

**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-2011-0337

Rebuttal Testimony of Michael P. 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 P. GORMAN WHO PREVIOUSLY FILED DIRECT
5 TESTIMONY IN THIS CASE?

6 A Yes.

7 Q PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

8 A This information is included in Appendix A to my direct testimony regarding revenue
9 requirement issues, filed on November 17, 2011.

10 Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

11 A This testimony is presented on behalf of the Missouri Industrial Energy Consumers
12 ("MIEC") and Triumph Foods, LLC ("Triumph"). These companies purchase

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1 substantial amounts of water from Missouri-American Water Company ("Missouri-
2 American" or "Company").

3 **Q WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?**

4 A The purpose of my rebuttal testimony is to respond to the direct testimony of James
5 A. Busch on behalf of the Missouri Public Service Commission ("Commission") Staff.
6 Mr. Busch sponsors Staff's class cost of service study ("CCOS") and proposed rate
7 design. I will specifically address Staff's proposed rate design as described by
8 Mr. Busch in his testimony.

9 **Q WHAT RATE DESIGN IS USED FOR THE COMPANY'S PRESENT RATES?**

10 A The Company's present rates are based on District-Specific Pricing ("DSP"). In my
11 direct testimony, I recommended that the Company's districts continue to be priced at
12 DSP and that the Commission reject the Company's proposal for consolidated
13 pricing. With DSP, water rates are developed for each operating district based upon
14 the costs incurred (both direct costs and allocated corporate costs) in providing water
15 service to each individual operating district. I also outlined the efficiency price signals
16 created by DSP in my direct testimony at page 5.

17 **Q WHAT IS THE PRIMARY BENEFIT OF YOUR DIRECT TESTIMONY
18 RECOMMENDATION THAT DISTRICT-SPECIFIC PRICING CONTINUE TO BE
19 USED TO DEVELOP THE COMPANY'S WATER RATES?**

20 A The primary benefit of DSP is to develop efficient pricing that reflects the cost of
21 providing water service, referred to as cost causation. Under DSP, the cost causers
22 pay for the costs incurred by the Company in providing water service. This is in

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1 contrast to the Company's proposal for consolidated pricing, which as I explained in
2 my direct testimony, abolishes the concept of cost causation since it ignores the
3 differences in costs of providing service in each district as well as the differences in
4 rate base investment that have been incurred to provide water service in each
5 operating district. As a result, consolidated pricing results in price subsidies to
6 customers in high-cost districts at great cost to customers in low-cost districts. Stated
7 differently, consolidated pricing results in prices that do not reflect costs. This in turn
8 results in improper price signals that encourage subsidized customers to make
9 inefficient consumption decisions.

10 **Q WHAT RATE DESIGN APPROACH DOES STAFF RECOMMEND IN ITS DIRECT**
11 **TESTIMONY?**

12 **A** Staff recommends a hybrid rate design consisting of both DSP and consolidated
13 pricing.

14 **Q WHAT IS STAFF'S SPECIFIC RATE DESIGN PROPOSAL?**

15 **A** Staff proposes to create three distinct water districts with consolidated pricing within
16 each of the three districts. The hybrid districts would be made up of the following
17 service territories:

- 18 • Water District 1 – St. Louis Metro, Warren County, Mexico, Jefferson City,
19 and Lake Carmel/Maplewood.
- 20 • Water District 2 – St. Joseph, Platte County, and Brunswick.
- 21 • Water District 3 – Joplin/Loma Linda, Roark, Warrensburg, White Branch,
22 Lake Taneycomo, Lakewood Manor, Rankin Acres, Spring Valley, and
23 Riverside Estates.

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1 Q DO YOU AGREE WITH STAFF'S HYBRID RATE DESIGN PROPOSAL?

2 A No, I do not agree with Staff's proposal.

3 Q WHY DO YOU NOT AGREE WITH STAFF'S RATE DESIGN PROPOSAL?

4 A Staff's proposal results in unjust subsidies being paid by customers in lower-cost
5 districts. For example, under Staff's proposal, a large subsidy would be provided by
6 the St. Louis Metro District to the Jefferson City District. Staff also proposes that a
7 subsidy would be provided by the St. Joseph District to both the Brunswick and Platte
8 County Districts. I do not agree that the St. Louis Metro and St. Joseph Districts
9 should pay higher rates to provide these subsidies as proposed by Staff.

10 Q AT PAGES 6-9 OF HIS DIRECT TESTIMONY, MR. BUSCH EXPLAINS WHY
11 STAFF IS PROPOSING TO MOVE AWAY FROM THE LONG-STANDING
12 PRACTICE OF DSP PRICING AND IS NOW PROPOSING A HYBRID PRICING
13 APPROACH IN THIS CASE. WHAT REASONS DOES HE PROVIDE?

14 A He provides the following four reasons as justification for Staff's proposal:

- 15 1. The increase in the number of water districts, particularly smaller water
16 districts, creates difficulty in allocating costs to the districts, particularly
17 corporate costs.
- 18 2. The increased number of districts puts a strain on Staff resources.
- 19 3. Investment in higher cost smaller districts is spread to a larger customer
20 base.
- 21 4. Staff's proposal encourages Missouri-American to purchase struggling
22 water and sewer companies.

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1 Q IS IT NECESSARY TO PROVIDE THE JEFFERSON CITY DISTRICT A COST
2 SUBSIDY TO ACCOMPLISH THESE OBJECTIVES IDENTIFIED BY STAFF?

3 A No. The proposed subsidy provided to the Jefferson City District is not needed to
4 accomplish the hybrid pricing objectives identified by Staff. Rather, the subsidy to the
5 Jefferson City District appears to be designed to mitigate the cost of this district's
6 large capital investment program in this case. This price mitigation for Jefferson City
7 is not appropriate because it is not consistent with similar regulatory decisions for
8 other districts.

9 Q WHAT PERCENT INCREASE WOULD THE JEFFERSON CITY DISTRICT
10 RECEIVE UNDER DSP?

11 A The Jefferson City District would receive an approximate 42% increase under the
12 Company's claimed revenue deficiency. This increase would be reduced if my
13 recommended return on equity and Staff's other positions on revenue requirement
14 are adopted.

15 Q HAVE OTHER DISTRICTS HISTORICALLY RECEIVED LARGE INCREASES
16 UNDER DSP DUE TO LARGE CAPITAL INVESTMENTS BY THE COMPANY?

17 A Yes. In Case No. WR-2000-281, the St. Joseph District received in excess of a 100%
18 increase in water rates. This large increase for the St. Joseph District was primarily
19 driven by investment in production plant. In Case No. WR-2007-0216, the Joplin
20 District received in excess of a 60% increase in water rates. This large increase for
21 the Joplin District was also primarily driven by investment in production plant.

22 Importantly, these districts' price increases were not mitigated by charging
23 subsidies to other districts. The Jefferson City District is a large district and should

1 support its own cost of service without subsidies, just as the St. Joseph and Joplin
2 Districts have done historically.

3 **Q WHAT IS YOUR RECOMMENDATION WITH RESPECT TO DISTRICT REVENUE**
4 **ALLOCATION AND RATE DESIGN?**

5 A In my direct testimony, I recommended that all districts continue on DSP. As an
6 alternative to strict DSP, I recommend that the seven large districts with cost of
7 service over \$1,000,000 remain on DSP. These seven districts include: St. Louis
8 Metro, St. Joseph, Joplin, Jefferson City, Parkville, Mexico, and Warrensburg. My
9 recommendation best reflects cost causation principles and recognizes the
10 differences in the costs in providing water service to each of these districts. To
11 reduce the number of small districts, I recommend that Warren County be combined
12 with the St. Louis Metro District.

13 Further, I recommend the remaining small districts be combined into a single
14 water district and rates be designed based on the combined cost of service for this
15 "Small District System."

16 **Q WHY ARE YOU RECOMMENDING THAT THE SMALL WATER DISTRICTS BE**
17 **COMBINED?**

18 A My proposal for large districts to stand on their own, and combining small districts, will
19 reduce the number of cost of service studies Staff must examine in rate proceedings,
20 and provide for an average cost of service to the smaller districts. This will
21 accomplish three of the four reasons Staff cited for moving away from DSP.

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1 Q DOES STAFF PROPOSE A SUBSIDY BE PAID BY THE WATER DISTRICTS TO
2 THE SEWER DISTRICTS?

3 A Yes.

4 Q DO YOU AGREE WITH STAFF'S PROPOSED SEWER SUBSIDY?

5 A No. Staff proposes that its proposed Water District 1, which includes the St. Louis
6 Metro District, provide a subsidy to the Company's sewer districts in the amount of
7 \$1,833,995. Staff's proposed methodology does not spread its proposed sewer
8 subsidy to all water districts. Hence, Staff's proposed allocation of this subsidy is not
9 equitable to all customers on the system.

10 Q WHY DID STAFF SELECT ONLY THE WATER DISTRICT 1 CUSTOMERS TO
11 PROVIDE A SEWER SUBSIDY?

12 A According to Mr. Busch's testimony, Staff chose this district because of the large
13 number of customers in the proposed Water District 1.

14 Q DO YOU AGREE WITH STAFF'S PROPOSAL FOR ONLY THE WATER
15 DISTRICT 1 TO PROVIDE A SEWER SUBSIDY?

16 A No, I do not. I recommend that in the event that the Commission decides some
17 support is necessary for the Company's sewer districts that all water districts'
18 customers provide support to the sewer districts. It is not reasonable for only the
19 Water District 1 customers to support a sewer subsidy, especially in light of Staff's
20 proposal to exclude those water customers in combined water and sewer districts.

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1 Q ARE THERE ANY OTHER ISSUES YOU WOULD LIKE TO ADDRESS?

2 A Yes. As stated earlier in my testimony, Staff witness Mr. Busch stated that one of the
3 reasons Staff desired to move away from DSP was that it would encourage utilities to
4 purchase struggling water and sewer utilities.

5 Q PLEASE RESPOND TO THIS ACQUISITION CONCERN.

6 A Staff's proposal to use consolidated pricing to accomplish this acquisition objective,
7 without any restrictions on the acquisition price of struggling utilities, is very troubling.
8 I strongly encourage the Commission to consider placing acquisition criteria on all
9 future acquisitions of water and sewer utilities. These criteria should encourage the
10 acquiring utility to perform due diligence of the target acquisition and limit the
11 acquisition price to an amount that can be supported at reasonable water/wastewater
12 service prices.

13 Such criteria would encourage the acquiring utility to engage in aggressive
14 arms-length negotiations to manage the acquisition price to a reasonable amount and
15 keep the acquired system rate and cost structures to a reasonable level. It is not
16 reasonable for the acquiring utility simply to purchase struggling systems at
17 unreasonable acquisition prices with the expectation that the acquisition price will be
18 subsidized by existing water districts. A reasonable service price criterion will help
19 prevent such transactions from occurring.

20 Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

21 A Yes, it does.

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