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Rate Design
Donald E. Johnstone
Rebuttal Testimony
AGP
WR-2010-0131
May 6, 2010

Missouri American Water Company
WR-2010-0131

Surrebuttal Testimony of

Donald E. Johnstone

on behalf of the

AG PROCESSING INC A COOPERATIVE



Missouri American Water Company
WR-2010-0131

Surrebuttal Testimony of Donald E. Johnstone

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Missouri American Water Company

WR-2010-0131

Surrebuttal Testimony of Donald E. Johnstone

1 INTRODUCTION

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 ARE YOU THE SAME DONALD JOHNSTONE THAT PREVIOUSLY SUBMITTED TESTIMONY
5 IN THIS CASE?

6 A Yes. My qualifications and experience are set forth in Schedule 1 attached to my
7 testimony that was submitted March 9, 2010.

8 Q ON WHOSE BEHALF ARE YOU APPEARING?

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

11 REVIEW OF MAWC REBUTTAL TESTIMONY

12 Q HAVE YOU REVIEWED MR. HERBERT'S CLASS COST OF SERVICE AND RATE DESIGN
13 REBUTTAL TESTIMONY ON BEHALF OF MAWC?

14 A Yes. I find areas of agreement and areas of disagreement in matters pertaining to the
15 industrial rate for Saint Joseph District.

16 Q ON WHAT POINTS DO YOU AGREE?

17 A I agree that rates should reflect the full allocated cost of service as a first principle.

1 Of course, other factors are also appropriately considered. For example,
2 considerations such as economic development, discrimination, understandability,
3 customer acceptance, and impact are also relevant, to a greater or lesser extent,
4 depending on the circumstances.

5 Q ON WHAT POINTS DO YOU DISAGREE?

6 A He disagrees with certain allocation approaches and disagrees with my
7 recommendation for an equal percentage adjustment to the current rate
8 design.

9 TREATMENT OF TRIUMPH SPECIAL CONTRACT

10 Q IS THE SPECIAL CONTRACT RATE FOR TRIUMPH ADDRESSED IN REBUTTAL
11 TESTIMONIES?

12 A Yes. It is addressed by Ms. Meisenheimer for OPC, Mr. Russo for Staff, Mr. Gorman for
13 Triumph and Mr. Herbert for MAWC. Ms. Meisenheimer asserts that the contract is ripe
14 for review while Mr. Russo asserts that it is not. Ms. Meisenheimer further suggests
15 that the current contract terms can result in additional rate increases to the tariff
16 customers if the contribution to the margin does not keep pace with other cost
17 increases.

18 Q PLEASE COMMENT ON THE OPC OPINIONS.

19 A The data I have reviewed show reduced rates for Triumph beginning in 2004,
20 apparently pursuant to the contract. That suggests that five years have elapsed and
21 that the contract may be reviewed. Given a review, I agree with the concern raised
22 by OPC that the contract, in its present form, could result in reduced margin

1 contributions, thereby increasing rates from other customers if they are asked to make
2 up the difference created by the reduction in the margin. This is a problem that may
3 be addressed within the framework of the current contract structure. As suggested by
4 OPC, the contract could be modified in order to maintain the margin, while at the
5 same time preserving a very substantial benefit for Triumph as compared to the
6 standard rates.

7 Q DO YOU UNDERSTAND AND SUPPORT THE NOTION OF ECONOMIC DEVELOPMENT
8 AND, IN APPROPRIATE CIRCUMSTANCES, RATES FOR WATER SERVICE THAT WILL
9 FACILITATE ECONOMIC DEVELOPMENT?

10 A Yes. My client operates in a competitive industry and appreciates the fact that all
11 costs are important. Water costs are no exception. It follows that it is important to
12 structure any special contracts in a way that will not disadvantage standard tariff
13 customers that face competitive pressures of their own, including AGP.

14 Q HOW DID STAFF ADDRESS THE CONCERNS AND INTERESTS OF INDUSTRIAL
15 CUSTOMERS IN THE CONTEXT OF THE TRIUMPH SPECIAL CONTRACT?

16 A Mr. Russo in his rebuttal explained his intent to provide the industrial class with the
17 benefit of the contribution of the Triumph contract to the St. Joseph District. He
18 reasons that this will benefit the other industrial customers while the increased
19 economic activity will result in additional residential and commercial customers, with
20 benefits redounding to those classes as a result. I agree with his reasoning.

21 Q IS THERE ADDITIONAL LOGIC IN SUPPORT OF THE MR. RUSSO'S RECOMMENDATION?

22 A Yes. It has been my experience that costs are important to many large industrial
23 customers, and AGP is no exception. Certainly large industrial customers as a group

1 offer economic benefits because they produce products with local inputs that can then
2 be sold outside of the service area, while producing the local benefits of jobs, taxes,
3 and all of the attendant economic benefits. Indeed all of the economic benefits
4 produced by Triumph are also produced by other large industrial customers; it is
5 simply a matter of degree. I have often testified as to these benefits and the
6 importance of maintaining industrial rates for utility services that are no higher than
7 the cost of service.

8 Q DOES MR. RUSSO'S PROPOSAL FURTHER THE GOALS OF ECONOMIC DEVELOPMENT?

9 A Yes. He recommends cost-based rates combined with a beneficial application of the
10 Triumph contribution to the system in a way that has many benefits, including the
11 promotion of additional economic development.

12 Q DO YOU SUGGEST ANY ADJUSTMENT TO MR. RUSSO'S APPROACH TO THE TRIUMPH
13 TREATMENT?

14 A Yes. The variable costs should be explicitly addressed to ensure Triumph alone pays
15 those costs. Once that is accomplished the benefits should flow as envisioned by Mr.
16 Russo.

17 Q DOES YOUR SUPPORT OF MR. RUSSO'S APPROACH TO TRIUMPH, AS ADJUSTED,
18 ADDRESS THE SEVERAL OTHER CONCERNS WITH STAFF'S CLASS COST-OF-SERVICE
19 STUDY APPROACH THAT YOU ADDRESS IN EARLIER TESTIMONY?

20 A No. Those concerns remain.

1 Q HAVE YOU MODIFIED YOUR CLASS COST-OF-SERVICE STUDY TO INCORPORATE
2 STAFF'S APPROACH TO TRIUMPH WHICH YOU NOW SUPPORT?

3 A Yes. The study is attached as Schedule Surrebuttal DEJ-1.

4 Q DO YOU HAVE ANY COMMENT ON THE OPC ANALYSIS OF THE TRIUMPH SPECIAL
5 CONTRACT?

6 A Yes. Assuming the Commission finds that a continuation of the contract is otherwise
7 appropriate, I recommend a clarification of the pricing to ensure that the margin rate
8 preserves the intended benefit to the remainder of the system regardless of changes in
9 the variable cost of the service. I recommend a rate equal to the variable cost of the
10 service provided plus a margin component that would track inflation. This will
11 maintain the intended equities. For example, if over a period of time there is general
12 inflation of 10%, it is appropriate to increase the Triumph margin rate in a
13 substantially similar way. With this approach other customers will not have their rate
14 going up to compensate for a relatively smaller margin contribution by Triumph.

15 RATE DESIGN

16 Q DOES MR. RUSSO CONTINUE TO SUPPORT A FLAT COMMODITY RATE FOR THE
17 INDUSTRIAL CLASS?

18 A Yes. He apparently assumes that all industrial customers have somewhat similar cost-
19 causing usage characteristics and then supports a flat rate in the name of
20 conservation.

21 Q ARE THERE IMPORTANT DIFFERENCES IN THE CUSTOMERS CHARACTERIZED AS
22 INDUSTRIAL?

23 A Yes. The most obvious is size. There are small industrial customers that are served by

1 the same ¾" meters that serve residential and commercial customers. There are also
2 industrial customers served by 1" meters. There is no evidence that these small
3 customers, while nominally residential, commercial, or industrial, impose different
4 costs on the system, yet the small industrial customers would pay a lower rate. Mr.
5 Russo's approach, without analytical support, implicitly assumes the usage
6 characteristics of small customers classified as industrial are the same as the usage
7 characteristics for large industrial customers with respect to maximum day ratios and
8 maximum hour ratios as the larger customers.

9 Q ARE THE RATES THE SAME FOR ALL SMALL CUSTOMERS PRESENTLY?

10 A No. While I have in past cases supported a uniform declining block rate structure
11 across rate classes, in the context of past settlements, AGP determined to defer to
12 parties with a more direct interest in the other classes. Nevertheless, the fact
13 remains that there is no documented difference in cost imposed by smaller customers
14 of a similar size, regardless of "customer class." The point I am making is that a
15 customer connected with a ¾" meter does not impose different costs on the system
16 simply because the Company classifies the customer as either commercial or
17 industrial. As explained in my earlier testimonies, load and usage assumptions are just
18 that, assumptions; there are no load research facts to support the differences.

19 Q PLEASE SUMMARIZE THE POINT YOU ARE MAKING.

20 A Size matters in several respects. Among other things, the average customer size
21 varies among customer classes. That is a consideration that results in a lower average
22 rate for classes with larger customers, but it does not follow that the small customers
23 in a class with larger customers, i.e. the industrial class, cause costs any differently

1 than another class, i.e. the commercial class. Staff's flat rate proposal misses this
2 important consideration and as a consequence would shift benefits created by larger
3 industrial customers to smaller industrial customers.

4 **Q TURNING NOW TO MR. HERBERT, IS HE CORRECT THAT YOUR PROPOSAL WOULD**
5 **PRODUCE A TAIL BLOCK RATE THAT IS TOO LOW?**

6 **A** No. Mr. Herbert asserts that an equal percentage adjustment to the present industrial
7 rate is unjust because the tail block rate would be below the base cost he derived.
8 That base cost was based on overall district costs that reflect the full rate increase
9 proposed by MAWC, notwithstanding the fact that other parties are in disagreement
10 with the proposed cost and rate level. Consequently it will be on the high side.

11 Mr. Herbert's rebuttal creates a conundrum beyond his rebuttal point relative
12 to the base cost of water. By his testimony, his base cost of water is the lowest rate
13 that can be found to be just. How then can a customer like Triumph, located just
14 down the road from other industrial customers, be served under a rate that is much
15 lower not just in the tail block, but in every block? In fact, there are no blocks in the
16 Triumph rate, so every gallon is sold at a price below the lowest that is "just"
17 according to Mr. Herbert.

18 **Q CAN THE EXISTING INDUSTRIAL RATES AND THE TRIUMPH RATE BE JUST IF THEY**
19 **ARE BELOW THE BASE COST OF WATER?**

20 **A** The simple answer is yes. First, the Commission has said so. Second, there is the
21 economic development rationale in support. Third, competitive cost pressures are not
22 limited to Triumph. Fourth is the matter of discrimination between and among
23 Triumph and the larger customers served under the industrial rate. Discrimination is

1 at least mitigated to the extent that the tail block is held down for the larger
2 customers in the industrial class.

3 I continue to recommend an equal percentage adjustment to the industrial rate
4 design.

5 Q DOES THIS CONCLUDE YOUR TESTIMONY?

6 A Yes it does.

**MISSOURI-AMERICAN WATER COMPANY
ST. JOSEPH DISTRICT
AGP CLASS COST OF SERVICE STUDY**

BASED ON STAFF \$267,611 INCREASE FOR THE DISTRICT
SPECIAL CONTRACT INCREMENTAL COST CREDIT ALLOCATED AMONG CUSTOMER CLASSES
SPECIAL CONTRACT MARGIN ASSIGNED TO THE INDUSTRIAL CLASS

Line No.	Customer Classification (1)	Cost of Service				Revenues, Present Rates (6)	Cost-Based Rate Increase	
		Amount (2)	Credit Special Contract Incremental Cost (3)	Credit Special Contract Margin (4)	Total (5)		Amount (8)	Percent (9)
1	Residential	\$ 11,718,041	(131,316)	\$ -	\$11,586,725	\$10,230,105	\$1,356,620	13.3%
2	Commercial	3,606,580	(69,680)	-	3,536,900	3,936,426	(399,526)	-10.1%
3	Industrial	3,022,870	(93,173)	(428,713)	2,500,983	3,015,768	(514,785)	-17.1%
4	Special Contracts	-	376,364	428,713	805,077	805,077	-	
5	Public Authority	715,787	(15,228)	-	700,559	769,745	(69,186)	-9.0%
6	Sales for Resale	1,946,142	(65,842)	-	1,880,300	2,033,205	(152,905)	-7.5%
7	Private Fire Service	272,907	(1,126)	-	271,782	250,061	21,721	8.7%
8	Public Fire Service	-	-	-	-	-	-	-
9	Total Rate Revenue	\$ 21,282,326	-	-	\$21,282,326	\$21,040,387	\$ 241,939	1.1%
10	Other Revenues	282,389	-	-	282,389	256,717	25,672	10.0%
11	Total Operating Revenue	<u>\$ 21,564,715</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$21,564,715</u>	<u>\$21,297,104</u>	<u>\$ 267,611</u>	1.3%

Adjustments

- No Special Contracts class in allocation study
- Allocate Special Contracts incremental cost credit among classes and assign cost to contracts
- Assign Special Contracts margin to industrial class and assign cost to contracts
- Review and adjust A&G allocations
- Adjust class allocations to be consistent with corporate allocation to district
- Factors 2 & 3 Maximum Day Weight factor: Industrial = 0.5
- Adjustment to Factors 4 & 5 Maximum Hour Weight factor: Industrial = 1.0
- A 10% increase is assumed for miscellaneous charges.
- Adjust present class revenues to match Staff March 24, 2010 revision

Note: The \$267,611 increase is equal to \$195,169 (the Staff midpoint before true-up as filed March 9) plus \$72,442 to accommodate the March 24 Staff revision to present operating revenue.

**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

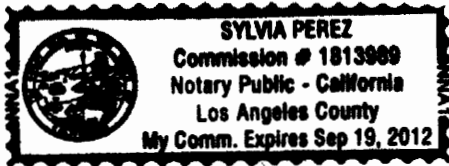
State of California)
) SS
County of Los Angeles)

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 6 day of May, 2010.




Notary Public

Competitive Energy
DYNAMICS