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December 5, 2003

BY HAND DELIVERY

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
Governor Office Building
St. Louis, Missouri 63101

FILED

DEC 05 2003

**Missouri Public
Service Commission**

Re: Case No. WR-2003-0500

Dear Mr. Roberts:

Enclosed for filing are an original and eight (8) copies of *Supplemental Surrebuttal Testimony of Michael Gorman on behalf of Missouri Industrial Energy Consumers* to be filed in the above case.

Thank you for your assistance in bringing this filing to the attention of the Commission.

Very truly yours,

Diana M. Vuylsteke

DMV: lea
Enclosures
cc: All parties

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*And Bryan Cave,
A Multinational Partnership,
London*

Exhibit No.
Witness: Michael Gorman
Type of Exhibit: Supplemental Surrebuttal Testimony
Sponsoring Party: MIEC
Subjects: Cost of Service and Rate Design
Date: December 5, 2003

**BEFORE THE
PUBLIC SERVICE COMMISSION OF MISSOURI**

In the Matter of Missouri-American Water)
Company for Authority to File Tariffs) Case No. WR-2003-0500
Reflecting Increased Rates for Water and)
Sewer Service.)

FILED

Supplemental Surrebuttal Testimony of

DEC 05 2003

Michael Gorman

Missouri Public
Service Commission

On behalf of

Missouri Industrial Energy Consumers

December 5, 2003
Project 8027



BRUBAKER & ASSOCIATES, INC.
ST. LOUIS, MO 63141-2000

**BEFORE THE
PUBLIC SERVICE COMMISSION OF MISSOURI**

In the Matter of Missouri-American Water)	
Company for Authority to File Tariffs)	Case No. WR-2003-0500
Reflecting Increased Rates for Water and)	
Sewer Service.)	

Affidavit of Michael Gorman

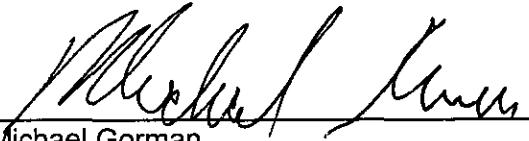
STATE OF MISSOURI)
) **SS**
COUNTY OF ST. LOUIS)

Michael Gorman, being first duly sworn, on his oath states:

1. My name is Michael Gorman. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000. We have been retained by the Missouri Industrial Energy Consumers in this proceeding on their behalf.

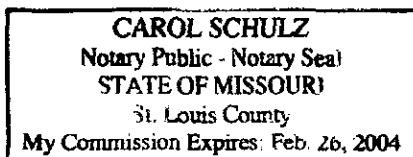
2. Attached hereto and made a part hereof for all purposes is my supplemental surrebuttal testimony which was prepared in written form for introduction into evidence in the WR-2003-0500 Proceeding.

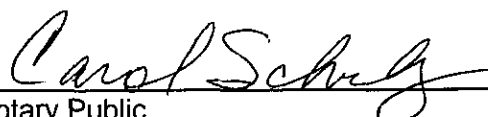
3. I hereby swear and affirm that the supplemental surrebuttal testimony is true and correct and shows the matters and things it purports to show.



Michael Gorman

Subscribed and sworn before this 4th day of December, 2003.





Notary Public

My Commission expires on February 26, 2004.

**BEFORE THE
PUBLIC SERVICE COMMISSION OF MISSOURI**

In the Matter of Missouri-American Water)	
Company for Authority to File Tariffs)	Case No. WR-2003-0500
Reflecting Increased Rates for Water and)	
Sewer Service.)	

Supplemental Surrebuttal Testimony of Michael Gorman

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

2 **A My name is Michael Gorman and my business address is 1215 Fern Ridge Parkway,**
3 **Suite 208, St. Louis, MO 63141-2000.**

4 **Q HAVE YOU PREVIOUSLY OFFERED TESTIMONY IN THIS PROCEEDING ON**
5 **BEHALF OF THE MISSOURI INDUSTRIAL ENERGY CONSUMERS (MIEC)?**

6 **A Yes, I have.**

7 **Q WHAT IS THE SUBJECT OF YOUR SUPPLEMENTAL SURREBUTTAL TESTIMONY?**

A In my supplemental surrebuttal testimony I will respond to Staff witness Hubbs' rebuttal
 testimony, OPC witness Busch's rebuttal testimony, and MAWC witnesses Grubbs and
 Jenkins' rebuttal testimonies.

8 **Mr. Hubbs' Rebuttal Testimony**

9 **Q PLEASE SUMMARIZE YOUR POSITION CONCERNING MR. HUBBS' CRITICISMS**
10 **OF THE COMPANY'S AND YOUR COST OF SERVICE STUDY METHOD OF**
11 **ALLOCATING SMALL MAINS COSTS AMONG CUSTOMERS.**

**Michael Gorman
Page 1**

1 A My response to Mr. Hubbs' position on small main allocation is summarized as follows:

2 • Mr. Hubbs appears to agree that small main costs should not be allocated to
3 customers that do not use those facilities. However, Mr. Hubbs believes that Rate J
4 customers should be subdivided into two subclasses, one consisting of customers
5 that take service directly off large mains, and another group that takes service off
6 smaller mains.

7 • If such subclasses were developed, Mr. Hubbs appears to be of the position that it
8 would be appropriate to assign the cost of small mains only to customers that use
9 the small mains.

10 • While Mr. Hubbs agrees that customers who do not use small mains should not pay
11 for them, he nevertheless ignores this relationship and makes no attempt to properly
12 allocate the cost of small mains among customer classes in his cost of service
13 (COS) study.

14 • Further, Mr. Hubbs also acknowledges that the base extra capacity methodology
15 can accommodate the objective of assigning facilities costs to only those customer
16 that use them. Therefore, while Mr. Hubbs acknowledges the appropriateness of
17 proper cost assignment, and acknowledges a base extra capacity method can be
18 adjusted to accommodate proper cost of service separation, he fails to offer a COS
19 analysis that properly assigns costs among rate schedules.

20 • Properly assigning an amount of small mains costs to Rate J customers, and
21 spreading that cost among all customers in the Rate J class is the most reasonable
22 means of spreading the cost among the customer classifications and rate schedules
23 proposed by the Company, and by Mr. Hubbs, and previously approved by the
24 Missouri Public Service Commission in the last St. Louis district rate proceeding.
25 Mr. Hubbs has offered no valid reason to deviate from this accepted COS
26 methodology.

27 Q PLEASE DESCRIBE THE ISSUES MR. HUBBS RAISES TO WHICH YOU WILL
28 RESPOND.

29 A Mr. Hubbs is critical of Missouri-American Water Company (MAWC) witness Herbert's
30 COS study. Mr. Hubbs asserts that the Company's method of assigning the cost of
31 small mains and large mains to the customer classes that actually use these facilities is
32 inappropriate. Company witness Herbert made this distinction in an adjustment to
33 Factor 4 used in his COS study. Factor 4 is a maximum hour allocator and is used to
34 allocate the capital cost of small mains between customer classes. Mr. Herbert defines

1 small mains as those mains whose diameters are less than 10 inches. Mr. Hubbs also
2 takes issue with Mr. Herbert's method of allocating the O&M costs for small mains and
3 large distribution pipes between customer classes.

4 **Q DOES MR. HUBBS CONTEND IT IS INAPPROPRIATE TO ASSIGN THE COST OF**
5 **SMALL MAINS TO ONLY THOSE CUSTOMERS FOR WHICH THESE FACILITIES**
6 **ARE USED TO PROVIDE SERVICE?**

7 A Apparently not. In fact, Mr. Hubbs argues that if separate rate classes are developed
8 that are distinguished based on the main size that serves them, such an allocation would
9 be appropriate (Hubbs Rebuttal at 5 and 6). Absent such a definition of classes,
10 however, Mr. Hubbs apparently believes it is not appropriate to develop a COS study
11 that allocates MAWC's costs to each of its existing rate schedule classifications in a
12 manner that best reflects cost causation.

13 **Q DO YOU AGREE WITH MR. HUBBS' POSITION ON ALLOCATING SMALL MAIN**
14 **COSTS?**

15 A. No. I strongly disagree with Mr. Hubbs on this position. MAWC witness Mr. Herbert
16 undertook a study that identified the specific facilities MAWC uses for serving its Rate J
17 and wholesale customers in the St. Louis, Joplin and St. Joseph Districts. Mr. Herbert's
18 cost study, with the few adjustments I recommended in my testimony, best represents
19 MAWC's costs for serving each of its rate classes.

20 While Mr. Hubbs acknowledges that it would be appropriate for customers to pay
21 for the cost of only the facilities that are used to provide them service, he nevertheless
22 ignores the obvious and clear distinction that these large customers in these classes
23 (Rate J and wholesale) who take service from large mains do not receive service from

1 MAWC's small distribution mains. Therefore, the classes in which the large customers
2 reside should not pay for the cost of the smaller distribution mains that are not used.
3 Rather, the cost of the smaller distribution mains should be allocated only to MAWC's
4 customers that actually use them.

5 **Q DOSE MR. HUBBS' PROPOSAL AFFECT MAWC'S ABILITY TO BE A COMPETITIVE**
6 **SUPPLIER TO ITS CUSTOMERS IN THE ST. LOUIS DISTRICT?**

7 **A** Yes. The rates MAWC charges its larger customers reflect the best estimates of its
8 costs of actually serving those customers. Including costs for facilities that are not used
9 in providing service to these large customers, as Mr. Hubbs proposes, will unnecessarily
10 increase rates to these customers and cause them to more aggressively consider
11 alternatives to MAWC supply. Because these customers pay a portion of MAWC's fixed
12 costs, retaining them on the system benefits all customers, large and small.

13 Mr. Hubbs' proposal will unjustly increase rates to large customers, thus
14 threatening MAWC's ability to retain and attract large customers to its system. Such
15 pricing signals are prejudicial to large customers and are essentially punitive to smaller
16 customers if MAWC looses load that helps spread its fixed costs among more
17 customers.

18 **Q WHAT IS YOUR RESPONSE TO STAFF WITNESS HUBBS' CONTENTION AT**
19 **PAGES 1 AND 2 OF HIS REBUTTAL TESTIMONY THAT COMPANY WITNESS**
20 **HERBERT MADE AN "INAPPROPRIATE" DISTINCTION BETWEEN TRANSMISSION**
21 **AND DISTRIBUTION MAINS FOR PURPOSES OF ALLOCATING THESE COSTS TO**
22 **THE CUSTOMER CLASSES THAT CAUSE THEM?**

1 A I disagree with Mr. Hubbs. I contend that Mr. Herbert's allocation distinction is
2 appropriate. Transmission and distribution mains are designed to meet load demands
3 that differ from one another, and they serve different functions, as Mr. Hubbs himself
4 admits at Lines 9 and 10 on Page 3 of his Rebuttal testimony.

5 Transmission lines are intended to provide bulk water flows from the treatment
6 plant throughout the utility's service territory. They are generally designed to provide
7 adequate capacity to meet *maximum day* load requirements. Transmission mains are a
8 part of the utility delivery system. This fact is widely recognized as transmission mains
9 costs are commonly classified to the *Base-Maximum Day* factor in water cost of service
10 studies.

11 Distribution mains, on the other hand, serve to connect customers to the water
12 delivery system, i.e., transmission mains, and they are sized to meet more localized
13 *peak hour* rates of flow. Accordingly, the *Base-Peak Hour* factor is commonly used to
14 classify distribution costs in water cost of service studies. Mr. Herbert's cost of service
15 study recognizes the proper functions of the transmission and distribution pipes and
16 allocates the costs to the customers who take service from the transmission or
17 distribution piping system.

18 **Q WHAT OTHER CONCERN DOES MR. HUBBS HAVE WITH THE CLASSIFICATION**
19 **OF TRANSMISSION MAINS?**

20 A Mr. Hubbs is concerned that the distinction between a transmission and distribution line
21 may be arbitrary. He notes on Page 3 that an 8-inch diameter main may serve a
22 transmission function for a smaller utility, while a 12-inch main may provide distribution
23 service in a larger utility.

1 **Q DO YOU AGREE THAT THE DISTINCTION BETWEEN TRANSMISSION AND**
2 **DISTRIBUTION MAINS MAY BE ARBITRARY?**

3 **A** No. His conclusion that main diameter alone cannot be a reliable guide to distinguishing
4 transmission from distribution mains is mistaken. A class cost of service study should
5 be tailored to the unique scope of operations and customer mix of each operating utility
6 district. In the course of performing a district-specific cost of service study, one must
7 decide if it is proper to make the distinction between transmission and distribution mains
8 for the district in question, and if so, what is the appropriate diameter size break for that
9 particular utility. For example, in the case of Mr. Hubbs's larger utility, only those mains
10 that are, say, sixteen inches and larger in diameter would be classified as transmission
11 mains for cost allocation purposes.

12 **Q DID THE COMPANY ATTEMPT TO DETERMINE WHERE IT WAS OR WAS NOT**
13 **APPROPRIATE TO MAKE THIS DISTINCTION IN THE COST STUDIES IT**
14 **PRESENTED FOR EACH OF ITS OPERATING DISTRICTS?**

15 **A** Yes. Mr. Herbert separated transmission from distribution mains in only three of his cost
16 studies - those for St. Louis, St. Joseph and Joplin. These locations are among the
17 largest operating districts of MAWC, and they all serve significant industrial or wholesale
18 loads.

19 As I stated in my rebuttal testimony, these larger customers cannot be efficiently
20 served from the grid of smaller distribution mains. This is the very reason to distinguish
21 transmission from distributions mains for these districts. This is not to deny that there
22 may be exceptions for other districts. However, in a class cost of service study, this
23 assumption is the fairest and most cost-efficient way to exclude costs that industrial or
24 wholesale customers do not cause the utility to incur.

1 **Q AT PAGES 1 AND 2 OF HIS REBUTTAL TESTIMONY, MR. HUBBS CITES THE**
2 **AWWA M1 MANUAL AS AN AUTHORITY THAT MAWC WITNESS HERBERT**
3 **SHOULD FOLLOW IN PERFORMING HIS COST STUDIES. DO YOU HAVE A**
4 **COMMENT ON THIS?**

5 **A Yes. As I noted in my direct testimony, the text on Page 63 of the Manual states that**
6 **utilities must sometimes consider that "... large-volume industrial customers, wholesale**
7 **customers, and other large users tend to be served directly from major treated water**
8 **transmission mains, whereas smaller users are served by both large and small mains."**
9 **Both Mr. Herbert and I have taken this consideration into account in our respective cost**
10 **studies. Mr. Hubbs, on the other hand, in this portion of his testimony at least, has taken**
11 **a position contrary to the very publication he cites as an authority.**

12 **Q BEGINNING AT PAGE 4 OF HIS REBUTTAL TESTIMONY, MR. HUBBS ARGUES**
13 **THAT IT MAY BE "VALID" TO REDESIGNATE INDUSTRIAL AND WHOLESALE**
14 **CUSTOMERS INTO SUBCLASSES ON THE BASIS OF THE MAIN DIAMETER SIZES**
15 **THEY TAKE SERVICE FROM OR WHETHER THEY ARE ON THE "OUTSKIRTS" OF**
16 **THE RETAIL SERVICE TERRITORY. WHAT IS YOUR RESPONSE?**

17 **A Mr. Hubbs criticizes Mr. Herbert for not creating and including these subclasses in his**
18 **studies. I do not believe that a lack of customer subcategories in addition to those used**
19 **in prior MAWC rate cases invalidates either Mr. Herbert's studies or my study for St.**
20 **Louis County in any way. Indeed, Mr. Hubbs does not add any customer subclasses in**
21 **his cost study for the St. Louis District. While the Commission may wish to consider**
22 **further refinements to defining customer classes at some future time, it must weigh any**

1 advantages against the additional costs involved and the increased complexity of water
2 tariffs designed to reflect any cost differences.

3 Also, Mr. Hubbs' discussion of cost allocation for wholesale customers is predicated
4 largely on hypothetical assumptions about their size and distance from the utility's
5 treatment plant. This runs counter to the standard procedure of the Base-Extra-Capacity
6 method, which considers broad groups of homogeneous customers in terms of the
7 average and peak loads they impose on the utility, and not their locations relative to the
8 utility's treatment plant(s).

9 **Q AT PAGES 13 AND 14 OF HIS REBUTTAL TESTIMONY, MR. HUBBS**
10 **RECOMMENDS THAT THE OPERATION AND MAINTENANCE COSTS OF T&D**
11 **MAINS BE CLASSIFIED ON THE BASIS OF NET PLANT INVESTMENT INSTEAD OF**
12 **THE RESPECTIVE LENGTHS OF LARGER AND SMALLER MAINS, AS MR.**
13 **HERBERT DID IN HIS COS STUDIES. WHAT IS YOUR RESPONSE?**

14 **A** I disagree. First, even Mr. Hubbs admits that neither the length of mains nor net plant
15 investment provides a "direct correlation" to the O&M expenses actually incurred.
16 Second, O&M expense can depend on many other factors not usually considered in the
17 Base-Extra Capacity method, such as the type of materials used and the age of the
18 mains. Thus, there is no basis for deviating from Mr. Herbert's length of mains method
19 of allocating these costs.

20 **Q DID MR. HUBBS ALLOCATE O&M COSTS FOR MAINS ON THE BASIS OF PLANT**
21 **INVESTMENT IN HIS OWN COST STUDY FOR ST. LOUIS?**

22 **A** No. He did not. He allocated mains O&M costs with the Base-Maximum Hour factor.

1 **Q AT PAGE 20 OF HIS REBUTTAL TESTIMONY, MR. HUBBS STATES THAT**
2 **UNIFORM RATES FOR A SINGLE CUSTOMER CLASS ARE MORE EQUITABLE**
3 **BECAUSE CUSTOMERS PAY THE SAME UNIT PRICE FOR WATER SERVICE AS**
4 **OTHER MEMBERS OF THE DEFINED CLASS. PLEASE COMMENT.**

5 **A The volumetric rate charged to all classes provides the Company with compensation for**
6 both fixed and variable costs of providing water utility service. Fixed costs reflect the
7 capital investment and certain O&M costs that will not fluctuate with the amount of water
8 used. In contrast, the variable costs reflect the utility's changes in operating costs that
9 are dependent directly upon the volume of water. Consequently, a uniform volume rate
10 would only be appropriate if all members of the class had approximately the same load
11 factor.

12 A uniform rate may be appropriate for a defined class if the members of the class
13 exhibit similar load factors. However, it is important to distinguish between high volumes
14 on the one hand, and high load factor on the other. If, for example, a subclass of
15 residential customers exhibit high volumes due to seasonal lawn watering, then it is
16 appropriate to recognize this through a uniform rate for those customers, or perhaps a
17 seasonal rate. However, if a customer subclass uses large volumes of water, yet
18 exhibits relatively consistent usage throughout the year, it imposes less peaking costs on
19 the utility relative to the other members of the class.

20 **Q AT PAGES 25 AND 26 OF HIS REBUTTAL TESTIMONY, MR. HUBBS OPPOSES**
21 **THE RECOVERY OF PUBLIC FIRE PROTECTION CHARGES ON A PER**
22 **CUSTOMER BASIS. HOW DO YOU RESPOND?**

23 **A I have already addressed this topic in my Rebuttal testimony. I recommend the recovery**
24 of public fire protection costs on a per customer basis in St. Louis, as has been the

1 practice for many years. Mr. Hubbs offers no sound basis to change this procedure. His
2 argument that a 50,000-gallon per month customer has "more valuable facilities" than a
3 5,000-gallon per month customer is pure, unsupported conjecture on Mr. Hubbs's part.
4 Additionally, his argument is based on value of service criteria, instead of the cost of
5 service basis he relies on in the balance of his testimony.

6 **Q AT PAGES 26 AND 27 OF HIS REBUTTAL TESTIMONY, MR. HUBBS OPPOSES**
7 **THE REVENUE CONTRIBUTION FROM ST. LOUIS TO CERTAIN OF THE OTHER**
8 **OPERATING DISTRICTS OF MAWC. DO YOU AGREE WITH MR. HUBBS ON THIS**
9 **POINT?**

10 **A** Yes. As stated in my direct testimony, the Company's proposal, which is endorsed by
11 OPC, would be a movement toward single-tariff pricing, which is a concept that was
12 rejected by the Commission in MAWC's last rate proceeding. Mr. Hubbs' rejection of
13 this revenue contribution is appropriate because it is consistent with the objective of
14 district-specific pricing.

15 **Q AT PAGES 27 AND 28 OF HIS REBUTTAL TESTIMONY, MR. HUBBS CRITICIZES**
16 **THE "ECONOMIES OF SCALE" METHODOLOGY SPONSORED BY OPC**
17 **WITNESSES MEISENHEIMER AND BUSCH. DO YOU CONCUR WITH MR.**
18 **HUBBS'S CRITICISMS?**

19 **A** Yes, I do. The economies of scale methodology should be rejected in favor of the
20 traditional and widely accepted base extra capacity cost of service methodology. Staff,
21 the Company and I sponsor these methodologies. The primary issue I have with Mr.
22 Hubbs' cost study is his failure to properly assign the cost of small mains to only those
23 customers that actually use those facilities. Both MAWC witness Herbert and I properly

1 assign the cost of small mains to the appropriate customers. The economy of scale
2 methodology, on the other hand, is not a widely accepted and recognized methodology
3 and should be rejected.

4 **RESPONSE TO OPC WITNESS BUSCH**

5 **Q PLEASE SUMMARIZE YOUR DISAGREEMENTS WITH MR. BUSCH'S COS**
6 **STUDIES.**

7 A Mr. Busch chose a single set of customer class maximum day and peak hour ratios and
8 applied them indiscriminately to costs in all nine of MAWC's operating districts,
9 regardless of their disparate operating characteristics or customer mix. He did not state
10 why his ratios were preferable to those used in the Company's study, and he did not
11 state why it was necessary to further adjust the ratios on the basis of a prior MAWC cost
12 study done by OPC.

13 Also, his application of the square root adjustment far exceeded even the
14 theoretical justification offered for it. Mr. Busch's allocation procedures, taken together,
15 constitute serious flaws in his assignment of cost responsibility to MAWC's customer
16 classes. Thus, his cost studies are little more than abstract mathematical exercises, and
17 the Commission should consider them invalid as a basis for designing rates in this
18 proceeding.

19 **Q HAVE YOU REVIEWED MR. BUSCH'S COST STUDIES AND THE ASSOCIATED**
20 **WORKPAPERS?**

21 A Yes, I have. I have identified several serious problems in his development of peak
22 allocation factors for the various customer classes. These problems invalidate the
23 results of his cost studies, in my opinion.

1 Q ARE YOU REFERRING TO HIS DECISION TO TAKE THE SQUARE ROOT FO THE
2 AVERAGE USE TO PEAK FLOW RATIOS THAT YOU TOUCHED ON IN YOUR
3 REBUTTAL TESTIMONY?

4 A Yes, in part. In reviewing his workpapers, I found additional problems with this
5 unsupported adjustment to the class allocators; but there are also serious problems with
6 his initial choice of class maximum day and peak hour ratios. Since these ratios provide
7 the basis for Mr. Busch's later square root adjustments, I will address them first.

8 Q PLEASE CONTINUE.

9 A First, Mr. Busch uses *identical* maximum day and peak hour ratios for each class,
10 regardless of the district in which they are located. Consider the residential class as an
11 example. Mr. Busch uses a maximum day ratio of 2.0 times average flow and a
12 maximum hour ratio of 4.5 times average flow to allocate costs to the residential
13 customers in *all nine operating districts*. Likewise, Mr. Busch uses maximum day and
14 peak hour ratios of 1.5 and 2.2, respectively, for the industrial class in every district.

15 This blanket approach is inappropriate for several reasons. First, the customer
16 mix varies greatly from one district to another. St. Louis has a significant volume of
17 industrial water sales (about 14%), while industrial usage is minimal in, say, Brunswick
18 and St. Charles. Thus, one would expect the individual class peaks in relation to other
19 classes to vary from one district to another. Mr. Busch's choice of identical factors fails
20 to reflect this.

21 Second, there is no reason to expect that, say, residential customers in one
22 district will exhibit the same peaking ratios as residential customers in another district.
23 Third, this blanket approach is inconsistent with OPC's stated position that rates should
24 be set on a district-specific basis. The very reason for setting district-specific rates is to

1 reflect identifiable differences in the costs imposed on the respective utilities serving
2 those districts by their customers. Identical peaking ratios simply gloss over those
3 differences, thereby distorting the calculation of cost differentials among customer
4 classes within each district.

5 **Q DID MR. BUSCH STATE WHY HE USED IDENTICAL CLASS PEAKING RATIOS FOR**
6 **ALL DISTRICTS?**

7 A No, he provided no rationale for his choices of class peaking ratios or why identical
8 ratios should be used in all nine districts.

9 **Q ARE MR. BUSCH'S CLASS PEAKING RATIOS THE SAME AS THOSE USED BY**
10 **MAWC'S COS STUDY WITNESS HERBERT?**

11 A No, they are not. Mr. Herbert's class ratios vary from one district to another.

12 **Q DID MR. BUSCH MAKE FURTHER ADJUSTMENTS TO HIS CLASS PEAKING**
13 **RATIOS BEFORE MAKING HIS SQUARE ROOT ADJUSTMENT?**

14 A Yes, he did. Mr. Busch made an additional adjustment to his class ratios with factors
15 apparently derived from a previous MAWC cost study done by one of his colleagues at
16 OPC. However, neither Mr. Busch, nor any other OPC witness, has explained or
17 justified the adjustments.

18 **Q HAVE YOU FOUND PROBLEMS WITH MR. BUSCH'S APPLICATION OF THE**
19 **SQUARE ROOT ADJUSTMENT IN ADDITION TO THE LACK OF THEORETICAL**
20 **SUPPORT YOU DISCUSSED IN YOUR REBUTTAL TESTIMONY?**

1 A Yes. Mr. Busch takes the square root of average to maximum day and average to peak
2 hour class ratios for each class. He then used the results to allocate supply, treatment,
3 pumping, storage, transmission and distribution costs to the customer classes. Thus,
4 the square root adjustment is applied to virtually all major investment and operating cost
5 items. The problem, of course, lies in the fact that OPC's theoretical discussion of the
6 square root adjustment was couched solely in terms of transmission and distribution
7 mains costs. There was no mention of other plant facilities or operating costs in OPC
8 witness Meisenheimer's testimony offered in support of the square root adjustment.
9 Thus, Mr. Busch has far exceeded the scope of his theoretical discussion.

10 Q DID MR. BUSCH OR ANY OTHER OPC WITNESS OFFER A QUANTITATIVE
11 ENGINEERING COST ANALYSIS THAT WOULD JUSTIFY MAKING THE SQUARE
12 ROOT ADJUSTMENT TO PLANT INVESTMENT AND OPERATING EXPENSES
13 OTHER THAN TRANSMISSION AND DISTRIBUTION MAINS?

14 A No.

15 **RESPONSE TO MAWC WITNESSES**

16 Q IN HIS REBUTTAL TESTIMONY, DID MAWC WITNESS EDWARD J. GRUBB
17 RESPOND TO YOUR PROPOSED PENSION EXPENSE ADJUSTMENT?

18 A No, not directly. I continue to recommend the Company's pension expense be reduced,
19 and the Company be permitted to track the difference between that amount collected in
20 rates and its FAS 87 pension expense estimate. The Company's readjusted pension
21 expense adjustment is more than sufficient to cover its cash contribution to its pension
22 trust projected for the test year. The Company's actuarially derived pension expense
23 estimates increase significantly as a result of the economic factors used in that study.

1 The Company's expense has gone up recently because interest rates have come down,
2 which has reduced its discount rate and increased the benefit obligation of the plans. If
3 interest rates return to more normal levels, which they are projected to do by the
4 Financial Blue Chip economic indicators, then the Company's planned benefit obligation
5 will be reduced and its FAS 87 derived pension expense will be reduced over the period
6 rates in this proceeding will be in effect. The Company's pension expense built into
7 rates should not be based on abnormally low interest rates, as they would be if the
8 Company's pension expense estimate in this proceeding is adopted. Therefore, my
9 proposed adjustment to the Company's pension expense estimate is reasonable.

10 **Q DID MAWC WITNESS JAMES JENKINS RESPOND TO YOUR PROPOSAL TO**
11 **ELIMINATE THE COMPANY'S PROPOSAL TO RECOVER AN ACQUISITION**
12 **ADJUSTMENT FROM CUSTOMERS?**

13 **A** Yes. However, the Company has still failed to provide a net benefits study indicating
14 that customers are better off because of the acquisitions. The Company has not shown
15 that net acquisition savings more than offset the proposal to recover the acquisition
16 costs (i.e., acquisition adjustment) from customers. Therefore, the Company's proposal
17 has not been shown to be in the public interest and therefore the Company's proposal to
18 recover an acquisition adjustment in this proceeding should be rejected.

19 **Q HAS THE COMPANY RESPONDED TO YOUR PROPOSAL TO DISALLOW A**
20 **PORTION OF ITS MAIN BREAK EXPENSE ADJUSTMENT?**

21 **A** No. Therefore, the Company's main break expense adjustment should be removed from
22 its cost of service for the St. Louis District.

1 **Q** **DOES THIS CONCLUDE YOUR SUPPLEMENTAL SURREBUTTAL TESTIMONY?**

2 **A** Yes, it does.

MPG:cs/8027/41490

Armstrong, Linda

From: Schulz, Carol [carols@consultbai.com]
Sent: Friday, December 05, 2003 1:32 PM
To: learnstrong@BryanCave.com
Cc: dmvuyksteke@bryancavellp.com; Brubaker, Maurice; Gorman, Mike; Harwig, Ernie
Subject: Missouri-American Supplemental Surrebuttal Testimony #8027

Sensitivity: Confidential



Mo-Am
estimony.pdf (69 KE)

Attached is a PDF copy of Michael Gorman's supplemental surrebuttal testimony to be filed this afternoon in the Missouri-American Water Company case. The affidavit was forwarded to you yesterday by FedEx.

Please return a file stamped copy of the testimony to us for our files.

Thank you for your help.

<<Mo-Am Testimony.pdf>>

Carol Schulz
for
Michael Gorman
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