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| Exhibit No.: | |
| Issues: | Rate Design |
| Witness: | James M. Russo |
| Sponsoring Party: | MO PSC Staff |
| Type of Exhibit: | Surrebuttal Testimony |
| Case No.: | WR-2008-0311 |
| Date Testimony Prepared: | October 16, 2008 |

# MISSOURI PUBLIC SERVICE COMMISSION

## UTILITY OPERATIONS DIVISION

# SURREBUTTAL TESTIMONY

# OF

# JAMES M. RUSSO

# MISSOURI-AMERICAN WATER COMPANY

# CASE NO. WR-2008-0311

**Jefferson City, Missouri**
**October 2008**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE 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 | ) ) ) ) ) | Case No. WR-2008-0311 |

**AFFIDAVIT OF JAMES M. RUSSO**

**STATE OF MISSOURI** )
) ss
**COUNTY OF COLE** )

James M. Russo, of lawful age, on his oath states: that he has participated in the preparation of the following Surrebuttal Testimony in question and answer form, consisting of 13 pages of Surrebuttal Testimony to be presented in the above case, that the answers in the following Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.

James M. Russo

Subscribed and sworn to before me this 15th day of October, 2008.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

Susan L Sundermeyer
Notary Public

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**SURREBUTTAL TESTIMONY**

**OF**

**JAMES M. RUSSO**

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2008-0311**

Q. Please state your name and business address.

A. James M. Russo, P. O. Box 360, Jefferson City, Missouri 65102.

Q. Are you the same James M. Russo who filed Direct and Rebuttal Testimony on behalf of the Commission Staff in Case No. WR-2008-0311?

A. Yes I am.

Q. What is the purpose of your Surrebuttal Testimony?

A. The purpose of my Surrebuttal Testimony is to rebut portions of the Rebuttal Testimony of Ag Processing's and City of Riverside's witness Donald E. Johnstone, City of Joplin witness Michael J. Ileo, M.I.E.C. witnesses Michael Gorman and Brian C. Collins, Office of the Public Counsel (OPC) witness Barbara A. Meisenheimer and Missouri-American Water Company (MAWC or Company) witness Paul R. Herbert.

## Donald E. Johnstone

Q. On whose behalf did Mr. Johstone file testimony?

A. Mr. Johnstone filed Rebuttal Testimony on behalf of Ag Processing and on behalf of the City of Riverside and the Missouri Gaming Commission.

Q. How do you plan on responding to Mr. Johnstone's rebuttal testimony?

A. Mr. Johnstone essentially filed the same Rebuttal Testimony for both of his clients. My answers will apply to both sets of his Rebuttal Testimony, unless I state otherwise.

Q. Do you agree with Mr. Johnstone's statement on page 2, of his Rebuttal Testimony (regarding customer charges) where he states "The effect is to move the rate design away from one which reasonably reflects cost."?

A. No I do not. The customer charges in Staff's Class Cost of Service (CCOS) study were developed based on the allocation of the costs associated with the Parkville district and Saint Joseph district. Mr. Johnstone has not presented any evidence other than general statements indicating his dissatisfaction with the results of Staff's CCOS study, such as the one above. He has not questioned the accuracy of any of the allocation factors used by Staff in the CCOS study, nor has he offered any alternatives to any of the allocation factors used by Staff for the allocation of costs in the Parkville and Saint Joseph districts.

Q. Please respond to Mr. Johnstone's statement in his Rebuttal Testimony on page 2 where he states "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."

A. Staff used the base-extra capacity method to prepare its CCOS study. Staff believes the results of its CCOS study properly allocates fixed costs to the customer costs included in Staff's calculation of the customer charge. Staff also believes that the CCOS study does not place additional fixed costs to be collected through a volumetric charge.

Q. Please respond to Mr. Johnstone's question in his Rebuttal Testimony on page 3 where he asks: "Has Staff provided any studies that would provide a conceptual basis for such a major change to rate design?

A. Staff did not rely on any other studies. Staff relied on the American Water Works Association (AWWA) Manual of Water Supply Practices Principles of Water Rates, Fees, and Charges (AWWA M1) for guidance in developing its CCOS study. Staff's CCOS study is based on the base-extra capacity method and Staff believes it is correct and appropriate in determining the meter charges for MAWC's customers. Staff has relied on this method in previous cases.

In addition, Staff does not believe that its CCOS study results are a major change to rate design. Staff's rate design will recover the costs allocated to each customer class in each district.

Finally, Staff also must point out that Mr. Johnstone did not cite or provide any studies or work papers for his proposed rates.

Q. Please respond to Mr. Johnstone's statement in his Rebuttal Testimony on page 4, line 31 where he states, "Instead, the Staff rate design in many respects moves rates away from cost."

A. Staff's does not agree with Mr. Johnstone's statement. AWWA M1 summarizes cost allocation for the base-extra capacity and commodity-demand methods on page 50:

> 1. Allocation of costs that apply to the functional cost components of base, extra capacity, and customer costs in the base-extra capacity method, and to commodity, demand, and customer costs in the commodity-demand method.

> 2. Distribution of costs by the various cost components to respective classes of customers according to the respective responsibility of the customer classes for each of the component costs

The only logical conclusion is since Staff's rate design is based on the results of Staff's CCOS study, which was performed using the base-extra capacity method, which was developed using the standards in the AWWA M1 manual, that the resulting rate design is based on cost.

Q. Do you agree with Mr. Johnstone's statement at the top of page 5 in his Ag Processing Inc. rebuttal testimony that states:

> "Large 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."

A. No I do not agree. Mr. Johnstone's statement is pure conjecture. He offers no supporting documentation that large customers would be encouraged to develop their own water supplies. In addition, it is simply his opinion that MAWC's water would be overpriced.

Staff believes part of Mr. Johnstone's statement is based on Staff's recommendation for single block rates. Single block commodity rates are equitable because customers pay the same unit price for water service as other members of that class. When a commodity rate for a district is designed properly, the actual cost of service of the customer class remaining to be recovered after the customer charge for the class is subtracted; the resulting single block is equitable for all customers in the class. This is in contrast to declining block rates which shift costs from large users to small users in the same customer class.

Q. Do you agree with Mr. Johnstone's statement on page 8 of his Rebuttal Testimony that the studies performed by MAWC, OPC and Staff all proceed from a series of assumptions, none of which are based on the reality of the specific customer usage patterns in the districts.

A. No. Staff's CCOS study relied upon the usage annualization completed by the Staff's Auditing Department for each customer class in each district. Mr. Johnstone is critical of the results of Staff's usage annualization, but, he has not offered any study of his own to show why Staff's usage annualizations are not appropriate.

**Michael J. Ileo**

Q. Do you agree with Joplin witness Ileo's rate increase phase-ins described on pages 11 thru 13 of his Rebuttal Testimony?

A. Staff is opposed to Joplin witness Ileo's phase-in of rates for the Joplin district. Staff realizes a potential 30% to 35% percent increase of rates may place a burden on some customers, especially in light of an approximate 63% increase in 2007. However, Staff does not believe that it is appropriate to phase-in the rates for the Joplin district when other districts in this case are facing similar or higher increases.

Q. Do you agree with Joplin witness Ileo's position that the Commission should reject the results of customer cost calculations as the sole basis of establishing minimum bills?

A. No I do not. The proposed customer charge by Staff includes the recovery of customer costs related to meters, services and billing and collections based on the base-extra capacity method. Staff believes that the customer charge is an appropriate method of recovering these costs and contributes to revenue stability and predictability. In fact, Joplin witness Ileo clarifies his answer by stating on page 17 of his Rebuttal Testimony that minimum bills should not be eliminated because they fulfill the important objective of revenue stability and predictability.

Q. Do you agree with Joplin witness Ileo's characterization of the customer costs on page 17 of his Rebuttal Testimony where he states:

> "As illustrated above, both Commission staff and MAWC compute monthly residential customer costs as the sum of the total costs of service applicable to investments and functions involving meters, services, and billing & collecting. Any representation, however, that these three categories of costs can be purely or uniquely ascribed as being customer-related instead of usage-related is misleading."

A. Staff has developed the customer charge in accordance with the AWWA M1 definition of customer costs. Customer costs are defined as those costs associated with serving customers, irrespective of the amount or rate of water use. Staff is not making any representation that these customer costs can be purely or uniquely ascribed as being customer-related instead of usage-related. Rather, Staff is simply stating that the proper costs to include in the customer charge are the meter, services and billing & collection related costs Staff used in developing the $8.73 customer charge for 5/8" water service customers in Joplin.

Q. Do you agree with Joplin witness Ileo's statements on page 18 of his Rebuttal Testimony on what the standard should be for setting monthly minimum charges?

A. Generally speaking, the customer charge should be set at a level that allows the utility to recover its true and fixed costs as much as possible. Staff has accomplished this by using the base-extra capacity method to allocate costs to each customer class in each district.

In addition, the correct setting of the customer charge does allow for revenue stability and predictability.

Q. Do you agree with Joplin witness Ileo's aggregate of 25% for minimum bill percentage as discussed on pages 20 thru 24 of his Rebuttal Testimony"

A. No, I do not. Joplin witness Ileo states that 25% of total costs allocated to a minimum bill may lie on the high side in his experience. My experience with the regulated water and sewer company's under the jurisdiction of the Missouri Public Service Commission (Commission) indicates that it is common for a minimum bill percentage to be in the 30% to 45% range, with some exceeding 50%. Joplin witness Ileo's own Schedule MJ1-3 shows a range of 18.16% to 32.03% for six of MAWC's districts, with Joplin being the highest.

Q. Do you agree with Joplin witness Ileo's customer cost approach to revenue stability and predictability (RSP) objectives as described on page 24 of his rebuttal testimony?

A. No. MAWC's and Staff's approaches are not simplistic and inappropriate. The methodology used by MAWC and Staff is consistent with the AWWA M1 manual. Furthermore, the base-extra capacity method is an industry wide standard.

Q. Do you agree with Joplin witness Ileo's conclusion of the implications of the modeling and statistical procedures relating to cost-causation he discusses on page 26 of his rebuttal testimony?

A. No. The primary area of concern is Joplin witness Ileo's statement that by proceeding directly to RSP objectives without regard to customer cost calculations that the results are not truly reflective of cost-causation. Staff believes that the base-extra capacity method properly addresses cost-causation in the allocation of the costs to customer costs.

**<u>Michael Gorman</u>**

Q. Do you agree with Mr. Gorman's methodology used in his small mains adjustment?

A. No I do not. Rather I agree with Mr. Herbert's statements in his Rebuttal Testimony on page 5, lines 14 thru 16. The end result of Mr. Gorman's methodology results in a base cost allocation of 0.18%. My experience tells me this allocation is grossly understated by just looking at this number and that it should be rejected by the Commission.

Q. Do you agree with Mr. Gorman's Rebuttal Testimony on pages 3 and 4 that Staff's assessment of mains does not properly recognize that the Company manages its cost of service by installing Transmission mains to service all customers but installs smaller Distribution mains for the final distribution and connection to smaller customers and therefore Staff's allocation does not reflect cost-causation and is, therefore, flawed and inappropriate?

A. I agree that large users may be served directly off of Transmission and Distribution (T & D) mains 10" or larger, and that these large users may have service characteristics that show they should not be assigned costs related to smaller size T & D mains. However, other service characteristics, such as the length of the transmission main serving the class in relationship to the average system length, are implicit in the base-extra capacity method. I believe when such service characteristics exist a new service class needs to be created and the costs related to this class should be directly allocated.

Q. Do you agree with Mr. Gorman's Rebuttal Testimony on page 5, regarding Staff's development of Factor 6?

A. No. Mr. Gorman states that Staff's development of Allocation Factor 6 is flawed because Staff did not include a max-hour component in the allocation factor. Mr.

Gorman further states that pumping equipment investment is sized for max-hour and the expenses are increased due to max-hour conditions.

Staff does not agree because pumping costs are not sized. Pumping costs are what they are. Each pump has specific functions and specific costs associated with it.

Q. Does Staff agree with Mr. Gorman's statement that Staff inappropriately allocated customer-related expenses on the basis of total operating expenses rather than on the number of customers?

A. No I do not. Staff's CCOS study allocates customer-related expenses based on the number of meters.

**Brian C. Collins**

Q. Does Staff agree with Mr. Collin's recommendation to eliminate the subsidy from the St. Louis district?

A. The Staff believes subsidies are still necessary for the Brunswick water district and the Warren County and Cedar Hill sewer districts. Staff believes that if the Commission approves any subsidy for any of these districts that it makes the most sense for these subsidies to come out of the St. Louis district. The impact on the Saint Louis district is extremely small when the dollars are spread over the large number of customers residing in that district. In comparison, the impact on customers in the Jefferson City district or the Mexico district would be significant because of the much smaller customer base.

**Barbara A. Meisenheimer**

Q. Does Staff agree with Ms. Meisenheimer's statements on page 6 of her rebuttal testimony that Staff's proposal would result in huge shifts between classes and that she would support adjusting class revenues in each district by an equal percent?

A. Staff agrees that some customers may be subject to large increases. However, Staff believes its CCOS study is reflecting the actual cost for each class of customer in each district. Staff believes that the "global" settlements in at least the last two cases are part of the reason for these increases.

Q. Does Staff agree with Ms. Meisenheimer's proposed phase-in of rates?

A. Staff does not oppose Ms. Meisenheimer's proposed phase-in of rates for the Brunswick water district and the Warren County sewer district if no subsidies are given to those two districts. However, a phase-in and/or subsidy of the Warren County water district is not warranted in this case. Staff also believes that Ms. Meisenheimer's proposed phase-in is different from Staff's opposition to any phase-in of rates for the Joplin district. Presently, these districts are receiving a subsidy from the customers in the Saint Louis district. Staff's goal has been to eliminate these subsidies and a phase-in of rates will accomplish this goal. Also, the rate impact on the customers of these districts would be significant if the subsidies were eliminated and a phase-in of rates was not approved.

## Paul R. Herbert

Q. Does Staff agree with Mr. Hebert's allocation of distribution mains described in his Rebuttal Testimony?

A. The classification of mains as either transmission or distribution based only on their size is inaccurate. All transmission and distribution mains are used to transmit and distribute water to customers. The distinction between major transmission lines and local distribution lines is gray rather than distinct. In small utilities, a 6" main may be considered a part of the major transmission system. In a large utility, a 12" main may be considered a local distribution line. The main point in the distinction between transmission and distribution is based on function and is not based on size.

Q. Does Staff agree with Mr. Herberts's Rebuttal Testimony on page 8 that states:

> "…Staff's allocation of operation and maintenance expenses for mains is inconsistent with how Staff allocated rate base and depreciation expense for mains." and "This assumes that all operation and maintenance expenses are performed only on small mains and none on the larger mains, which is not logical."

A. This would be a correct statement if Staff had performed a small mains adjustment as other parties in this case have done, and, allocated operation and maintenance expenses in the same manor consistent with Staff's filing in this case. Staff did not allocate any of the operation and maintenance expenses in Factor 7 since Staff did not do a small main adjustment and did not perform a main functionalization. Staff's dilemma is how to allocate these expenses, particularly since Staff does not believe these expenses can be allocated based on main size alone. An example of this dilemma is that maintenance work on a 6" main located under pavement would very likely cost more than similar maintenance work on a 24" main in a vacant field.

Further, Staff's treatment of operation and maintenance expenses in Factor 7 does not mean Staff did not allocate these expenses. Staff's treatment of these expenses had the effect of all customers in all classes sharing these expenses equally. As a result, Mr. Herbert's statement that Staff's approach assumes all maintenance expenses result from work on small mains only is inaccurate.

Q. Do you agree with Mr. Herbert's exclusion of volumes and revenues associated with contract sales from the cost of service from all classes in proportion to the result of each class's cost of service?

A. No I do not. Staff has included the volumes and imputed the revenues associated with the contract sales in Staff's updated CCOS study filed with Rebuttal Testimony.

Q. Does Staff agree with Mr. Herbert's assessment of the estimated system-wide peak hour ratios used in the studies?

A. Yes, Staff did use non-coincident demands to estimate the peak hour factor. Staff also believes this is appropriate. The AWWA M1 manual states on page 52:

> "In the base-extra capacity method, cost must be carefully separated between base costs and extra capacity costs. The appropriate allocation factors between base and extra capacity usually vary among systems and should be determined on the basis of the actual operating history or design criteria for each system."

Staff believes that it is important to consider the operating history and the design criteria when developing the peak hour factor.

Q. Do you agree with Mr. Herbert's statement on pages 12 and 13 of his rebuttal testimony that uniform customer charges make sense because all customers have a service line and meter?

A. No I do not. Using one uniform customer charge ignores the results of the CCOS study and would shift cost responsibility between customers in each district. I believe customers in each district should be responsible for the recovery of their specific-allocated customer charge costs. In addition, Mr. Herbert ignores the fact that both the Company and the Staff developed customer charge related costs for each district. The Company's and Staff's results show that the customer charge for each district is different. The bottom line is the customer charge will and should be different for each district based on the results of any of the filed CCOS studies.

Q. Does Staff agree with Mr. Herbert's statement on page 13 of his rebuttal testimony that it is appropriate and justified from a cost standpoint for larger customers with favorable load factors to pay less per unit as their volumes increase?

A. Staff believes single block rates are appropriate. Staff also believes that the advantages of single block rates outweigh any advantages of a declining block rate. Single block rates allow for simplicity, equity, revenue stability, and conservation. Simple from the standpoint that single block rates are easy for the customer to understand. Equitable because all customers in the class pay the same unit price for water regardless of their usage. Revenue stability when compared to other complex rate design. Uniform rates encourage conservation because a customer knows his bill will vary with the amount of water usage. However, Staff agrees that Mr. Herbert's methodology is an option in developing volumetric rates with the caveat that the tail block cannot be below the cost of water as determined by the base-extra capacity method.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes, it does.