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Missouri American Water Company

WR-2008-0311

Rebuttal Testimony of

Donald E. Johnstone

Before the
Missouri Public Service Commission

On behalf of

CITY OF RIVERSIDE
AND
MISSOURI GAMING COMPANY

September 30, 2008



Missouri American Water Company

WR-2008-0311

Rebuttal Testimony of Donald E. Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A Donald E. Johnstone. My address is 384 Blackhawk Drive, Lake Ozark, MO 65049.

Q ON WHOSE BEHALF ARE YOU APPEARING FOR THE PURPOSES OF THIS REBUTTAL TESTIMONY?

A I am appearing for the purposes of this testimony on behalf of the City of Riverside and Missouri Gaming Company, with separate testimony filed on behalf of intervenor AGP. The City of Riverside receives service directly and its residents also receive service from Missouri-American Water Company (MAWC). The Missouri Gaming Company also receives service from MAWC. The City and the Missouri Gaming Company both receive service in the Parkville District.

Q PLEASE SUMMARIZE YOUR TESTIMONY.

A My testimony may be summarized as follows:

- Staff offers no explanation in its direct testimony and has no studies to support a major change in a rate design that is proposed for the Parkville District.
- Staff makes no claim that its proposed rate design changes better reflect the cost of service within the customer classes.

- The Staff class cost-of-service study, like those of MAWC and OPC, relies on assumed class usage characteristics which have not been shown to be representative or appropriate for the Parkville District.
- The MAWC and Staff proposed changes to the design of the rates for the Parkville District should be rejected. Also there should be no shifts among the customer classes. Instead, each rate element should be adjusted on an equal percentage basis to reflect the district specific revenue requirement.

Response to Staff Testimony

Q WHAT RATE DESIGN IS PROPOSED BY THE STAFF OF THE COMMISSION?

A In the Parkville District the Staff proposes to increase the meter charge for a 5/8" meter by 11.8%. For other meter sizes the Staff proposes decreases ranging from 18.6% to 50.2%. The meter charge amounts to a customer charge that varies according to the size of the meter used to provide service to the customers. Staff goes on to recommend a single commodity rate for each customer class to replace the current declining block structure.

Q IS THE STAFF PROPOSED RATE DESIGN A MAJOR DEPARTURE FROM THE PRESENT RATE DESIGN?

A Yes, it is. The reductions in the meter charges translate into reductions in revenues that are collected on a fixed-charge basis, notwithstanding the fact that the vast majority of the costs of the water system are in fact fixed in nature. The effect is to move the rate design away from one which reasonably reflects cost.

Under the rate design proposed by Staff fewer fixed costs of the system are collected on a capacity basis and more fixed costs are subject to collection through a volumetric charge. There are two reasons why this proposal moves rates away from

1 costs. First, the fixed costs, by definition, do not vary based on changes in usage.
2 Thus, the proposal to collect more fixed costs via a usage charge, as though they were
3 variable, is a move away from cost-based rates. Second, the current meter charges do
4 not collect all fixed costs, which are higher on a per unit basis for smaller customers.
5 They are higher for small customers because small usages do not result in the
6 economies of scale in delivery that occur with larger usages. Another consideration
7 can be the fact that larger customers tend to have higher load factors which results in
8 a lower rate when designed as a usage charge.

9 As an alternative to the Staff proposal, the present declining block structure
10 for usage charges better reflects cost and is therefore appropriate and more equitable
11 than the single rate for all usage (by customer class) that is proposed by Staff.

12 Q HAS STAFF PROVIDED ANY STUDIES THAT WOULD PROVIDE A CONCEPTUAL BASIS
13 FOR SUCH A MAJOR CHANGE TO THE RATE DESIGN?

14 A No. Staff has merely prepared class cost-of-service studies for each of the MAWC
15 districts, including the Parkville District. After deriving understated meter charges,
16 Staff computes a single volumetric charge for each customer class. With the
17 exception of the increase in the charge for a 5/8" meter the result is reduced meter
18 charges and a single volumetric charge for each class to replace the four step
19 declining block structure. The consistency in the usage charges among the classes is
20 eliminated. In every case the bill will depend on the customer class into which the
21 customer is classified, even if the usage is identical for two customers in different
22 classes.

1 In response to data requests for the studies relied upon Staff answered as
2 follows:

3 59. Please identify and provide a copy of all studies by Mr. Russo which explain the
4 reasoning for a single volumetric charge for all customers in a class for a water utility.

5 A. No studies were performed.

6 60. Please identify and provide a copy of all studies relied upon by Mr. Russo which
7 explains the reasoning for a single volumetric charge for all customers in a class for a
8 water utility.

9 A. No studies were relied upon.

10 61. Please identify and provide a copy of all studies by Mr. Russo which shows that
11 an existing declined block volumetric charge for a water utility is not consistent with
12 cost of service principles.

13 A. No studies were performed.

14 62. Please identify and provide a copy of all studies relied upon by Mr. Russo which
15 show that an existing declined block volumetric charge for a water utility is not
16 consistent with cost of service principles.

17 A. No studies were relied upon.

18 63. Is it the contention of Mr. Russo that the existing declining block rate structure for
19 each of the customer classes is inconsistent with the cost of service? If so, please
20 explain fully.

21 A. No.

22 64. Is it the contention of Mr. Russo that the existing declining block rate structure for
23 each of the customer classes is unreasonable? If so, please explain fully.

24 A. No.

25 Q DOES STAFF ASSERT THAT THE RATES CONTAINED IN THE TESTIMONY OF MR. RUSSO
26 BETTER REFLECT THE COST OF SERVICE FOR CUSTOMERS ACROSS CLASSES AND WITHIN
27 EACH CLASS?

28 A Mr. Russo states that within a customer class, a small customer will pay relatively less
29 under his rate design as compared to the present rate design. While that statement is
30 true as far as it goes, it does not follow that it is an appropriate change in rates.
31 Instead, the Staff rate design in many respects moves rates away from cost.

Response to OPC Testimony

Q HAVE YOU REVIEWED THE DIRECT TESTIMONY SUBMITTED BY MS. MEISENHEIMER ON BEHALF OF THE OFFICE OF PUBLIC COUNSEL (OPC)?

A Yes. Ms. Meisenheimer submitted what she characterizes as a “preliminary” class cost-of-service study but did not recommend changes to the relative class revenues and did not recommend changes in the design of the rates for each customer class.

Q DOES THE STUDY MS. MEISENHEIMER PERFORMED RELY ON USAGE CHARACTERISTICS FOR THE PARKVILLE DISTRICT THAT HAVE BEEN SHOWN TO BE APPROPRIATE FOR THE DISTRICT?

A No, she does not. There are no usage characteristics available for the state of Missouri as a whole or for the Parkville District.

Q DO YOU DISAGREE WITH ANY OF THE RECOMMENDATIONS OF MS. MEISENHEIMER?

A I have no disagreement with the “no change” recommendation for the Parkville District. Since her study is characterized as preliminary, I may have further comment if there are changes in the study or the recommendations.

Customer Class Definitions and Usage Characteristics

Q HOW DO STAFF AND OPC DEFINE CUSTOMER CLASSES FOR THE PURPOSES OF THE CLASS COST-OF-SERVICE STUDIES AND RATE DESIGN?

A Both rely on the customer classifications used by MAWC.

Q HOW DOES MAWC DEFINE RESIDENTIAL CUSTOMERS, COMMERCIAL CUSTOMERS, AND INDUSTRIAL CUSTOMERS?

A There are no definitions.

1 Q WHY IS IT IMPORTANT TO UNDERSTAND THE DEFINITIONS OF THE CUSTOMER
2 CLASSES?

3 A In order for a rate design to properly reflect the cost for any customer class the usage
4 characteristics of the customers within the class must be homogeneous. Thus, it is
5 necessary to have class definitions that are consistent and that foster the grouping of
6 customers with homogeneous usage characteristics.

7 Q IS THERE ANY QUESTION ABOUT CUSTOMERS THAT ARE CLASSIFIED AS RESIDENTIAL
8 AND THEIR USAGE CHARACTERISTICS?

9 A It is apparent that for most customers that are classified as residential, there would be
10 little reason to question the classification. However, within the residential class there
11 are not only customers that are served by the typical small meters, but there are also
12 customers served with much larger meters and that consume much larger than average
13 amounts of water. That calls into question whether or not the customers with larger
14 meters share the same usage and cost characteristics as the other customers within
15 the class. Similarly, among the commercial and industrial customers, there are some
16 with the same small meters as the typical residential customer while there are others
17 with much larger meters that consume larger volumes.

18 Q SHOULD THE RATES NECESSARILY REFLECT A DIFFERENT CHARGE PER GALLON OF
19 WATER FOR CUSTOMERS WITH THE SAME LEVEL OF USAGE, BUT THAT ARE DEFINED
20 AS RESIDENTIAL, COMMERCIAL, OR INDUSTRIAL?

21 A Not necessarily. It is the usage characteristics of a customer, not the definition of the
22 customer as residential, commercial or industrial that imposes costs on the system.
23 The current rate design largely has the beneficial effect of self-selecting the price
24 paid according to the usage characteristics. It begins with meter charges that are

1 consistent across all customer classes, according to the size of the meter. In the case
2 of Parkville, there are then declining block usage charges which are also consistent
3 across all classes of service.

4 Q ARE THE CURRENT RATES IN THE PARKVILLE DISTRICT FAIR AND EQUITABLE?

5 A From the standpoint of design, they have been approved by the Commission and relied
6 upon by customers as being fair and equitable. To my knowledge, there have been no
7 complaints filed to suggest that the rates are either unfair or not equitable. Of
8 course, since MAWC has filed the instant rate case, it will to be necessary to adjust
9 the rates to the extent needed to reflect the current revenue requirements within
10 each district. Other than adjusting to the current level of revenue requirements, I am
11 aware of no particular problems with the current rate design for Parkville.

12 Q SEVERAL TIMES YOU HAVE DISCUSSED OR ALLUDED TO CLASS USAGE
13 CHARACTERISTICS AND HOMOGENEOUS RATE CLASSES. DO YOU HAVE ANY
14 FURTHER COMMENT?

15 A Yes. There is certainly a need for the customer classes - however defined - to contain
16 groups customers with homogeneous usage characteristics. If such data were
17 available, it would be useful to improve the design of rates to better reflect the cost
18 of service. But such data does not exist and that is a consequential limitation.
19 Neither MAWC nor Staff nor OPC has access to local data that captures any differences
20 in usage characteristics that may or may not exist among customers in the Parkville
21 District.

22 Since there is no actual local data on usage characteristics the result is a series
23 of assumptions about the relationship of average use to measures of maximum use
24 among residential, commercial, industrial and sales for resale customers. It is indeed

1 remarkable that the MAWC, Staff and OPC studies for the Parkville District all proceed
2 from a series of assumptions, none of which are based on the reality of the specific
3 customer usage patterns in the districts.

4 Q WOULD IT BE USEFUL TO HAVE DATA DERIVED FROM THE CUSTOMERS IN THE
5 DISTRICTS?

6 A There is no question that the data would be useful if it could be obtained at a
7 reasonable cost. Having collected the data, one would be able to more confidently
8 proceed to distinct rates for any customer classes -- as then defined to include
9 customers homogeneous usage patterns within the classes.

10 Recommendations

11 Q WHAT IS YOUR RECOMMENDATION FOR RATES IN THE PARKVILLE DISTRICT?

12 A I recommend that the rate design changes proposed by MAWC, Staff and OPC be
13 rejected. Instead all rate elements should be adjusted on an equal percentage basis
14 to reflect the current district specific revenue requirement and to continue the
15 current rate design.

16 Q WHAT IS THE RECOMMENDATION OF THE CITY OF RIVERSIDE FOR RATES IN THE
17 PARKVILLE DISTRICT?

18 A The City of Riverside and the Missouri Gaming Company believe the current rate design
19 to be fair and equitable, and therefore respectfully recommend and request that any
20 change in rates be applied on an equal percentage basis - which will preserve the
21 current rates that are the same across customer classes.

22 Q DOES THIS CONCLUDE YOUR TESTIMONY?

23 A Yes, it does.