

No.:  
Witness: Michael Gorman  
Type of Exhibit: Rebuttal Testimony  
Issues: Cost of Service, Rate Design  
Sponsoring Party: Missouri Industrial Energy Consumers  
Case No.: WR-2010-0131

**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 )  
Services Provided in Missouri )  
Service Areas )  
\_\_\_\_\_ )

**Case No. WR-2010-0131**

Rebuttal Testimony and Schedule of

**Michael Gorman**

On behalf of

**Missouri Industrial Energy Consumers**

April 15, 2010



Project 9233

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

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Company's Request for Authority )  
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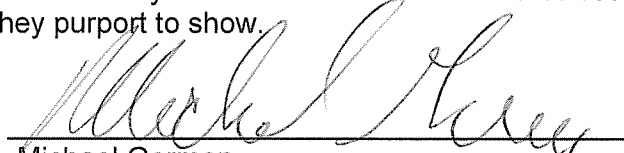
Case No. WR-2010-0131

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

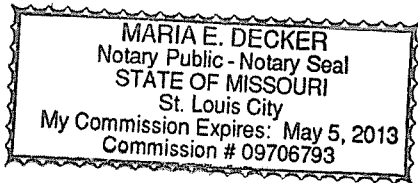
**Affidavit of Michael Gorman**

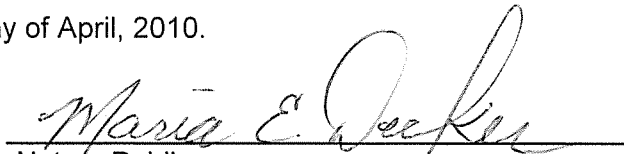
Michael Gorman, being first duly sworn, on his oath states:

1. My name is Michael Gorman. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 16690 Swingley Ridge Road, Suite 140, Chesterfield, Missouri 63017. 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 rebuttal testimony and schedule which were prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. WR-2010-0131.
3. I hereby swear and affirm that the testimony and schedule are true and correct and that they show the matters and things that they purport to show.

  
\_\_\_\_\_  
Michael Gorman

Subscribed and sworn to before me this 15th day of April, 2010.



  
\_\_\_\_\_  
Notary Public

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

	)	
In the Matter of	)	
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Increase for Water and Sewer	)	Case No. WR-2010-0131
Services Provided in Missouri	)	
Service Areas	)	
	)	

**Rebuttal Testimony of Michael Gorman**

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

2    A    Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,  
3    Chesterfield, MO 63017.

4    **Q    ARE YOU THE SAME MICHAEL GORMAN WHO FILED DIRECT TESTIMONY IN**  
5    **THIS PROCEEDING?**

6    A    Yes. On March 26, 2010, I filed direct testimony on behalf of the Missouri Industrial  
7    Energy Consumers (MIEC) regarding cost of service and rate design issues. I am  
8    also filing a separate rebuttal testimony on behalf of Triumph Foods, LLC.

9    **Q    PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

10   A    This information was included in Appendix A to my direct testimony.

11   **Q    WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

12   A    I will respond to Staff's cost of service study and proposed rate design for the  
13   St. Louis Metro District (SLM) as included in the document "Missouri Public Service

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1 Commission Staff's Class Cost-of-Service and Rate Design Report," dated March 26,  
2 2010, sponsored by Staff witness James M. Russo.

3 **Q PLEASE SUMMARIZE YOUR COMMENTS CONCERNING MR. RUSSO'S COST**  
4 **OF SERVICE AND RATE DESIGN FOR THE SLM.**

5 A Mr. Russo's cost of service for the SLM is severely flawed and should not be relied  
6 upon. Mr. Russo's cost of service study produces an incorrect and flawed allocation  
7 of costs between customer classes in the SLM.

8 Staff's Class Cost-of-Service and Rate Design Report, in Section E, states  
9 that Staff agrees that mains should be adjusted in the allocation to large industrial  
10 customers relative to small customers. However, Staff's allocation factors for mains  
11 (Factor 4 and Factor 7) fail to properly limit the allocation of small mains cost to  
12 Rate J customers, to the amount of the small mains serving these customers. As a  
13 result, Staff has substantially over-allocated small main costs to Rate J customers in  
14 its class cost of service study.

15 **Q WHY HAS STAFF ALLOCATED FAR TOO MUCH SMALL MAIN COST TO RATE J**  
16 **CUSTOMERS?**

17 A Mr. Russo developed Allocation Factors 4 and 7 because he assumed that only  
18 industrial facilities served on 12-inch mains and larger should receive a reduced  
19 allocation of the small main costs.

1 Q **WHY IS MR. RUSSO'S SMALL MAIN ADJUSTMENT TO ALLOCATION**  
2 **FACTORS 4 AND 7 WRONG?**

3 A Mr. Russo proposed to only use the Company's consumption adjustment of 54.2% for  
4 the large industrial customers served on 12-inch and larger mains. Mr. Russo did not  
5 believe that it was appropriate at this time to make an adjustment on the remaining  
6 industrial customers being served on smaller mains because all transmission and  
7 distribution mains are being used to transmit and distribute water to these remaining  
8 customers. (Staff's Class Cost of Service and Rate Design Report, pg 6.) Mr.  
9 Russo's allocation factor development completely contradicts the Company's finding  
10 that small mains have very limited use in providing service to Rate J customers.  
11 Specifically, at page 10 of his testimony, Company witness Mr. Herbert states that  
12 only approximately 0.7% of total small distribution mains are used to serve all Rate J  
13 customers. As a result, Mr. Herbert modified his Factor 4 to accommodate this  
14 reduced allocation of small main costs to Rate J customers.

15 In significant contrast, Mr. Russo proposed to only use the Company's  
16 consumption adjustment of 54.2% for the large industrial customers served on 12-  
17 inch and larger mains. Despite making this proposal, Mr. Russo only applied his  
18 proposal to the Factor 4 - Max Hour Extra Capacity but did not make the same  
19 change to the Factor 4 – Average Hourly Consumption. By not making the same  
20 change to the Factor 4 – Average Hourly Consumption, Mr. Russo included a full  
21 allocation of small distribution mains to all Rate J customers that are served from  
22 mains that are 12 inches or smaller.

23 This error had a dramatic effect on his development of Allocation Factors 4  
24 and 7 in his cost of service study for SLM. The consequence of incorrectly

1 developing Allocation Factors 4 and 7 is that Mr. Russo substantially over-allocated  
2 the cost of small mains to Rate J customers.

3 **Q DID STAFF CONTEST THE COMPANY'S FINDINGS THAT RATE J CUSTOMERS**  
4 **USE A VERY SMALL PERCENTAGE OF SMALL MAINS?**

5 A No.

6 **Q WOULD CORRECTING FACTOR 4 TO REFLECT THE VERY SMALL AMOUNT OF**  
7 **SMALL DISTRIBUTION MAINS SERVING RATE J CUSTOMERS PROPOSED BY**  
8 **MR. HERBERT SIGNIFICANTLY IMPACT MR. RUSSO'S COST OF SERVICE**  
9 **STUDY FOR SLM?**

10 A Yes. As shown on my attached Schedule MIEC-MPG-1, I adjusted Mr. Russo's cost  
11 of service study to only correct Factor 4 in his cost of service study. However,  
12 correcting Factor 4 also had implications on other allocation factors that were derived  
13 using Factor 4. The effect of this correction to his cost of service study results in a  
14 significant change in the relationship between cost of service for Rate J customers,  
15 and revenues at current rates.

16 As shown on my attached Schedule MIEC-MPG-1, out of a system-wide  
17 revenue deficiency of 6.6%, Rate J customers' revenue deficiency is only 5.20%, or a  
18 below system average deficiency. In significant contrast, Mr. Russo's cost of service  
19 study suggests that Rate J customers are substantially below cost of service and  
20 rates would need to be increased by 35.4% in comparison to a system average  
21 increase of 6.6%. (Schedule 1.1-SSTL).

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1 **Q DO YOU HAVE ANY OTHER ISSUES WITH STAFF'S ALLOCATION FACTORS?**

2 A Yes, Staff's development of Allocation Factor 6 is flawed. This factor is used to  
3 allocate pumping equipment and expenses. This factor is flawed because Staff did  
4 not include a max-hour component in the allocation factor. This is erroneous,  
5 because pumping equipment investment is sized for max hour and the expenses are  
6 increased due to max-hour conditions. Therefore, Staff's development of Allocation  
7 Factor 6 is flawed and its cost study is not reliable.

8 **Q DID STAFF EXPLAIN WHY IT EXCLUDED MAX-HOUR FACTORS IN**  
9 **CONSTRUCTING ALLOCATION FACTOR 6?**

10 A No.

11 **Q ARE THERE OTHER CONCERNS YOU HAVE WITH MR. RUSSO'S**  
12 **DEVELOPMENT OF ALLOCATION FACTORS IN HIS CLASS COST OF SERVICE**  
13 **STUDY FOR THE ST. LOUIS METRO DISTRICT?**

14 A Yes. Mr. Russo did not consistently use 2008 data in the development of his  
15 allocation factors. For example, his Factor 3 is based on data from calendar year  
16 2007. Also, his Factor 4 is based on data from calendar year 2006. Mr. Russo's  
17 study is flawed because the customer load consumption profiles used in the  
18 development of the allocation factors, do not match the costs incurred to serve that  
19 load profile because the data is from different time periods.

20 **Q HOW DO YOU PROPOSE TO MODIFY STAFF'S COST OF SERVICE STUDY?**

21 A There are so many flaws in Staff's cost of service study that I have not been able to  
22 properly adjust it to reasonably allocate Missouri-American's cost of service for the

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1 St. Louis Metro District between rate classes. Therefore, I recommend Staff's cost of  
2 service study be rejected.

3 **Q ARE THERE ANY OTHER PROPOSALS BY MR. RUSSO TO WHICH YOU WOULD**  
4 **LIKE TO RESPOND?**

5 A Yes. Mr. Russo states that he is proposing the elimination of the declining block rate  
6 structure and proposes to replace it with a single commodity rate structure for each  
7 customer classification within each district based on the results of the class cost of  
8 service study. (Russo Direct Testimony at 3).

9 **Q IS MR. RUSSO'S PROPOSED RATE DESIGN REASONABLE?**

10 A No. A declining block rate structure is appropriate for the SLM Rate J customers  
11 because a single volumetric rate will not accurately recover the cost of service from  
12 customers with the Rate J class, because the customers have varying load factors  
13 and consumption characteristics. For example, a smaller industrial facility should pay  
14 a larger volume rate to cover MAWC investments in the production and main costs  
15 serving the facility. Conversely, a larger Rate J customer can pay a smaller price per  
16 volume to cover the same costs. An economy of scale would justify a lower  
17 volumetric charge to a larger water customer. A single volumetric rate would, as a  
18 result, cause intraclass cost subsidization and produce inefficient price signals.

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1 Q DOES THE AMERICAN WATER WORKS MANUAL ON SETTING PRICES  
2 RECOGNIZE THE BENEFITS OF DECLINING BLOCK RATES?

3 A Yes. Benefits in accurate pricing for declining block rate structures are also  
4 recognized by the American Water Works Association (AWWA) in its *Water Rate*  
5 *Structures and Pricing* manual. The AWWA states the following:

- 6 “Utilities may consider using a declining block rate structure when
- 7 • A single rate structure is used for all customer classes of service.
  - 8 • A class of service has an array of customers with varying usage  
9 and demand requirements (e.g., a class of service containing both  
10 small and large commercial customers).
  - 11 • System costs decline with increasing water usage (i.e., economies  
12 of scale).
  - 13 • Economic circumstances dictate that price incentives be provided  
14 to encourage specific large-volume customers to remain on the  
15 system (e.g., a large-volume customer that can develop its own  
16 source of supply by drilling a well). This consideration may be  
17 characterized as an economic incentive rate.” (*Water Rate*  
18 *Structures and Pricing*, American Water Works Association Manual  
19 of Water Supply Practices, Second Edition, 1999, at 50).

20 Because of differences in investments to serve Rate J customers, varying load  
21 factors, and the need for each customer to properly pay for the cost incurred to serve  
22 their facility, a declining rate block structure is appropriate for Rate J in the SLM.

23 Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

24 A Yes, it does.

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**MISSOURI-AMERICAN WATER COMPANY**  
**(ST. LOUIS METRO AREA DISTRICT)**  
**PSC STAFF STUDY - ADJUSTED FACTOR 4**

Customer Classification (1)	Cost of Service		Revenues, Present Rates		Increase to Cost	
	Amount (2)	Percent (3)	Amount (4)	Percent (5)	Amount (6)	Percent Increase (7)
Rate A & K	\$ 153,871,705	90.8%	\$ 137,890,577	86.8%	\$ 15,981,128	11.6%
Rate B	4,157,600	2.5%	2,418,389	1.5%	1,739,211	71.9%
Rate D	-	0.0%	-	0.0%	-	0.0%
Rate F & E	1,491,611	0.9%	9,077,635	5.7%	(7,586,024)	-83.6%
Rate H	2,857,900	1.7%	2,857,900	1.8%	-	0.0%
Rate J	6,913,142	4.1%	6,573,293	4.1%	339,849	5.2%
<b>Total Sales</b>	<b>\$ 169,291,958</b>	<b>100.0%</b>	<b>\$ 158,817,794</b>	<b>99.9%</b>	<b>\$ 10,474,164</b>	<b>6.6%</b>
Other Revenues	1,518,285		1,518,285		-	0.0%
<b>Total</b>	<b>\$ 170,810,243</b>		<b>\$ 160,336,079</b>		<b>\$ 10,474,164</b>	<b>6.5%</b>
True-Up Estimate	\$0				\$0	
<b>Total w/ True-up</b>	<b>\$170,810,243</b>				<b>\$ 10,474,164</b>	<b>6.5%</b>