

Exhibit No.:
Issue: Rate Design
Witness: Donald E. Johnstone
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Sponsoring Party: AGP
Case Number: WR-2008-0311
Date Prepared: October 16, 2008

Missouri American Water Company

WR-2008-0311

Surrebuttal Testimony of

Donald E. Johnstone

Before the
Missouri Public Service Commission

On behalf of

AG PROCESSING INC A COOPERATIVE


October 16, 2008



In the Matter of Missouri-American Water)
Company's Request for Authority to)
Implement a General Rate Increase for) WR-2008-0311
Water and Sewer Service Provided)
in Missouri Service Areas)

State of Missouri)
) SS
County of Jackson)

1. My name is Donald E. Johnstone. I am a consultant and President of Competitive Energy Dynamics, L.L.C. I reside at 384 Black Hawk Drive, Lake Ozark, MO 65049. I have been retained by AG Processing Inc. a Cooperative.
2. Attached hereto and made a part hereof for all purposes are my testimony and schedules in written form for introduction into evidence in the above captioned proceeding.
3. I hereby swear and affirm that my testimony is true and correct and show the matters and things they purport to show.


Donald E. Johnstone

Subscribed and sworn to this 16th day of October, 2008.

Angela Hedger
Notary Public

My Commission expires: 8-15-09



Missouri American Water Company

WR-2008-0311

Surrebuttal 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 SURREBUTTAL TESTIMONY?

A I am appearing for the purposes of this testimony on behalf of AGP, with separate testimony filed on behalf of interveners City of Riverside and Missouri Gaming Company.

Q PLEASE SUMMARIZE YOUR TESTIMONY.

A My testimony may be summarized as follows:

- Staff observes that I have not prepared studies to support a continuation of important aspects of the present rate design. Staff fails to note that it is they, not I that are proposing a major change from a rate design already found to be fair and

1 reasonable by the Commission and indeed the product of a stipulation submitted
2 for the purposes of the prior rate case, WR-2007-0216.

- 3 • The Staff class cost-of-service study, like those of MAWC and OPC continues to rely
4 on assumed class usage characteristics which have not been shown to be
5 representative or appropriate for the St. Joseph District.
- 6 • The OPC class cost-of-service study continues to rely on assumed class usage
7 characteristics that are not shown to be representative or appropriate for the St.
8 Joseph District.
- 9 • Mr. Ileo, on behalf of the City of Joplin, appears to be making rate design
10 recommendations for the St. Joseph District, in which he presumably has no
11 interest. To the extent that Mr. Ileo proposes changes to the design of the rates
12 for the St. Joseph District. the proposal should be rejected for lack of a vested
13 interest, besides the fact that his theories and explanations are deficient.
- 14 • I understand Mr. Ileo to be requesting leave to file a class cost-of-service study at
15 the date specified for true-up testimony. This is troublesome and will be opposed
16 by AGP in part because there will be inadequate opportunity to respond, but also
17 for other reasons including but not limited to the very practical reason that the out
18 of time filing would add substantial cost and complexity to a case that is already
19 complex simply due to the numerous districts for which parties may investigate a
20 multitude of interests. If Mr. Ileo's request is granted it makes participation more
21 difficult and expensive for AGP, and presumably other parties as well. To the
22 extent that Mr. Ileo proposes changes to the design of the rates for the St. Joseph
23 District, his proposal should be rejected.

- Any class cost-of-service study prepared by Mr. Ileo would necessarily rely on assumed class usage characteristics that cannot be shown to be representative or appropriate for the St. Joseph District.

Response to Staff Rebuttal Testimony

Q IS MR. RUSSO CORRECT IN HIS SUGGESTION THAT YOU SUPPORT A UNIFORM CUSTOMER CHARGE?

A No. In my direct testimony I simply support MAWC's proposed customer charge as applied to the St. Joseph District. I do not take a position as to the customer charge for other districts. In fact, in rebuttal testimony I supported an equal percentage adjustment as an approach that preserves the current rate design for the Parkville District. Mr. Russo was mistaken in his interpretation of my testimony.

Q DOES STAFF COMPLAIN THAT YOU HAVE NOT PREPARED A STUDY TO SUPPORT YOUR RECOMMENDATIONS FOR THE ST. JOSEPH DISTRICT?

A Staff apparently fails to recognize that I am proposing a minor modification to a rate design approach that has the advantage of having been already approved by the Commission. And importantly, while Staff opines about the assumptions inherent in its class cost-of-service study as compared to the MAWC's, an important point is that the disagreement between Staff and MAWC arises because both rely on assumptions and judgments where it would be preferable to develop usage characteristic from load research data for MAWC's Missouri districts. Staff, MAWC and OPC cost studies all suffer from the lack of factual usage characteristics that would clarify important cost causing characteristics for the customer classes in general and the customer classes in the St. Joseph District in particular.

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

3 A Yes, it is. While Staff misses the mark in its criticisms of my proposals based on the
4 existing structure, it continues to be true that Staff offers no studies and no
5 explanation for the major redesign it proposes for the St. Joseph District.

6 Q DOES STAFF CRITICIZE THE DECLINING BLOCK APPROACH FOR THE FIRST TIME IN
7 REBUTTAL TESTIMONY?

8 A Yes. In its criticism Staff ignores an important benefit of declining block rates.
9 Among other things, the declining block structure allows the rates to better track cost
10 when all customer related costs are not fully collected in a customer charge.

11 Customers sometimes find a high customer charge offensive because it appears
12 to be a charge "for nothing." In the case of MAWC no water is provided as a part of
13 the meter charges (the "customer charge"). Understandably, it can appear to
14 customers that are not steeped in rate theory that anything beyond a nominal
15 customer charge is unfair. Such customers are unlikely to understand that a below
16 cost customer charge results in some of their costs being paid by other customers.
17 Thus, from the perspective of the public's understanding and acceptance of the rates,
18 a declining block approach can be beneficial because it can be used to maintain a rate
19 design that is reasonably cost based while avoiding the problems of a higher customer
20 charge.

21 It is unreasonable to eliminate the declining blocks without a substantial
22 increase in the customer charges to reflect the full measure of customer related costs,
23 and for that reason the Staff criticism of existing declining block structure misses the
24 mark and should be rejected along with the Staff rate design proposal.

1 In summary, as a practical matter, a higher charge for the first block in a
2 declining block structure is useful for mitigating the perception problem for those
3 customers that do not understand or care about rate design theory that would support
4 a higher cost based customer charge while at the same time doing a fair job of
5 collecting costs from the customers that cause the costs.

6 Mr. Ileo's Rate Design Proposals On Behalf Of The City of Joplin

7 Q IS MR. ILEO LIMITING HIS COMMENTS AND RECOMMENDATIONS TO RATES FOR THE
8 JOPLIN DISTRICT?

9 A It does not appear so.

10 Q HAS MR. ILEO SUBMITTED A STUDY THAT ALLOCATES COSTS AMONG THE DISTRICTS?

11 A No.

12 Q HAS MR. ILEO SUBMITTED A CLASS COST-OF-SERVICE STUDY FOR JOPLIN OR ANY
13 OTHER DISTRICT?

14 A No.

15 Q HAS MR. ILEO DESIGNED RATES FOR JOPLIN OR ANY OTHER DISTRICT?

16 A No. While Mr. ileo offers opinions with which I disagree, I find no rates for analysis
17 and I do not understand how my client would have a fair opportunity to analyze the
18 impact and respond to rates that have not been offered into testimony by this stage of
19 the proceeding.

20 Q WOULD IT BE APPROPRIATE AND FAIR FOR THE CITY OF JOPLIN TO WORK ON A
21 DIFFERENT SCHEDULE THAN THE COMMISSION HAS SET FOR OTHER PARTIES IN
22 ORDER TO SUBMIT DATA AND STUDIES LATER IN THIS PROCEEDING?

1 A The appropriateness, or lack thereof, of such an approach is a matter to be addressed
2 in due course if it arises. Suffice to say at this point that it is certainly a concern and
3 my client is no way acquiescing to the suggestion of Mr. Ileo that true-up testimony
4 might be used by him for the purposes of introducing district and class specific cost
5 studies and specific rate proposals for the first time.

6 Response to OPC Testimony

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

9 A Yes. Among other issues Ms. Meisenheimer addresses a revised class cost-of-service
10 study she has submitted. I will respond to her testimony regarding these issues.
11 Silence on other issues should not be viewed as either support or disagreement with
12 any particular position.

13 Q DOES THE CLASS COST-OF-SERVICE STUDY MS. MEISENHEIMER SUBMITTED WITH HER
14 REBUTTAL CONTINUE TO RELY ON USAGE CHARACTERISTICS FOR THE ST. JOSEPH
15 DISTRICT THAT HAVE NOT BEEN SHOWN TO BE APPROPRIATE FOR THE DISTRICT?

16 A Yes. There are no usage characteristics available for the state of Missouri as a whole
17 or for the St. Joseph District in particular. For this reason, among others, the value of
18 the study is limited.

19 Q DOES MS. MEISENHEIMER OPPOSE THE INCREASES YOU RECOMMEND IN THE
20 CUSTOMER CHARGES IN THE ST. JOSEPH DISTRICT?

21 A Yes. She prefers a lower customer charge.

22 Q PLEASE COMMENT.

1 A As a practical matter the fixed costs incurred by MAWC to provide water are much
2 larger than the variable costs. A cost based rate would reflect this with a relatively
3 lower usage charge and with some combination of meter charges, customer charges
4 and demand charges to designed to collect the fixed costs according to the principle
5 of cost causation. If the meter charge is held to a low level then it is necessary to
6 collect fixed costs in another rate element. I suggest use of the first block of the
7 declining block rate as a practical alternative in the context of the current rate
8 structure.

9 First, for all customers with usage that exceeds the level of the first block, the
10 effect would be the identical to that of a higher meter charge. Second, for the
11 remaining customers, those with usage levels entirely within the first block, this
12 alternative approach would still provide a result more consistent with cost than the
13 alternative of a low customer charge and a flat usage charge, the alternative proposed
14 by Staff.

15 Q DO YOU AGREE WITH MS. MEISENHEIMER'S ALTERNATIVE PROPOSAL FOR AN ABOVE
16 AVERAGE INCREASE FOR THE INDUSTRIAL CLASS IN THE ST. JOSEPH DISTRICT?

17 A No. As explained above, the study is built on unchecked assumptions regarding the
18 usage characteristics of the customer classes. OPC, Staff, and MAWC disagree about
19 these assumptions. I further disagree because there is a lack of data and because
20 there has been no apparent effort to study whether the rate classes are even
21 appropriate for the purposes of rate design. Once there is data, there can then be a
22 more useful exploration of the differences in the approach to class cost-of-service
23 studies among the parties.

Response to MAWC - Customer Class Definitions and Usage Characteristics

Q HAS MAWC ADDRESSED CUSTOMER CLASS DEFINITIONS IN REBUTTAL TESTIMONY?

A Yes, the matter is addressed by Mr. Herbert and Mr. Grubb.

Q WHAT IS THE SOURCE OF THE DEFINITIONS PROFFERED BY MAWC?

A Mr. Herbert states that the company uses the AWWA standard and attaches several pages from the AWWA manual M1. However, in the pages he attached, there is no definition for the public authorities class. Presumably that definition is the creation of either MAWC or Mr. Herbert.

Q DID MR. HERBERT REBUT YOUR TESTIMONY AS TO THE IMPORTANCE OF THE DEFINITIONS IF THEY ARE TO BE USED FOR RATE DESIGN PURPOSES?

A No. As I stated in my earlier testimony, in order for a rate design to properly reflect the cost for any customer class the usage characteristics of the customers within the class must be homogeneous. From the perspective of rate design, rate classes need to group customers with homogeneous usage characteristics.

Q DOES MR. HERBERT ARGUE THAT CUSTOMERS WITH SIMILAR USAGE CHARACTERISTICS SHOULD PAY A DIFFERENT RATE SIMPLY BECAUSE OF THEIR CUSTOMER CLASSIFICATION?

A No, not that I have seen. In the AWWA material attached to his testimony it is stated: "... the cost of providing service can reasonably be determined for groups of classes of customers that have similar water-use characteristics ..." and it goes on to state "In establishing customer classes, water utilities consider service characteristics, demand patterns ..."

1 Q HAS MAWC PROVIDED ANY DATA COLLECTED IN THE ST. JOSEPH DISTRICT TO
2 ESTABLISH THE USAGE CHARACTERISTICS OF THE CLASSES AND THAT THE
3 CUSTOMERS WITHIN THE CLASSES HAVE HOMOGENEOUS USAGE CHARACTERISTICS?

4 A None that I have seen.

5 Response to MAWC - St. Joseph District Rate Design

6 Q DOES MAWC DISAGREE WITH THE REDUCTIONS YOU PROPOSE FOR THE USAGE
7 CHARGES IN THE ST. JOSEPH DISTRICT?

8 A Yes, MAWC asserts that the tail block usage rate I recommend is too low because it is
9 below the average base cost. However, MAWC supports its customer charge proposal
10 as cost based and provides no alternative approach that would reconcile to the lower
11 St. Joseph District revenue requirement supported by the Staff. MAWC has only its
12 proposed rates that collect the much higher level of the MAWC proposed revenue
13 requirement. MAWC provides no indication of which of the proposed charges would be
14 too high.

15 Q DOES MR. HERBERT CONSISTENTLY ADHERE TO HIS SUGGESTION THAT THE
16 AVERAGE BASE COST SHOULD BE A FLOOR FOR THE TAIL BLOCK RATE?

17 A No. There is a direct contradiction in the Premium Pork contract rate. If he were
18 correct that a tail block below the base cost is improper, then it would also be
19 improper to have a single usage rate for all usage that is below the base cost. Yet
20 that is the situation for Premium Pork and Mr. Herbert has made no proposal to
21 correct that rate based on the standard he suggests in his rebuttal testimony.
22 Conversely, if it is acceptable to price Premium Pork below the "base cost" it would
23 certainly be reasonable to move at least the tail block rate applicable to the larger
24 volume usages of non-contract customers downward towards the same contract rate

1 level. Otherwise, it has every appearance that the contract rate level is a subsidy
2 and undue rate discrimination.

3 Q DOES THIS CONCLUDE YOUR TESTIMONY?

4 A Yes, it does.