

Exhibit No.:	450
Issue:	Contract Service
Witness:	Donald Johnstone
Type of Exhibit:	Direct Testimony
Sponsoring Party:	AGP
Case Number:	WR-2010-0131
Date Prepared:	March 9, 2010

**Missouri American Water Company  
WR-2010-0131**

**Direct Testimony of**

**Donald E. Johnstone**

on behalf of the

**AG PROCESSING INC, A COOPERATIVE**

March 9, 2010



AGP Exhibit No 450  
Date 5-17-10 Reporter KF  
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**Missouri American Water Company**

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**Revenue Direct Testimony of Donald E. Johnstone**

**TABLE OF CONTENTS**

INTRODUCTION AND OVERVIEW ..... 1  
THE POTENTIAL FOR REVENUES THAT EXCEED THE COST OF SERVICE ..... 2  
RECOMMENDATIONS ..... 5

**Missouri American Water Company**

**WR-2010-0131**

**Revenue Direct Testimony of Donald E. Johnstone**

1 **INTRODUCTION AND OVERVIEW**

2 **Q PLEASE STATE YOUR NAME AND ADDRESS.**

3 A Donald E. Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, MO 65049.

4 **Q BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A I am President of Competitive Energy Dynamics, L. L. C. My qualifications and  
6 experience are set forth in Schedule 1 attached to this testimony.

7 **Q ON WHOSE BEHALF ARE YOU APPEARING?**

8 A I am appearing on behalf of AG PROCESSING INC A COOPERATIVE ("AGP"). AGP is a  
9 customer in the St. Joseph District.

10 **Q PLEASE PROVIDE AN OVERVIEW YOUR TESTIMONY.**

11 A The rates for service in each district should reflect the cost of the services provided in  
12 each district. Where MAWC offers contract rates for particular large customers that  
13 are below the fully allocated costs used to establish rates for the various customer  
14 classes, the company has a special burden to show that these contract rates are not  
15 unduly discriminatory. Also, to the extent that recovery of the revenue difference  
16 between the rates is sought, MAWC has the additional burden of showing that any  
17 customers contributing to such additional revenue recovery are no worse off as a

1 result. Absent such a showing, customers must not be required to pay rates that  
2 contribute the difference. For in such circumstance such customers would, absent that  
3 showing, be asked to pay a subsidy pursuant to rates that were both above the cost of  
4 service and unduly discriminatory.

5 AGP also supports the proposition that the reasonable cost of providing services  
6 in the St. Joseph District should be the fundamental starting point for the design of  
7 rates. AGP testimony addressing cost allocation to the District and rate design will  
8 follow in due course. However, here again in due course I will explain that different  
9 rates are appropriate only to the extent that there are differences in costs that are  
10 reflected in the rates. Otherwise, it is important that similarly situated customers in  
11 the same district pay the same rate so there will be no undue discrimination and no  
12 cross subsidies.

13 Another important issue to AGP is of course the overall cost of service for the  
14 St. Joseph District since that is the starting point for the class cost-of-service study for  
15 the district. Silence on related issues in this testimony does not indicate either  
16 support for, or acquiescence to, any particular proposal of MAWC as AGP may assert  
17 additional positions at appropriate times in this proceeding.

18 **THE POTENTIAL FOR REVENUES THAT EXCEED THE COST OF SERVICE**

19 **Q UNDER THE MAWC PROPOSED RATES FOR THE ST. JOSEPH DISTRICT IS THERE A**  
20 **POTENTIAL FOR REVENUES THAT EXCEED THE COST OF SERVICE.**

21 **A** Yes. This possibility arises because of contract rates that have not been shown to be  
22 cost-based. Indeed, the usage and cost characteristics are included along with others  
23 in the class cost-of-service study. This is a tacit admission that the cost of serving  
24 these customers is the same as the cost of serving other customers in the class.

1 Furthermore, to the extent that the other customers are worse off as a result, the  
2 only possible conclusion is that the non-contract rates would be too high and unduly  
3 discriminatory if the MAWC proposal were adopted.

4 **Q UNDER WHAT CONDITIONS WOULD NON-CONTRACT RATE CUSTOMERS NOT BE**  
5 **WORSE OFF AS A RESULT OF THE PROPOSED CONTRACT RATES?**

6 **A** There are two alternative approaches to the answer to this question. Under the first  
7 alternative approach revenues would be imputed. Under this approach the non-  
8 contract customers may appropriately be charged rates designed under the assumption  
9 that contract rate customers are contributing revenues equal to the otherwise  
10 applicable rate. As a consequence the non-contract customers in total (and  
11 individually assuming an otherwise equitable rate design) would be no worse off as a  
12 result of the contract rates. Of course there must be a reasonable basis for offering  
13 the contract rate that is consistent with the public interest and direct competitors, if  
14 there are any, must be offered the same rate. Under these conditions the rates for  
15 the non-contract customers would not be excessive and would include no undue  
16 discrimination so long as the basis for offering the contract rate is consistent with the  
17 public interest.

18 From the perspective of MAWC the problem with this approach is that it will be  
19 more challenging for it to earn the allowed return. In effect, it would be necessary  
20 for MAWC to improve efficiencies above and beyond the test year level to achieve the  
21 allowed return. There are always numerous considerations that affect the earned  
22 returns and this would be one that would add to the challenge.

1 Q WHAT IS THE SECOND ALTERNATIVE APPROACH TO DESIGNING RATES THAT WILL  
2 ENSURE THAT NON-CONTRACT CUSTOMERS ARE NOT WORSE OFF AS A RESULT OF  
3 THE CONTRACT SERVICE?

4 A There is the possibility of designing rates that would be above the apparent fully  
5 allocated cost of service for all of the non-contract customers in order to design rates  
6 that would recover the full test year revenue requirement, even if there is no post  
7 rate case increase in the efficiency/productivity of MAWC. Under this alternative  
8 approach the contract customer(s) in effect become a separate class of service. In  
9 these circumstances it is a more difficult analysis to show that non-contract customers  
10 are not worse off and are charged rates that are fair and reasonable. Nonetheless, it  
11 is an appropriate burden for MAWC if it wishes to pursue the additional revenues.

12 First, it is necessary to show that all incremental costs incurred by MAWC to  
13 serve the contract customer(s) are recovered. Second, it is necessary to show that the  
14 rate is no lower than it needs to be for the contract customer to accept the service.  
15 Third, it is a necessary condition that no large fixed asset costs, such those of an  
16 expensive water treatment plant were or will be incurred to enable service to the  
17 contract customer (without an allocated contribution to the cost thereof). Fourth, it  
18 is necessary that the rate so designed provides a revenue contribution above the  
19 incremental cost of the service.

20 The contribution above incremental cost should then be allocated among the  
21 non-contract customers to ensure that all are better off as a result of MAWC providing  
22 the contract service. With these conditions met the one remaining test would be that  
23 there must be no direct competitor of the contract customer in the service area that  
24 was not offered the same rate.

1 Q HAS MAWC UNDERTAKEN EITHER OF THE ALTERNATIVE APPROACHES TO  
2 ESTABLISHING RATES IN THE ST. JOSEPH DISTRICT IN THIS PROCEEDING?

3 A No. Consequently it is not proposing a level of rates for the non-contract customers  
4 that has been shown to be fair and reasonable. Said another way, the proposed rates  
5 for the non-contract customers in total must be reduced by imputing revenues unless  
6 MAWC is able to prove the conditions to demonstrate that no customer is worse off as  
7 a result of the contract service.

8 Q DOES THE MAWC APPROACH TO ITS CLASS COST-OF-SERVICE STUDY FOR THE ST.  
9 JOSEPH DISTRICT AND THE DESIGN OF THE RATES FOR THE NON-CONTRACT  
10 CUSTOMERS ALSO IMPACT THE RESULT?

11 A Yes. These issues will be addressed in the next round of direct testimony.

12 **RECOMMENDATIONS**

13 Q PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS TESTIMONY.

14 A Inasmuch as MAWC has submitted virtually nothing in its testimony to support the need  
15 for the contract rates and the appropriateness of the particular rate levels, it is  
16 appropriate to impute revenues consistent with the otherwise applicable rates.

17 In the alternative, MAWC must undertake the burden of satisfying the several  
18 conditions necessary to ensure that non-contract customers, both as a group and as  
19 individual customers, are not worse off as a result of the contract service. The rate  
20 design conditions that attach to this alternative will be further addressed in the rate  
21 design phase of direct testimony.

1 Q DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

2 A Yes it does.



### Qualifications of Donald E. Johnstone

**Q PLEASE STATE YOUR NAME AND ADDRESS.**

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

**Q PLEASE STATE YOUR OCCUPATION.**

A I am President of Competitive Energy Dynamics, L.L.C. and a consultant in the field of public utility regulation.

**Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

A In 1968, I received a Bachelor of Science Degree in Electrical Engineering from the University of Missouri at Rolla. After graduation, I worked in the customer engineering division of a computer manufacturer. From 1969 to 1973, I was an officer in the Air Force, where most of my work was related to the Aircraft Structural Integrity Program in the areas of economic cost analysis, data base design and data processing. Also in 1973, I received a Master of Business Administration Degree from Oklahoma City University.

From 1973 through 1981, I was employed by a large Midwestern utility and worked in the Power Operations and Corporate Planning Functions. While in the Power Operations Function, I had assignments relating to the peak demand and net output forecasts and load behavior studies which included such factors as weather, conservation and seasonality. I also analyzed the cost of replacement energy associated with forced outages of generation facilities. In the Corporate Planning Function, my assignments included developmental work on a generation expansion planning program and work on the peak demand and sales forecasts. From 1977

through 1981, I was Supervisor of the Load Forecasting Group where my responsibilities included the Company's sales and peak demand forecasts and the weather normalization of sales.

In 1981, I began consulting, and in 2000, I created the firm Competitive Energy Dynamics, L.L.C. As a part of my thirty years of consulting practice, I have participated in the analysis of various electric, gas, water, and sewer utility matters, including the analysis and preparation of cost-of-service studies and rate analyses. In addition to general rate cases, I have participated in electric fuel and gas cost reviews and planning proceedings, policy proceedings, market price surveys, generation capacity evaluations, and assorted matters related to the restructuring of the electric and gas industries. I have also assisted companies seeking locations for new manufacturing facilities.

I have testified before the state regulatory commissions of Delaware, Hawaii, Illinois, Iowa, Kansas, Massachusetts, Missouri, Montana, New Hampshire, Ohio, Pennsylvania, Tennessee, Virginia and West Virginia, and the Rate Commission of the Metropolitan St. Louis Sewer District.

BEFORE THE  
PUBLIC SERVICE COMMISSION OF MISSOURI

In the Matter of Missouri-American Water )  
Company's Request for Authority to )  
Implement a General Rate Increase for )      WR-2010-0131  
Water Service Provided )  
in Missouri Service Areas )

**Affidavit of Donald E. Johnstone**

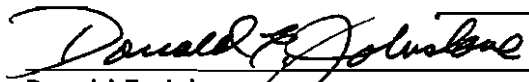
State of Missouri                    )  
County of Camden                )      SS

Donald E. Johnstone, being first duly sworn, on his oath states:

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 9<sup>th</sup> day of March, 2010.

  
\_\_\_\_\_  
Notary Public



CAROLYN NEPORADNY  
My Commission Expires  
August 30, 2013  
Camden County  
Commission #09452654

Competitive Energy  
DYNAMICS