Exhibit No.:
Witness: Michael Gorman
Type of Exhibit: Direct Testimony
Issues: Cost of Service and Rate Design
Sponsoring Parties: Missouri Industrial Energy Consumers
Case No.: WR-2008-0311

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**

Direct Testimony and Schedules of

Michael Gorman
on Cost of Service and Rate Design Issues

On Behalf of

Missouri Industrial Energy Consumers

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

September 3, 2008
Project 8980

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

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

Affidavit of Michael Gorman

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, Missouri 63141. 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 are my direct testimony and schedules on cost of service and rate design issues, which were prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. WR-2008-0311.

3. I hereby swear and affirm that the testimony and schedules are true and correct and that they show the matters and things they purport to show.

Michael Gorman

Subscribed and sworn to before me this 2nd day of September, 2008.

MARIA E. DECKER
Notary Public, State of Missouri
St. Louis City
Commission # 05706793
My Commission Expires May 05, 2009

Notary Public

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Direct Testimony of Michael Gorman

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q ARE YOU THE SAME MICHAEL GORMAN WHO PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A Yes, I filed direct testimony on revenue requirement issues on August 18, 2008.

Q WHAT IS THE PURPOSE OF YOUR COST OF SERVICE TESTIMONY IN THIS PROCEEDING?

A I will propose two corrections to the St. Louis Metro District's cost of service study sponsored by Missouri-American Water Company (Missouri-American or Company) witness Paul R. Herbert.

Q PLEASE SUMMARIZE YOUR RECOMMENDATIONS AND FINDINGS.

A I am proposing two corrections to Mr. Herbert's cost of service study for the St. Louis Metro District. These corrections are necessary to properly allocate cost between

customer classes in the St. Louis Metro District. First, Mr. Herbert used an incorrect allocation factor to allocate purchased power expense between classes. I proposed to correct the St. Louis Metro District cost of service study to properly allocate purchased power expense.

Second, Mr. Herbert's Factor 4 for the St. Louis Metro District was incorrectly developed and over-allocates small main costs to large customers that do not use small distribution mains. Therefore, I propose a correction to the Factor 4 used in Mr. Herbert's cost of service study for the St. Louis Metro District.

Q HOW DID MR. HERBERT ALLOCATE PURCHASED POWER COSTS IN HIS ST. LOUIS METRO DISTRICT COST OF SERVICE STUDY?

A Mr. Herbert used Factor 1 to allocate purchased power costs between customer classes. Mr. Herbert's Factor 1 allocates purchased power costs between customers based on each class's average daily consumption. Mr. Herbert describes this Factor as one that "allocates costs that vary with the amount of water consumed" (Schedule C-SLM, at SLM-10).

Q WHY IS IT NOT CORRECT TO USE FACTOR 1 TO ALLOCATE PURCHASED POWER COSTS BETWEEN CUSTOMER CLASSES?

A Mr. Herbert's use of Factor 1 does not recognize how Missouri-American incurs purchased power expense. Purchased power expense is based on demand and energy consumption. Demand costs are based on the highest power demand usage in a month. Demand charges are not based on average daily usage. Therefore, the demand component of purchased power expenses does not "vary with the amount of water consumed," but rather varies with peak day and peak hour power consumption.

Further, the energy consumption portion of purchased power also varies with time and seasonal use and, therefore, does not vary evenly with the daily amount of water consumed. Indeed, AmerenUE's commercial rates in the St. Louis Metro District have energy charges that vary by summer and winter period, and have optional time-of-day adjustments to reflect the variation of energy prices based on when energy is actually consumed, and the variability of energy costs across peak and non-peak periods.[1] As such, Missouri-American's cost of energy within its purchased power adjustment does not evenly vary across all water consumed, but rather the price increases during peak periods and summer season, and is lower during the off-peak periods and winter season.

Q WHAT FACTOR SHOULD BE USED TO ALLOCATE PURCHASED POWER COSTS IN MR. HERBERT'S COST OF SERVICE STUDY?

A The use of Factor 6 is more appropriate and more accurately allocates purchased power expense between customer classes. Factor 6 allocates costs between customers based on average flow and peak day and peak hour demand. Average daily usage reasonably allocates a portion of the energy component of purchased power, and peak day and peak hour factors properly correspond to the demand component and higher on-peak energy prices that correspond to Missouri-American's purchased power expense during peak consumption periods.

[1] Union Electric Company, 11th Revised Sheet No. 67.1 and 68, PSC Case ER-2007-0002, July 6, 2007.

As such, Factor 6 more accurately allocates purchased power expense between customer classes based on how Missouri-American incurs purchased power expense to meet customer seasonal, monthly and daily consumption demands.

Q WHAT ALLOCATION FACTOR DID MR. HERBERT USE TO ALLOCATE SMALL MAIN COSTS BETWEEN CUSTOMER CLASSES?

A Mr. Herbert characterized mains of 10 inches and larger to be primarily transmission mains. He found that mains smaller than 10 inches should be classified as serving a distribution function and be classified as distribution mains. (Herbert Direct Testimony at 6-7).

Mr. Herbert developed a Factor 4 to allocate small mains between customer classes. Mr. Herbert's Factor 4 was designed to recognize that larger customers are predominately served by transmission mains and should not be allocated a significant amount of costs associated with smaller distribution mains. Based on his assessment of Joplin, St. Joseph and the St. Louis Metro area, Mr. Herbert proposed to allocate no (zero) small main costs to large customers in the districts of Joplin and St. Joseph. However, he proposed to allocate 10% of the distribution main costs to large customers in the St. Louis Metro District served under Rate J.

In support of this recommendation, Mr. Herbert estimated that Rate J customers in St. Louis are largely served by transmission mains, but a small portion of Rate J customers do take service from distribution mains. Based on his analysis, Mr. Herbert estimated that 1.3% of total distribution mains on a length of pipe basis are used to serve Rate J customers. Based on this analysis, Mr. Herbert arbitrarily proposed to allocate 10% of small distribution main costs to Rate J customers.

Q PLEASE DESCRIBE WHY YOU BELIEVE MR. HERBERT HAS IMPROPERLY DEVELOPED THE FACTOR 4 HE USED IN HIS COST OF SERVICE STUDY FOR THE ST. LOUIS METRO DISTRICT.

A Mr. Herbert allocated 10% of small distribution main costs to Rate J customers despite his own finding that only 1.3% of the distribution main investment serves Rate J customers (Herbert Direct Testimony at 10). As such, Mr. Herbert's own testimony clearly illustrates he biased Factor 4 for the St. Louis Metro District by over-allocating small main costs to Rate J customers. Mr. Herbert's recommendation for the St. Louis Metro District is in stark contrast to his proper allocation of small main costs to customers in the Joplin and St. Joseph Districts.

Q HOW DO YOU PROPOSE TO CORRECT FACTOR 4?

A I propose to use the correct Factor 4 for the St. Louis Metro District by a more accurate allocation of small main costs to Rate J customers. Mr. Herbert states at page 10 of his testimony that 1.3% of small mains are attributable to Rate J customers. Hence, I modified Factor 4 to use a 1.3% allocation of small main costs to Rate J customers, rather than Mr. Herbert's arbitrary use of a 10% allocation of a small main cost to Rate J customers.

As shown on Schedule MPG-COS-1, I revised Factor 4 to use a 1.3% small main cost allocation to Rate J customers.

Q PLEASE DESCRIBE THE IMPACT ON THE ST. LOUIS METRO DISTRICT'S COST OF SERVICE STUDY BY USE OF FACTOR 6 FOR ALLOCATION OF PURCHASED POWER COSTS, AND CORRECTING THE FACTOR 4 TO PROPERLY ALLOCATE SMALL MAIN COSTS TO RATE J CUSTOMERS.

A This is shown on Schedule MPG-COS-2. Based on only these two adjustments to Mr. Herbert's cost of service study, Rate J customers move significantly closer to cost of service. Indeed, with these two corrections to Mr. Herbert's cost of service study, Rate J customers should get a below system average increase in order to adjust their rates up to cost of service at the Company's claimed revenue deficiency. Specifically, based on a system average increase of 29.9%, Rate J customers should get approximately a 16.9% increase, or 58% of the system average increase in order to move Rate J up to cost of service.

Also, with these adjustments, Rate A customers should get a slightly higher increase relative to Mr. Herbert's proposal in order to bring this rate class closer to cost of service. However, Rate A will still receive a below system average increase. On the other hand, the resale class and Rate J customers should get a slightly lower increase relative to Mr. Herbert's proposal. In this schedule, I am not proposing a change to the fire service rates proposed by Mr. Herbert.

Q DOES THIS COST OF SERVICE DEMONSTRATION INDICATE THAT YOU ENDORSED THE COMPANY'S CLAIMED REVENUE DEFICIENCY FOR THE ST. LOUIS METRO DISTRICT?

A No. The increase for Rate J customers will decline as proper adjustments are made to the Company's claimed revenue deficiencies. MIEC offered several reasonable and appropriate adjustments to the Company's claimed revenue deficiency in this

proceeding. Other parties may also make appropriate revenue requirement adjustments that MIEC did not propose. As such, I recommend my proposed adjustments to Mr. Herbert's St. Louis Metro District cost of service study be adopted, and be used to allocate the Commission-approved revenue deficiency for the St. Louis Metro District.

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MISSOURI-AMERICAN WATER COMPANY

ST. LOUIS METRO AREA DISTRICT (ST. LOUIS COUNTY, ST. CHARLES AND WARREN COUNTY WATER DISTRICTS)

ADJUSTED FACTOR 4

FACTOR 4. ALLOCATION OF COSTS ASSOCIATED WITH FACILITIES SERVING BASE AND MAXIMUM HOUR EXTRA CAPACITY FUNCTIONS.

Factors are based on the weighting of the average daily consumption, the maximum day extra capacity demand, and the fire protection demand for each customer classification.

Customer Classification	Average Hourly Consumption			Maximum Hour Extra Capacity		Fire Protection		
	Adjusted Thousand Gallons	Allocation Factor	Weighted Factor	Allocation Factor	Weighted Factor	Allocation Factor	Weighted Factor	Allocation Factor
	(1)	(2)	(3)=(2) X	(4)	(5)=(4) X	(6)	(7)=(6) X	(8)=(3)+(5)+(7)
	0.013		0.3780		0.5671		0.0549	
Res/Com/Ind/OPA - Rate A	4,895.6	0.9899	0.3741	0.9992	0.5666			0.9407
Sales for Resale - Rate B	0.0	0.0000	0.0000	0.0000	0.0000			0.0000
Large Industrial - Rate J [1]	8.7	0.0018	0.0007	0.0008	0.0005			0.0012
Private Fire - Rate F	8.9	0.0018	0.0007			0.2204	0.0121	0.0128
Public Fire - Rate E	32.5	0.0066	0.0025			0.7796	0.0428	0.0453
Total	4,945.7	1.0000	0.3780	1.0000	0.5671	1.0000	0.0549	1.0000

Note: [1] Replaced Company proposed 10% of Large Industrial - Rate J volumes with 1.3% of Large Industrial - Rate J volumes.

Source: Direct Testimony of Paul Herbert on Behalf of Missouri-American Water Company, pg 10.

MISSOURI-AMERICAN WATER COMPANY

CORRECTED ST. LOUIS METRO AREA DISTRICT
(ST. LOUIS COUNTY, ST. CHARLES AND WARREN COUNTY WATER DISTRICTS)
COST OF SERVICE STUDY

Customer Classification	Cost of Service** Amount (Schedule B)	Cost of Service** Percent	Revenues, Present Rates Amount	Revenues, Present Rates Percent	Revenues, Proposed Rates Amount	Revenues, Proposed Rates Percent	Proposed Increase Amount	Proposed Increase Percent Increase
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Res/Com/Ind/OPA - Rate A	$ 149,611,708	86.4%	$ 116,500,747	87.5%	$ 149,519,930	86.3%	$ 33,019,183	28.3%
Sales for Resale - Rate B	2,622,611	1.5%	2,341,267	1.8%	2,622,611	1.5%	281,344	12.0%
Large Industrial - Rate J	7,389,463	4.3%	6,320,529	4.7%	7,389,463	4.3%	1,068,934	16.9%
Private Fire - Rate F	1,512,601	0.9%	1,634,891	1.2%	1,634,891	0.9%	-	0.0%
Public Fire - Rate E	12,040,290	7.0%	6,537,318	4.8%	$12,011,857	6.9%	5,474,539	83.7%
Total Sales	173,176,674	100.0%	133,334,752	100.0%	173,178,752	100.0%	39,844,000	29.9%
Other Revenues*	4,587,717		4,587,717		4,587,717		-	0.0%
Total	$ 177,764,391		$ 137,922,469		$ 177,766,469		$ 39,844,000	28.9%

* Includes Rate G and H Contract Sales.

** Cost of Service includes a revenue contribution to the Brunswick, Parkville Water, Warren County Sewer and Cedar Hill Sewer Districts.
Includes an adjustment of Purch Fuel / Power for Pump from Factor 1 to Factor 6 and allocating a small mains adjustment of 1.3% to the Large Industrial - Rate J consumption for Factor 4.