wholesale customers to share in the Board’s fixed charges based on their projected usage  
23 regardless of their actual usage.

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## 25 **COST ALLOCATION**

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27 **Q. Do you suggest any changes to the cost allocations from the proposed rates included**  
28 **with your direct testimony?**

29 A. Based on discussions since I filed my direct testimony, I suggest the following changes to  
30 the cost allocations:

- 1
- 2 • Included unaccounted for water in Allocation Factor A
- 3 • Updated Allocation Factor F with more recent data
- 4 • Updated Allocation Factors HM, HMC, and HOC with more recent data
- 5 • Revised allocation of benefits and pension costs for supply, treatment, and pumping to be
- 6 consistent with the labor costs in those categories
- 7

## 8 **UNACCOUNTED FOR WATER**

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10 **Q. Do you agree that unaccounted for water should be included in the cost allocation**  
11 **methodology, as suggested by Mr. Woodcock and Mr. Mierzwa?**

12 A. Yes, I agree that unaccounted for water should be included in the cost allocations and have  
13 added this to the calculations. This change directly affects Allocation Factor A and has an  
14 indirect affect on several other allocation factors.

## 15

## 16 **INCH-MILES OF PIPE**

17

18 **Q. Do you propose that Allocation Factor F be updated?**

19 A. Yes, I propose that it be updated using data as of June 30, 2007 as provided by the Board  
20 previously in response to Division 2-13.

## 21

## 22 **ALLOCATION FACTORS HM, HMC, and HOC**

23

24 **Q. Do you propose to update Allocation Factors HM, HMC, and HOC?**

25 A. Yes, I propose that it be updated based on an average of data from 2004, 2005, and 2006. In  
26 the previous filing a single year's worth of data was used, but I propose that several years of  
27 historical data be used to even out variations in expenses from year to year.

1 **BENEFIT AND PENSION ALLOCATIONS**

2

3 **Q. Because the methodology previously agreed upon to allocate benefit and pension**  
4 **expenses results in what could be considered inequitable distribution of costs, what would**  
5 **you suggest be used to allocate these costs?**

6 A. I agree with Mr. Woodcock that it would be appropriate to allocate these costs in the same  
7 manner as labor for each of the cost categories. To address the Commission's previous concerns  
8 over allocation of costs to Meters & Services and Billing & Collection, I also agree with Mr.  
9 Woodcock's suggestion to reallocate those costs to Base for Customer Accounts, Transmission  
10 & Distribution, and Administration.