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October 3, 2003

BY HAND DELIVERY

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
Governor Office Building
St. Louis, Missouri 65101

Re: Case No. WR-2003-0500

Dear Mr. Roberts:

Enclosed for filing are an original and eight (8) copies of *Rebuttal Testimony and Schedules 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

FILED²
OCT 03 2003
**Missouri Public
Service Commission**

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Partnership*
London

Exhibit No.
Witness: Michael Gorman
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: MIEC
Subjects: Revenue Requirement Adjustments
Date:

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.)

Rebuttal Testimony and Schedules of

Michael Gorman

On behalf of

Missouri Industrial Energy Consumers

October 3, 2003
Project 8027



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

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BEFORE THE
PUBLIC SERVICE COMMISSION OF MISSOURI

In the Matter of Missouri-American Water)
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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.

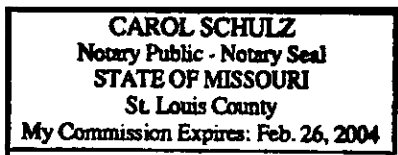
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony and schedules which were prepared in written form for introduction into evidence in the WR-2003-0500 Proceeding.

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



Michael Gorman

Subscribed and sworn before this 3rd day of October, 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.)	

Rebuttal 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 WHAT IS YOUR OCCUPATION?**

5 A I am a consultant in the field of public utility regulation and a principal in the firm of
6 Brubaker & Associates, Inc., energy, economic and regulatory consultants.

7 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

8 A These are set forth in Appendix A to my testimony.

9 **Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

10 A I am appearing on behalf of the Missouri Industrial Energy Consumers (MIEC).

11 **Q WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

12 A In my rebuttal testimony I will respond to Missouri-American Water Company's (MAWC
13 or Company) estimated revenue deficiency for the St. Louis County District of \$15.5

**Michael Gorman
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1 million, or 13.5% (MAWC Schedule A-STL). I will be filing additional rebuttal testimony
2 concerning the Company's proposed cost allocation and rate design for the St. Louis
3 County District at the next filing date.

4 **Q PLEASE SUMMARIZE YOUR TESTIMONY.**

5 A As outlined below, I recommend revenue requirement adjustments that reduce MAWC's
6 estimated revenue deficiency for its St. Louis County District by \$5.231 million. My
7 proposed revenue requirement adjustments alone will lower the Company's estimated
8 revenue deficiency of 13.5% down to 7.9%. However, other parties may propose
9 additional revenue requirement adjustments that the Commission may find reasonable.
10 Therefore the Commission should not interpret my silence on revenue requirement
11 adjustments not addressed in my testimony as an endorsement of the Company's
12 position.

13 **Q PLEASE DESCRIBE YOUR REVENUE REQUIREMENT ADJUSTMENTS.**

14 A The revenue requirement adjustments I am proposing are outlined below in Table 1.
15 Each of the revenue requirement adjustments will be discussed individually later.

Table 1	
Proposed Revenue Requirement Adjustments St. Louis County District	
Description	Amount (000)
Revenue Contribution	\$ 880
Acquisition Adjustment	1,000
Pension Expenses	2,287
Main Break Expense	1,064
Total	\$5,231

INTER-DISTRICT REVENUE SUBSIDY

Q PLEASE DESCRIBE THE COMPANY'S INTER-DISTRICT SUBSIDY THAT IT PROPOSES TO HAVE THE ST. LOUIS COUNTY DISTRICT PAY.

A The Company is proposing to allocate \$880,000 of revenue requirements to the St. Louis County District to cover part of its cost of service in other MAWC operating districts. The Company's stated purpose for the proposed transfer is to help ameliorate the rate impact on the six districts receiving the revenue subsidy. The Company claims its proposal is consistent with the Commission's finding in MAWC's last rate case that it was appropriate for one district to contribute revenues to other districts to ameliorate rate impacts.

Q IS MAWC'S PROPOSAL FOR THE ST. LOUIS DISTRICT TO SUBSIDIZE OTHER DISTRICTS' REVENUE REQUIREMENTS BY \$880,000 CONSISTENT WITH THE COMMISSION'S FINDINGS IN MAWC'S LAST RATE CASE?

A No. In MAWC's last rate case, the Commission rejected the concept of single tariff pricing for MAWC's operating districts, and found it appropriate to continue with district-specific pricing, except that no district in that case would receive a rate decrease.

In MAWC's last rate case, the Joplin District was producing a rate of return on utility assets of 10.77%, when the Commission found that MAWC should earn a return of 8.16% (Order, Missouri Public Service Commission, Case No. WR-2000-281, at 24 and 56). Consequently, the Joplin District was producing a rate of return in excess of what the Commission found appropriate for MAWC. Rather than decrease the revenues in the Joplin District, the Commission instead used the excess revenues earned in the Joplin District to offset the revenue deficiencies estimated for the other districts. Importantly, Joplin customers did not receive a rate increase in order to reduce the rate

1 impact on other districts. Rather, the MPSC simply did not reduce any districts' rates,
2 including Joplin's.

3 In significant contrast in this case, MAWC is proposing to increase the St. Louis
4 District's revenue deficiency of \$14.6 million, or 12.5% (Schedule CAS-2-STL), up to
5 \$15.5 million, or 13.5%, to reduce the rate increase for other districts. Accordingly,
6 MAWC's proposal is in direct contradiction to the MPSC findings in its last rate order in
7 two respects. First, and most importantly, MAWC's proposal for the St. Louis District to
8 fund part of the revenue requirements of other districts is in direct contradiction to the
9 MPSC's finding that it will rely on district-specific pricing. The MPSC stated as follows:

10 "The Commission will move away from STP [Single Tariff
11 Pricing] and toward DSP [District Specific Pricing]. One
12 factor for consideration in determining just and reasonable
13 rates is public perception. The testimony adduced at the
14 local public hearings held in this matter was strongly in
15 favor of DSP. MAWC, therefore, must set its rates
16 separately for each service area in order to recover the
17 appropriate revenue requirement for each service area.
18 As the Company requested, no phase-in of the rate
19 increase shall be permitted. In moving toward DSP,
20 however, the Commission will adhere to the principle that
21 no district will receive a rate decrease." (Public Service
22 Commission of the State of Missouri, Report and Order,
23 Case No. WR-2000-281 at 58, August 31, 2000)

24 Therefore, MAWC's proposal here is inconsistent with the Commission's order
25 because it does not adhere to DSP, and its proposed rates for the St. Louis District are
26 not based on "the appropriate revenue requirement" for the St. Louis service area.

27 Second, the proposed allocation of additional revenues is not based on the fact
28 that a specific district is currently producing revenues in excess of MAWC's cost of
29 service. The allocation of excess revenue to another district could help ameliorate
30 revenue increases in other districts, if it existed, which it does not, without a rate
31 increase to the district proposed to contribute revenue. MAWC is proposing to elevate
32 the percentage increase in rates in the St. Louis District in order to reduce the

percentage increase in other districts. MAWC's proposal is inconsistent with district-specific pricing, it is patently unfair to the St. Louis District's customers, and is simply a back door effort to move toward the single tariff pricing objective that the Commission rejected in MAWC's last rate filing.

Q ARE THERE OTHER REASONS TO REJECT MAWC'S PROPOSAL TO INCREASE THE ST. LOUIS DISTRICT'S RATES IN ORDER TO CONTRIBUTE REVENUE TO OTHER DISTRICTS?

A Yes. The St. Louis District is already receiving among the highest rate increases, even without the revenue allocation.

As shown on the attached Schedule 1, the St. Louis District's revenue deficiency, as estimated by MAWC, is 12.5%, excluding the proposed \$880,000 revenue allocation to other districts, and 13.5% with MAWC's proposed revenue allocation. MAWC's estimated revenue increase for the St. Louis district is higher than the claimed system average revenue deficiency of the Company of 12.2%.

Furthermore, MAWC is proposing an Infrastructure System Replacement Surcharge (ISRS) that would further increase its charges to the St. Louis District's customers if approved. Indeed, based on the Company's filing in Case No. WO-2004-0116, MAWC is proposing an ISRS to recover an annual revenue requirement for qualified assets of over \$4 million or 3.4% of current revenues. The revenue increase produced by this proposed surcharge is in addition to the revenue increase proposed in this filing. A combination of the rate increase here, and the proposed new ISRS, will create significant rate burdens on the St. Louis District's customers. For these reasons, the Company's proposal for St. Louis District's customers to subsidize other districts is wholly inappropriate and unjust.

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1 **ACQUISITION ADJUSTMENT**

2 **Q PLEASE DESCRIBE THE COMPANY'S PROPOSAL FOR RECOVERY OF AN**
3 **ACQUISITION ADJUSTMENT IN ITS REVENUE REQUIREMENT.**

4 **A** The Company is proposing to include an acquisition adjustment in its revenue
5 requirement. The acquisition adjustment is based on the difference between the
6 purchase price and the original cost book value of MAWC's acquisition of the United
7 Water Jefferson City District, the Valley Park District, the Webster Groves District and
8 the Florissant District (Schedule EJG-2). The Company is proposing to amortize this
9 acquisition adjustment over a period commensurate with the average composite
10 depreciation rates in these districts, which will vary between 37 and 41 years, and to
11 include the unamortized balance in rate base (Grubb at 12).

12
13 **Q WHY DOES THE COMPANY BELIEVES IT IS REASONABLE FOR IT TO BE**
14 **ALLOWED TO RECOVER AN ACQUISITION ADJUSTMENT.**

15 **A** MAWC witness Edward J. Grubb describes the Company's justification at Pages 12-16.
16 To summarize his testimony, he believes the Company's request is reasonable for the
17 following reasons:

- 18 a. He identifies certain Commission proceedings where the Commission stated it
19 would consider including merger-related savings within utility rate proceedings.
- 20 b. He believes that acquisitions are benefiting existing customers because they
21 increase the number of customers, and allow MAWC to spread its fixed costs
22 over a larger customer base.
- 23 c. He believes that the acquisition of Webster Groves allows the Company to
24 spread its production costs over a larger customer base because, prior to the
25 acquisition, the Company did not provide 100% of the water needs of the
26 Webster Groves community, and now it does.
- 27 d. He believes the customers of the acquired systems benefit because MAWC is
28 more capable of making needed infrastructure investments and the communities

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1 from which these systems were acquired receive large acquisition proceeds and
2 now receive property tax payments from MAWC.

3 e. Finally, he states from a public policy perspective that it would be important for
4 the Commission to indicate a willingness to allow recovery of acquisition
5 adjustments as economies of scale make operating water utilities more efficient
6 and better run.

7 **Q IS THE COMPANY'S PROPOSAL FOR RECOVERY OF AN ACQUISITION**
8 **ADJUSTMENT REASONABLE?**

9 **A** No. The Company has failed to prove that it has satisfied any reasonable standard for
10 including an acquisition adjustment in its rates in this case.

11 **Q PLEASE RESPOND TO EACH OF THE REASONS MAWC IDENTIFIES IN SUPPORT**
12 **OF ITS PROPOSAL FOR RECOVERY OF AN ACQUISITION ADJUSTMENT.**

13 **A** First, the Company identifies orders where the Commission states it would consider
14 sharing merger related savings in a utility rate proceeding. However, the Company's
15 acquisition adjustment is not based on "merger-related savings." Rather, the acquisition
16 adjustment MAWC proposes to include in rates is the acquisition cost. Consequently,
17 the Company's proposed acquisition adjustment is in direct contradiction to the
18 Commission's finding that it would consider sharing merger-related savings in a rate
19 proceeding.

20 The Company has referenced specific savings that may have been produced by
21 the acquisitions, including: spreading its overheads over a larger customer base,
22 eliminating employees, and spreading the cost of the water treatment plant serving the
23 Webster Groves district over a larger customer base. However, the Company hasn't
24 quantified any net savings attributable to the acquisitions. Net savings will be based on

1 a comparison of the acquisition-related costs, less the acquisition-related savings. If the
2 savings exceed the cost, then the acquisition would have produced "net" savings.

3 **Q HAS THE ACQUISITION INCREASED MAWC'S COSTS IN ANY WAY?**

4 **A** Yes. The acquisitions have increased MAWC's costs in the form of system
5 improvements, and higher parent company allocated management fees. The acquisition
6 increases MAWC's system improvements for the acquired districts to bring them up to
7 the quality and reliability standards of MAWC's other operating districts.

8 Also, MAWC's allocated share of its parent company's charges, or management
9 fees, increases as the number of customers increases. This occurs because American
10 Water Works allocates its affiliate charges to its operating districts on the basis of the
11 number of customers. Consequently, MAWC's allocated overhead expenses from its
12 parent company increased because it acquired these operating districts since the
13 acquisitions increased the number of customers on its system. This is particularly
14 relevant now because the parent company's overhead costs increased significantly with
15 the added expense of the Alton National Call Center and the corporate data processing
16 center.

17 **Q PLEASE CONTINUE WITH YOUR RESPONSE TO MR. GRUBB'S REQUEST FOR**
18 **RECOVERY OF AN ACQUISITION ADJUSTMENT.**

19 **A** The Company argues that by acquiring these systems, those newly acquired districts will
20 receive a higher quality of service because MAWC is more capable of making needed
21 infrastructure investments. While this may be true, it is important to recognize that
22 MAWC will be fairly compensated for those investments in needed infrastructure at the
23 time of rate filings. MAWC does not need to receive an acquisition adjustment in order

1 to receive fair compensation for incremental investments to enhance the infrastructure of
2 these newly acquired operating districts.

3 Finally, the Company's contention that the Commission should approve recovery
4 of acquisition adjustments for public policy reasons is without merit. The Company's
5 purchase price as a ratio of book value is 1.30x (based on Schedule EJC-2). This
6 purchase price to book value ratio is comparable to normal market price to book value
7 trading premiums for water utility systems. As shown on my Schedule 2, water utility
8 stocks have traded at premiums to book value of 1.4x to over 2.2x during the period
9 1996-2003.

10 Investors who purchase water utility stocks at premiums to book value are not
11 allowed to recover the premiums to book value in the utility cost structure and tariff rates.
12 Nevertheless, even without rate recovery of purchase price to book value premiums,
13 investors have continued to invest in water utility common stock. MAWC's proposal to
14 recover its purchase price premium over book value in utility rates would provide it with
15 an investment advantage that other water utility investors do not receive. Consequently,
16 MAWC's proposed recovery of an acquisition adjustment is not necessary to encourage
17 it to acquire water utility districts. The premium MAWC is paying is no different than the
18 typical premium any other water utility investor would pay to make an investment in a
19 water utility.

20 **Q SHOULD THE COMMISSION ENSURE THAT THE PUBLIC IS PROTECTED FROM**
21 **COMPANIES SUCH AS MAWC PROPOSING RECOVERY OF ACQUISITION**
22 **ADJUSTMENTS?**

23 **A** Yes. Rates should not increase as the result of a Company acquiring another utility
24 company. Therefore, the Commission should only consider an acquisition premium cost

1 if the utility makes a clear and verifiable demonstration that the merger or acquisition
2 produced savings that would not have otherwise been produced, and the savings
3 significantly exceeded the merger or acquisition cost. With this type of policy the public
4 interest would be preserved, because rates would have been reduced as a result of the
5 acquisition and the Company will be provided an opportunity to recover acquisition
6 adjustments, but only from a share of verifiable savings.

7 **Q DID MR. GRUBB HAVE ANY OTHER ARGUMENTS IN SUPPORT OF MAWC**
8 **RECOVERING AN ACQUISITION ADJUSTMENT IN RATES?**

9 **A** Yes. Mr. Grubb also argues that there may be small water districts that MAWC would
10 not consider for acquisition unless recovery of an acquisition premium was provided for
11 in rates. He proposes to work with the Commission Staff and Office of Public Counsel to
12 develop a program that would facilitate the acquisition of Missouri water and wastewater
13 districts where the ownership by MAWC would, in his opinion, benefit the public interest.

14 **Q HOW DO YOU RESPOND?**

15 **A** I would not oppose such a proposition, as long as the rates of existing MAWC customers
16 do not increase in order to encourage MAWC to acquire new districts. Any rate
17 consideration to encourage MAWC to acquire a struggling water district should be
18 imposed on the district receiving the benefit of MAWC's ownership. Again, the rates of
19 existing MAWC customers should not increase because it is acquiring a water and/or
20 wastewater district.

1 **PENSION EXPENSE**

2 **Q PLEASE DESCRIBE THE COMPANY'S PROPOSED INCREASE IN PENSION**
3 **EXPENSES.**

4 **A** MAWC is proposing to increase its pension expense (total company basis) from
5 \$1,277,952 to \$4,139,534. This is an increase of over \$2,861,582. The increase to the
6 St. Louis District is \$2,286,685 (Schedule CAS-15, Page 3). The Company maintains
7 this increase in pension expense is based on changes in labor and an update of the
8 actuarial study provided to the Company by its actuary.

9 **Q HAS THE COMPANY BEEN ABLE TO SHOW THAT ITS PROPOSED INCREASE TO**
10 **ITS PENSION EXPENSE IS REASONABLE?**

11 **A** No. In response to MIEC Data Request 1-14, the Company was unable to provide an
12 updated actuarial study, as referenced in Schedule CAS-15, to support an increase to its
13 pension expense. However, the Company indicated that an updated actuarial study may
14 be available by mid-October, 2003. In any event, the Company has the burden of proof,
15 and it has not supported its claim that its pension expense increase was based on its
16 "latest actuary study."

17
18 **Q SHOULD THE COMMISSION CONSIDER ONLY AN INCREASE IN AN**
19 **ACTUARIALLY DERIVED PENSION EXPENSE ESTIMATE, AND ADJUST RATES**
20 **TO RECOVER MAWC'S INCREASED PENSION EXPENSE?**

21 **A** No. The Commission should ensue that customers pay rates that make MAWC whole
22 for its contributions to its pension trust fund account. However, pension expensed
23 derived from actuarial studies are highly impacted by changes to the economic
24 parameters used in the actuary study. Temporary swings in the trust asset values,

1 abnormally high or low interest rates used as discount factors in establishing planned
2 benefit obligations (PBO), and overly conservative estimates of future labor expense
3 escalation can drive up pension expense estimates far in excess of the actual cash
4 contributions MAWC plans to make to its pension trust accounts. Indeed, it is clearly
5 happening in the current case.

6 As indicated in the Company's Schedule CAS-15, MAWC is proposing a true-up
7 period pension expense of \$4,139,534. However, the Company only plans to make a
8 cash contribution to its pension trust in calendar year 2003 of \$377,000 (Supplement
9 Response to MIEC's Data Request 1-14 via e-mail message from Ed Grubb).

10 This significant difference between the accrual expense and actual cash
11 contribution will be retained by MAWC to enhance its cash working capital. Depending
12 on future changes to the actuarial study, this difference between accrued expense
13 charged to customers in the development of rates, and the actual cash contributions
14 made to the pension trust fund, may be retained permanently by MAWC. Indeed, the
15 liability recorded for the difference between accrued expense and cash contributions can
16 be offset by changes in the value of trust fund assets, changes to expected labor
17 escalation rates, changes to PBO discount factors and recorded accrued pension
18 expense.

19 All of these factors were working against the Company in terms of increasing the
20 pension expense for calendar year 2003. For example, the stock market was down and
21 interest rates were the lowest they have been in the last 40 years. These economic
22 factors resulted in higher PBO, lower trust fund assets, and higher pension expense
23 accruals. If MAWC's trust fund asset values recover from the 2002 stock market
24 declines, and interest rates recover to a more normal level, then pension expense
25 accrual amounts estimated in future actuarial studies may go down. If this happens,

1 then the accrual expense estimated under the more adverse economic factor
2 assumptions and built into rates, MAWC will consistently over-recover future pension
3 expense accrual amounts.
4

5 **Q IS THERE A WAY THE COMMISSION COULD BALANCE MAWC'S NEED TO**
6 **RECOVER ITS PENSION EXPENSE COST AND ENSURE RATES DO NOT PROVIDE**
7 **MORE THAN ADEQUATE COVERAGE OF THAT COST?**

8 **A** Yes. To balance the variability these economic factors can have on the pension accrual
9 expense, MAWC's rates should be adjusted to reflect more normal levels of trust fund
10 asset values and discount rates. And, the difference between what is recovered in rates
11 and the actual accrual expense could be recorded as a regulatory asset or liability on
12 MAWC's balance sheets. This over or under-recovery of pension expense could then be
13 used in subsequent rate proceedings to develop an appropriate annual pension expense
14 recovery amount. This will help ensure MAWC recovers its pension expense, and that
15 rates are not unreasonably increased to recover expenses which are based on
16 abnormally low or high economic factors used in the actuarial study.

17 **Q HOW SHOULD THE COMMISSION RESPOND TO MAWC'S NEED TO PROPERLY**
18 **FUND ITS PENSION OBLIGATIONS IN THIS RATE PROCEEDING?**

19 **A** Before the Commission makes any pro forma adjustments to the test year pension
20 expense, the Company should provide sufficient information that will ensure that the
21 Commission does not develop rates that will overcompensate the Company for its actual
22 pension contributions. Given the parameters of many of the actuarial studies causing
23 what may be a temporary increase in accrual pension expenses in the 2002 test year, I

1 would encourage the Commission to mitigate the increase in pension expense to ensure
2 that customers are not overcharged for pension expenses.

3 **Q WHAT PENSION EXPENSE DO YOU RECOMMEND THE COMMISSION BUILD INTO**
4 **MAWC'S RATES IN THIS PROCEEDING?**

5 A I recommend the Company's proposed pro forma adjustment, as shown on its Schedule
6 CAS-15, be rejected as unsupported. Consequently, the amount of pension expense
7 that should be built into the Company's rates should be \$1,277,952 on a total company
8 basis, and \$909,122 on a St. Louis District basis. This is the Company's test year
9 depreciation expense, excluding the pro forma adjustments, and is more than adequate
10 to cover the Company's planned cash contribution in 2003 of \$377,000. Again, the
11 Commission should provide MAWC with an accounting mechanism that allows it to track
12 the amount of accrual expense it is required to report for FASB 87, and the amount that
13 is recovered in rates. The Commission should continue to require MAWC to record the
14 pension liability or asset that is included in its rate base in this proceeding.

15 **MAIN BREAK EXPENSE ADJUSTMENT**

16 **Q PLEASE EXPLAIN THE COMPANY'S PROPOSED ADJUSTMENT TO MAIN BREAK**
17 **EXPENSE.**

18 A The Company is proposing to increase its main break expense for the St. Louis District
19 from a per book amount of \$3.5 million, up to a pro forma adjusted amount of \$4.57
20 million, an increase of \$1.06 million.

21 **Q IS THE COMPANY'S PROPOSED PRO FORMA ADJUSTMENT TO MAIN BREAK**
22 **EXPENSE REASONABLE?**

1 A No. The Company's proposed pro forma adjustment to this expense is based on a
2 hodge-podge of inconsistent data. The Company estimates its pro forma expense from
3 three primary factors, including the following:

- 4 • A five-year average of the number of occurrences in main break expenses ending
5 March 2003.
- 6 • A two-year average of the cost for repairing main breaks, per main break,
7 excluding repairing costs, over the years 2001 and 2002.
- 8 • Finally, the Company uses a paving expense cost estimate per main break based
9 on historical average costs of main break expenses for a 15-month period ending
10 March 2003.

11 As noted above, the Company's pro forma adjustment reflects inconsistent time
12 periods, and does not reflect the actual cost of repairing each main break occurrence as
13 has actually been explained by MAWC.

14 **Q WHY IS IT IMPORTANT TO USE CONSISTENT TIME PERIOD DATA IN ESTIMATING**
15 **MAIN BREAK EXPENSE?**

16 A It is important because, as shown in Table 2 below, MAWC's average costs, on a "per
17 break basis," of repairing main breaks is correlated with the number of main breaks the
18 Company experiences in any given year.

19 As shown in Table 2, in the year 1999 when the Company incurred an
20 abnormally high number of main breaks (3,151), the average repair cost per break was
21 the lowest (\$1,307 per break repair). Conversely, in calendar year 2001, when the
22 Company had the fewest number of main breaks (1,991), the average cost of main
23 break repair was the highest for this five-year period (\$1,747 repair).

Table 2		
<u>Main Break Expense</u>		
<u>Description</u>	<u>Number of Breaks</u>	<u>Cost per Break</u>
Test Year Pro Forma	2,415	\$1,892
Test Year Actual (2002)	2,053	\$1,707
2001	1,991	1,747
2000	2,280	1,454
1999	3,151	1,307
1998	2,076	1,409

1 The Company's convoluted method of estimating the number of breaks, along
2 with average cost per break, results in an abnormal increase in the average annual
3 number of main break expenses, and an exaggeration of the repair cost per main break.
4 As a result, the Company is substantially and unreasonably overstating its main break
5 expense in the test year. As a result, MAWC's pro forma adjustment to its main break
6 expenses should be rejected and rates should be set using the per books expense of
7 \$3,504,571 as shown on Schedule CAS-15, Page 14.

8 **Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

9 **A Yes.**

Qualifications of Michael Gorman

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

2 A Michael P. Gorman. My business mailing address is P. O. Box 412000, 1215 Fern
3 Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

4 **Q PLEASE STATE YOUR OCCUPATION.**

5 A I am a consultant in the field of public utility regulation and a principal at Brubaker &
6 Associates, Inc., energy, economic and regulatory consultants.

7 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK
8 EXPERIENCE.**

9 A In 1983 I received a Bachelors of Science Degree in Electrical Engineering from
10 Southern Illinois University, and in 1986, I received a Masters Degree in Business
11 Administration with a concentration in Finance from the University of Illinois at
12 Springfield. I have also completed several graduate level economics courses.

13 In August of 1983, I accepted an analyst position with the Illinois Commerce
14 Commission (ICC). In this position, I performed a variety of analyses for both formal and
15 informal investigations before the ICC, including: marginal cost of energy, central
16 dispatch, avoided cost of energy, annual system production costs, and working capital.
17 In October of 1986, I was promoted to the position of Senior Analyst. In this position, I
18 assumed the additional responsibilities of technical leader on projects, and my areas of
19 responsibility were expanded to include utility financial modeling and financial analyses.

20 In 1987, I was promoted to Director of the Financial Analysis Department. In this
21 position, I was responsible for all financial analyses conducted by the staff. Among other
22 things, I conducted analyses and sponsored testimony before the ICC on rate of return,

1 financial integrity, financial modeling and related issues. I also supervised the
2 development of all Staff analyses and testimony on these same issues. In addition, I
3 supervised the Staff's review and recommendations to the Commission concerning utility
4 plans to issue debt and equity securities.

5 In August of 1989, I accepted a position with Merrill-Lynch as a financial
6 consultant. After receiving all required securities licenses, I worked with individual
7 investors and small businesses in evaluating and selecting investments suitable to their
8 requirements.

9 In September of 1990, I accepted a position with Drazen-Brubaker & Associates,
10 Inc. In April 1995 the firm of Brubaker & Associates, Inc. (BAI) was formed. It includes
11 most of the former DBA principals and Staff. Since 1990, I have performed various
12 analyses and sponsored testimony on cost of capital, cost/benefits of utility mergers and
13 acquisitions, utility reorganizations, level of operating expenses and rate base, cost of
14 service studies, and analyses relating industrial jobs and economic development. I also
15 participated in a study used to revise the financial policy for the municipal utility in
16 Kansas City, Kansas.

17 At BAI, I also have extensive experience working with large energy users to
18 distribute and critically evaluate responses to requests for proposals (RFPs) for electric,
19 steam, and gas energy supply from competitive energy suppliers. These analyses
20 include the evaluation of gas supply and delivery charges, cogeneration and/or
21 combined cycle unit feasibility studies, and the evaluation of third-party asset/supply
22 management agreements. I have also analyzed commodity pricing indices and forward
23 pricing methods for third party supply agreements. Continuing, I have also conducted
24 regional electric market price forecasts.

1 In addition to our main office in St. Louis, the firm also has branch offices in
2 Corpus Christi, Texas; Plano, Texas; Asheville, North Carolina; Denver, Colorado; and
3 Chicago, Illinois.

4 **Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?**

5 A Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of
6 service and other issues before the regulatory commissions in Arizona, Delaware,
7 Florida, Georgia, Illinois, Indiana, Michigan, Missouri, New Mexico, Oklahoma,
8 Tennessee, Texas, Utah, Vermont, West Virginia, Wisconsin and Wyoming. I have also
9 sponsored testimony before the Board of Public Utilities in Kansas City, Kansas;
10 presented rate setting position reports to the regulatory board of the municipal utility in
11 Austin, Texas, and Salt River Project, Arizona, on behalf of industrial customers; and
12 negotiated rate disputes for industrial customers of the Municipal Electric Authority of
13 Georgia in the LaGrange, Georgia district.

14 **Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR ORGANIZATIONS**
15 **TO WHICH YOU BELONG.**

16 A I earned the designation of Chartered Financial Analyst (CFA) from the Association for
17 Investment Management and Research (AIMR). The CFA charter was awarded after
18 successfully completing three examinations which covered the subject areas of financial
19 accounting, economics, fixed income and equity valuation and professional and ethical
20 conduct. I am a member of AIMR's Financial Analyst Society.

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MISSOURI AMERICAN WATER COMPANY

Summary of MAWC's Estimated District Revenue Deficiencies

<u>Line</u>	<u>Description</u>	<u>Total Company</u>	<u>Brunswick</u>	<u>Jefferson City</u>	<u>Joplin</u>	<u>Mexico</u>
1	Rate Base	\$ 497,681,177	\$ 1,125,616	\$ 11,829,628	\$ 27,087,226	\$ 12,065,229
2	Operating Income at Present Rate	29,073,155	(37,030)	720,132	1,771,208	629,671
3	Earned Rate of Return	5.84%	-3.29%	6.09%	6.54%	5.22%
4	Requested Rate of Return	8.30%	8.30%	8.30%	8.30%	8.30%
5	Required Operating Income	41,307,538	93,426	981,859	2,248,240	1,001,414
6	Operating Income Deficiency	12,234,383	130,456	261,727	477,032	371,743
7	Gross Revenue Conversion Factor	1.63557	1.63870	1.63937	1.64940	1.64017
8	Revenue Deficiency	20,010,153	213,778	429,068	786,817	609,722
9	Adjusted Operating Revenues	163,449,873	204,979	4,065,029	8,060,300	2,561,804
10	Total Revenue Requirement	\$ 183,460,026	\$ 418,757	\$ 4,494,097	\$ 8,847,117	\$ 3,171,526
11	Percent Increase	12.2%	104.3%	10.6%	9.8%	23.8%

MISSOURI AMERICAN WATER COMPANY

Summary of MAWC's Estimated District Revenue Deficiencies

<u>Line</u>	<u>Description</u>	<u>Parkville Water</u>	<u>St. Charles</u>	<u>St. Joseph</u>	<u>St. Louis</u>	<u>Warrensburg</u>	<u>Parkville Sewer</u>
1	Rate Base	\$ 11,102,062	\$ 33,788,613	\$ 81,733,019	\$ 309,427,796	\$ 9,486,447	\$ 35,541
2	Operating Income at Present Rate	670,793	2,526,101	5,433,842	16,719,904	636,593	1,941
3	Earned Rate of Return	6.04%	7.48%	6.65%	5.40%	6.71%	5.46%
4	Requested Rate of Return	8.30%	8.30%	8.30%	8.30%	8.30%	8.30%
5	Required Operating Income	921,471	2,804,455	6,783,841	25,682,507	787,375	2,950
6	Operating Income Deficiency	250,678	278,354	1,349,999	8,962,603	150,782	1,009
7	Gross Revenue Conversion Factor	1.62944	1.62742	1.63431	1.63502	1.64022	1.62308
8	Revenue Deficiency	408,465	452,999	2,206,317	14,654,035	247,315	1,637
9	Adjusted Operating Revenues	2,914,493	8,682,717	16,875,711	117,561,461	2,473,801	49,578
10	Total Revenue Requirement	\$ 3,322,958	\$ 9,135,716	\$ 19,082,028	\$ 132,215,496	\$ 2,721,116	\$ 51,215
11	Percent Increase	14.0%	5.2%	13.1%	12.5%	10.0%	3.3%

MISSOURI AMERICAN WATER COMPANY

MARKET-TO-BOOK RATIOS WATER UTILITY COMPANIES (1996 - 2003)

Line	Company	1996	1997	1998	1999	2000	2001	2002	2003
1	American States Water Co.	N/A	N/A	1.53	1.72	1.70	1.73	1.81	1.80
2	American Water Works Company, Inc.	1.59	1.65	2.09	1.88	1.42	1.90	2.48	2.50
3	Aquarion Company	1.42	1.52	1.86	2.32	2.63	N/A	N/A	N/A
4	Artesian Resources Corp.	N/A	N/A	N/A	N/A	1.44	1.63	1.64	1.68
5	California Water Service Company	1.53	1.80	2.33	1.99	1.87	1.95	1.90	2.06
6	Connecticut Water Service, Inc.	1.55	1.59	1.85	2.19	2.35	2.65	2.98	2.67
7	Consumers Water Company	1.42	1.43	1.93	2.40	N/A	N/A	N/A	N/A
8	Dominguez Services Corporation	1.37	1.62	1.85	2.76	2.95	N/A	N/A	N/A
9	E'town Corporation	1.20	1.34	1.57	1.79	2.47	N/A	N/A	N/A
10	IWC Resources Corporation	1.65	2.21	N/A	N/A	N/A	N/A	N/A	N/A
11	Middlesex Water Company	1.51	1.50	1.74	1.98	2.06	2.35	2.40	2.39
12	Pennichuck Corporation	N/A	N/A	N/A	N/A	1.70	1.78	2.12	1.92
13	Philadelphia Suburban Corporation	1.79	2.22	2.96	2.82	2.39	3.13	3.10	3.07
14	SJW Corporation	1.14	1.39	1.42	1.73	2.54	1.82	1.64	1.61
15	Southern California Water Company	1.35	1.37	1.43	N/A	N/A	N/A	N/A	N/A
16	Southwest Water Company	1.07	1.39	1.75	2.06	2.29	2.39	2.55	2.09
17	United Water Resources, Inc.	1.28	1.58	1.59	2.11	2.85	N/A	N/A	N/A
18	York Water Company	N/A	N/A	N/A	N/A	N/A	2.19	2.78	2.89
19	Average	1.42	1.61	1.85	2.13	2.19	2.14	2.31	2.24

Source: Monthly C.A. Turner Utility Reports (January 1996 - September 2003)