Exhibit No.:	
Issue:	Rate Design
Witness:	Donald E. Johnstone
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	AGP
Case Number:	WR-2008-0311
Date Prepared:	September 30, 2008

Missouri American Water Company

WR-2008-0311

Rebuttal Testimony of

Donald E. Johnstone

Before the
Missouri Public Service Commission

On behalf of

AG PROCESSING INC A COOPERATIVE

September 30, 2008

Competitive Energy
DYNAMICS

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 Water and Sewer Service Provided in Missouri Service Areas	)))))	WR-2008-0311

Affidavit of Donald E. Johnstone

State of Missouri)
) SS
County of Jackson)

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, the City of Riverside, and the Missouri Gaming Company.

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 30th day of September, 2008.

Notary Public

My Commission expires: 8/15/2009

Competitive Energy
DYNAMICS

ANGELA HEDGES
Notary Public - Notary Seal
State of Missouri - County of Jackson
My Commission Expires Aug. 15, 2009
Commission #05402477

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 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 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 St. Joseph 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 St. Joseph District.
- The OPC class cost-of-service study relies on assumed class usage characteristics that are not shown to be representative or appropriate for the St. Joseph District.
- The Staff proposed changes to the design of the rates for the St. Joseph District should be rejected.

Response to Staff Testimony

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

A In the St. Joseph District the Staff proposes to increase the meter charge for a 5/8" meter by 7%. For other meter sizes the Staff proposes decreases ranging from 9% to 50.9%. 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 costs. First, the fixed costs, by definition, do not vary based on changes in usage. Thus, the proposal to collect more fixed costs via a usage charge, as though they were variable, is a move away from cost-based rates. Second, the current meter charges do not collect all fixed costs, which are higher on a per unit basis for smaller customers. They are higher for small customers because small usages do not result in the economies of scale in delivery that occur with larger usages. Another consideration can be the fact that larger customers tend to have higher load factors which results in a lower rate when designed as a usage charge.

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

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

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

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

> 59. Please identify and provide a copy of all studies by Mr. Russo which explain the reasoning for a single volumetric charge for all customers in a class for a water utility.
> A. No studies were performed.
> 60. Please identify and provide a copy of all studies relied upon by Mr. Russo which explains the reasoning for a single volumetric charge for all customers in a class for a water utility.
> A. No studies were relied upon.
> 61. Please identify and provide a copy of all studies by Mr. Russo which shows that an existing declined block volumetric charge for a water utility is not consistent with cost of service principles.
> A. No studies were performed.
> 62. Please identify and provide a copy of all studies relied upon by Mr. Russo which show that an existing declined block volumetric charge for a water utility is not consistent with cost of service principles.
> A. No studies were relied upon.
> 63. Is it the contention of Mr. Russo that the existing declining block rate structure for each of the customer classes is inconsistent with the cost of service? If so, please explain fully.
> A. No.
> 64. Is it the contention of Mr. Russo that the existing declining block rate structure for each of the customer classes is unreasonable? If so, please explain fully.
> A. No.

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

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

Q ARE THERE POTENTIAL CONSEQUENCES OF RAISING THE RATES FOR LARGER CUSTOMERS AS OCCURS UNDER THE STAFF PROPOSAL.

A Yes. Larger customers would be encouraged to develop their own water supplies in order to reduce or eliminate the purchase of overpriced water from MAWC. As a consequence, the customers that would have been the intended beneficiaries of below cost rates may well find pressure to increase their rates so the fixed cost of MAWC could continue to be recovered in rates.

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 ST. JOSEPH 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 St. Joseph District in particular.

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

A While Ms. Meisenheimer recommends "no change" for the St. Joseph District, I have previously supported the increased customer charges proposed by MAWC, but with volumetric charges adjusted on an equal percentage basis to collect the remaining revenue requirement for the district. To that extent I disagree with her

recommendation. Also, 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.

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

A 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. Thus, it is necessary to have class definitions that are consistent and that foster the grouping of customers with homogeneous usage characteristics.

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

A It is apparent that for most customers that are classified as residential, there would be little reason to question the classification. However, within the residential class there are not only customers that are served by the typical small meters, but there are also customers served with much larger meters and that consume much larger than average amounts of water. That calls into question whether or not the customers with larger meters share the same usage and cost characteristics as the other customers within

the class. Similarly, among the commercial and industrial customers, there are some with the same small meters as the typical residential customer while there are others with much larger meters that consume larger volumes.

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

A Not necessarily. It is the usage characteristics of a customer, not the definition of the customer as residential, commercial or industrial that imposes costs on the system. The current rate design largely has the beneficial effect of self-selecting the price paid according to the usage characteristics. It begins with meter charges that are consistent across all customer classes, according to the size of the meter. In the case of the St. Joseph District, there are then declining block usage charges which are consistent across most customer classes.

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

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

Since there is no actual local data on usage characteristics the result is a series of assumptions about the relationship of average use to measures of maximum use among residential, commercial, industrial and sales for resale customers. It is indeed remarkable that the MAWC, Staff and OPC studies for the St. Joseph District all proceed from a series of assumptions, none of which are based on the reality of the specific customer usage patterns in the districts.

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

A There is no question that the data would be useful if it could be obtained at a reasonable cost. Having collected the data, one would be able to more confidently proceed to distinct rates for any customer classes -- as then defined to include customers that have homogeneous usage patterns within the classes. The Commission should require that MAWC perform an appropriately-designed class cost-of-service study in its next rate filing. Alternatively, at a minimum, the Commission should require MAWC to consult with the parties following this case to identify the needed data and then provide the collected data in a timely manner so that the other parties may perform their own studies.

Recommendations

Q WHAT IS YOUR RECOMMENDATION FOR RATES IN THE ST. JOSEPH DISTRICT?

A I recommend that changes proposed by Staff and OPC be rejected. Instead the meter charges should be increased as proposed by MAWC all other rate elements should be adjusted on an equal percentage basis to reflect the current district specific revenue requirement.

Q DOES THIS CONCLUDE YOUR TESTIMONY?

A Yes, it does.