

Exhibit No.: *AGP03*
Issue: Rate Design
Witness: Donald Johnstone
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: AGP
Case Number: WR-2011-0337
Date Prepared: February 2, 2012

FILED
March 8, 2012
Data Center
Missouri Public
Service Commission

**Missouri American Water Company
WR-2011-0337**

Surrebuttal Testimony of

Donald E. Johnstone

on behalf of

AG PROCESSING INC, A COOPERATIVE

February, 2012



AGP Exhibit No. 3
Date 2-21-12 Reporter JL
File No. WR-2011-0337

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-2011-0337
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.

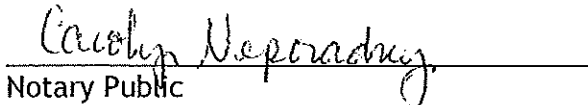
2. Attached hereto and made a part hereof for all purposes is my testimony in written form for introduction into evidence in the above captioned proceeding.

3. I hereby swear and affirm that my testimony is true and correct and shows the matters and things it purports to show.



Donald E. Johnstone

Subscribed and sworn to this 2nd day of February, 2012.



Notary Public



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

Missouri American Water Company

WR-2011-0337

Surrebuttal Testimony of Donald E. Johnstone

TABLE OF CONTENTS

INTRODUCTION 1
SUMMARY OF TESTIMONY AND RECOMMENDATIONS..... 2
SUMMARY OF DR. MCDERMOTT’S REBUTTAL 3
RESPONSE TO DR. MCDERMOTT’S REBUTTAL TESTIMONY 4
RESPONSE TO MR. HERBERT’S REBUTTAL TESTIMONY 7

1 Missouri American Water Company

2
3 WR-2011-0337

4
5 Surrebuttal Testimony of Donald E. Johnstone
6

7 **INTRODUCTION**

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

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

10 **Q ARE YOU THE SAME DONALD JOHNSTONE THAT SUBMITTED DIRECT AND REBUTTAL**
11 **TESTIMONIES IN THIS PROCEEDING?**

12 **A** I previously submitted rate design direct and rebuttal testimonies in this docket.

13 **Q PLEASE PROVIDE AN OVERVIEW OF YOUR TESTIMONY.**

14 **A** As explained in my earlier direct testimony, the rates for MAWC water service in each
15 district should reflect the cost of the water services provided in each district for each
16 rate class for the reasons set forth in that testimony. In my rebuttal testimony I
17 responded to the proposal of the Staff to create what are characterized as "Hybrid"
18 districts. A part of my response was a counterproposal that would group the smaller
19 districts according to cost/price, thereby consolidating while preserving a cost basis
20 for the rates charged.

21 In this surrebuttal testimony I respond to the MAWC testimonies of Dr.
22 McDermott on the matter of MAWC's consolidated tariff proposal and Mr. Herbert's
23 testimony regarding rate design.

24 I am aware that several parties address revenue requirements issues. Silence
25 on any issue at this time should not be construed as either support or opposition.

1 **SUMMARY OF TESTIMONY AND RECOMMENDATIONS**

2 Q GIVEN DR. MCDERMOTT’S REBUTTAL TO THE PARTIES OPPOSING THE MAWC
3 CONSOLIDATED TARIFF PROPOSAL, WOULD YOU PLEASE PROVIDE A SUMMARY OF
4 YOUR SURREBUTTAL OF DR. MCDERMOTT?

5 A

- 6 • Dr. McDermott would have the Commission turn away from the reality of
7 present rates and the history of district-specific costs, revenue requirements
8 and rates.
- 9 • Dr. McDermott criticizes accounting costs and several analyses submitted on
10 behalf of Staff, OPC, MIEC, and AGP that document wide cost variations among
11 districts. The criticisms ignore that these same types of costs are the basis for
12 rates presumed to be just and reasonable.
- 13 • Dr. McDermott talks about “economic costs” and “marginal costs” that he
14 would have the Commission use to rationalize the consolidated tariff proposal.
15 While providing no study of MAWC economic or marginal costs, he asserts that
16 marginal costs are similar among the districts. However, he fails to reconcile
17 any marginal costs with the embedded accounting costs that form the revenue
18 requirement, and he provides no determination of marginal costs for MAWC, for
19 the districts, or for the customer classes.
- 20 • Dr. McDermott disputes the longstanding practice of setting rates based on
21 allocations of accounting costs, with such rates being consistent with just and
22 reasonable rates devoid of undue discrimination or disadvantage or preference
23 for any locality.

24 Q PLEASE PROVIDE A SUMMARY OF YOUR SURREBUTTAL OF MR. HERBERT.

25 A

- 26 • Mr. Herbert complains that I did not do an analysis that he suggests would lead
27 to a recommendation of a rate that would be the same or similar for small
28 commercial customers and small industrial customers.
- 29 • Given an appropriate analysis and a timely proposal by MAWC to change the
30 design of rates for the St. Joseph District (in a future proceeding), I would
31 recommend to my client a full review and response. However, in this
32 proceeding MAWC has no such proposal and I stand by my recommendation for
33 an equal percentage increase to all rates in the St. Joseph District.

1 SUMMARY OF DR. MCDERMOTT'S REBUTTAL

2 Q PLEASE SUMMARIZE DR. MCDERMOTT'S REBUTTAL ON THE SUBJECT OF A
3 CONSOLIDATED TARIFF.

4 A MAWC witness Dr. McDermott in his direct testimony supported MAWC's consolidated
5 tariff proposal and has now offered rebuttal testimony critical of the several
6 testimonies that stand in opposition to the MAWC consolidated tariff proposal. More
7 specifically, he was critical of testimonies submitted by Staff witness Busch, OPC
8 witness Meisenheimer, MIEC witness Gorman, and myself for AGP. As a part of his
9 criticisms, Dr. McDermott makes numerous references to marginal costs, although he
10 offers no study in which marginal costs are quantified for MAWC, for any of the
11 districts separately, or for customer classes across and within districts.

12 Dr. McDermott is critical of virtually every effort to compare costs across the
13 districts. However, he admits that ". . .it sounds reasonable to suggest that if a new
14 water treatment plant is built for a particular district, those customers should pay for
15 that plant. . ." From this admission he goes on to assert: "that conclusion is not based
16 on economic principles, **it is based on regulatory concepts of cost-causation and**
17 **fairness.**"[emphasis supplied] He then rejects the apparent cost-causation and argues
18 that having other districts pay the cost under consolidated tariff pricing would provide
19 a "fairer mechanism." (McDermott Rebuttal, p. 13, l. 285-289) After his rejection of
20 the longstanding regulatory principles of cost causation and fairness he continues to be
21 in support of the proposed consolidated tariff pricing scheme. He sets about the task
22 of attempting to undermine the analyses of parties that proceed from the regulatory
23 concepts of cost-causation and fairness. However, he offers no "economic" cost
24 study, no "marginal" cost study, no quantification of MAWC economic or marginal cost
25 similarities or differences between and among districts or customer classes.

1 **RESPONSE TO DR. MCDERMOTT'S REBUTTAL TESTIMONY**

2 Q DOES DR. MCDERMOTT ACKNOWLEDGE THE USE OF ACCOUNTING COSTS TO
3 DETERMINE THE ALLOWED REVENUE REQUIREMENT OF MAWC IN A RATE CASE?

4 A Yes. He does not deny that accounting costs must be used to determine the revenue
5 requirement. Nor does he deny that some of those accounting costs are the result of
6 accounting costs incurred elsewhere, but then allocated to the jurisdiction.

7 As a matter of fact, accounting costs and allocations of such costs are the
8 essence of the revenue requirement as determined in a rate case.

9 Q ARE THE PRESENT RATES OF MAWC BASED ON THE COST OF SERVICE AS DEFINED BY
10 ACCOUNTING COSTS?

11 A The answer to this question is yes, and the explanation fundamentally has two parts.
12 The first part goes to the revenue requirement for each district. The second part goes
13 to the rates within each district that are designed to collect the revenue requirement.

14 In all recent cases the Staff developed a revenue requirement for the company
15 in total that was the sum of the revenue requirements of the districts. The costs that
16 comprised the revenue requirements in all cases were accounting costs. Some were
17 incurred locally while others were not local, but were incurred outside of the districts
18 and became a district cost via a cost allocation. At yet another level, some costs were
19 incurred outside of the jurisdiction and became a jurisdictional cost via a cost
20 allocation. In every instance, it was the sum of such accounting costs and a return on
21 rate base that comprised revenue requirements.

22 Then, once the revenue requirement of each district was determined based on
23 accounting costs and return, rates in each district were designed to collect the
24 allowed accounting costs and return. In all recent cases there have been several class

1 cost-of-service studies that have informed the design of the rates that were approved
2 by the Commission.

3 In the final analysis the present rates, for most purposes, reflect the
4 accounting costs and return allowed by the Commission in WR-2010-0337.

5 There is one caveat - MAWC acquired new service territories after the last rate
6 case. The rates for customers in the acquired service areas simply were not a part of
7 costs, rates, or revenues in the last case, and could not have been. They will,
8 however, be a part of this and future rate cases.

9 **Q WHY ARE THESE FACTS ARISING IN SURREBUTTAL TESTIMONY?**

10 A Dr. McDermott would have the Commission ignore, or at least greatly minimize the
11 weight, of evidence that proceeds from analyses of the accounting costs that have
12 been presented by several parties. I disagree.

13 **Q WHY DO YOU DISAGREE?**

14 A The accounting costs that comprise the MAWC revenue requirement are the essence of
15 the rate case and constitute the reality of the costs that will form the revenue
16 requirement and the "rate increase." Moreover, rates will necessarily be designed to
17 collect these costs and the "rate increase." To denigrate the importance of these
18 accounting costs is to depart from the reality of the rate case.

19 **Q DOES DR. MCDERMOTT INTRODUCE MARGINAL COSTS AS A MATTER FOR**
20 **CONSIDERATION BY THE COMMISSION?**

21 A Yes and no.

22 The answer is yes in that he opines that accounting costs are of no importance

1 in an “economic” sense. According to Dr. McDermott, the world would presumably be
2 operate more equitably and efficiently if rates were based on marginal costs instead
3 of accounting costs. While he provides no study of the level of marginal costs (no
4 studies of MAWC, district, or class marginal costs) he nevertheless asserts that
5 marginal costs, whatever their actual value, ought to be relied on to rationalize the
6 MAWC consolidated tariff proposal.

7 The “no” part of my answer arises because there are no marginal cost
8 numbers. Instead, Dr. McDermott merely assumes or asserts results for the marginal
9 costs. Nor does he suggest that MAWC should recover the marginal costs as the
10 revenue requirement. He provides no bridge from his theories to the costs that must
11 be recovered. Nevertheless, it seems that at every step he finds ways to be critical of
12 the work of the parties so that he can fall back to his incomplete analysis of marginal
13 costs as a basis for the MAWC consolidated tariff proposal.

14 **Q ARE THE EXISTING DISTRICT-SPECIFIC RATES OF MAWC UNJUST OR UNREASONABLE?**

15 **A** The existing rates reflect accounting costs, allocations of those costs to the
16 jurisdiction, to the districts, and to the classes, and a design of rates that was
17 approved by the Commission. While I am not a lawyer and offer no legal opinion, the
18 current rates, by my understanding, have followed a process that is consistent with
19 the manner in which just and reasonable rates are determined in Missouri. Thus, my
20 answer as a rate analyst is that existing district-specific rates are entitled to a
21 presumption that they are just and reasonable.

1 Q IN THIS RATE CASE IS THERE A PROCESS FOR DETERMINING THE MAWC REVENUE
2 REQUIREMENT AND RATE INCREASE THAT WILL AGAIN RELY ON ACCOUNTING
3 COSTS?

4 A Yes. The underlying Staff process is the same. Staff determined the revenue
5 requirement and rate increase for each district based on accounting costs and
6 allocations of those costs, and of course a return on rate base.

7 Q ARE THERE AGAIN WIDE VARIATIONS IN COSTS AMONG THE DISTRICTS IN THIS RATE
8 CASE?

9 A Yes. The wide variations have been illustrated in several ways by several witnesses.
10 On the other hand, there is no study that would support the conclusion that the wide
11 variations in present rates were a mistake. While Dr. McDermott alleges that
12 “economic” and/or “marginal” costs are similar across districts, no study has been
13 submitted to provide evidence that even this subset of costs that are important to Dr.
14 McDermott are the same across districts and customer classes.

15 **RESPONSE TO MR. HERBERT’S REBUTTAL TESTIMONY**

16 Q HAVE YOU REVIEWED THE REBUTTAL TESTIMONY OF MAWC WITNESS HERBERT?

17 A Yes. Mr. Herbert complains that I did not recommend a rate that would be the same
18 or similar for small commercial customers and small industrial customers.

19 Q HAVE YOU ADDRESSED THIS ISSUE IN PAST MAWC CASES?

20 A In past cases, among other things, I testified in support of a single rate schedule
21 applicable for commercial and industrial customers, consistent with the principle that
22 rates for customers with similar usage characteristics should be the same. I did not

1 prevail. In this case I did not contest the presumption of the present rates as just and
2 reasonable, and did not undertake the burden of demonstrating the need for any
3 improvement, including the one belatedly suggested by Mr. Herbert.

4 **Q DO YOU ACKNOWLEDGE MR. HERBERT'S POINT TO THE EXTENT THAT HE IS**
5 **SUGGESTING THAT SIMILARLY SITUATED CUSTOMERS WITH SIMILAR USAGE**
6 **CHARACTERISTICS SHOULD PAY THE SAME RATE?**

7 A Yes. Given a timely proposal by MAWC to improve the design of rates for the St.
8 Joseph District (in a future proceeding), I would recommend to my client a full review
9 and response. The first task would be to test the usage characteristics of the groups
10 to determine if they are indeed similar, or not. That has not been done. Also, at this
11 point there is no MAWC proposal to change the design of the rates for the St. Joseph
12 District. MAWC proposes only its consolidated tariff. I stand by my recommendation
13 of an equal percentage increase to each of the rates for the St. Joseph District.

14 **Q DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

15 A Yes it does.