





**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	)	Case No. WR-2011-0337
Services Provided in Missouri	)	
Service Areas	)	
	)	

**Surrebuttal 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       **AND REBUTTAL 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 SURREBUTTAL TESTIMONY?**

4 A The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of  
5 Company witnesses Paul Herbert and Dr. Karl McDermott. I will also comment on the  
6 rebuttal testimony of Donald Johnstone on behalf of Ag Processing.

7 **Q ON PAGES 4 AND 5 OF HIS REBUTTAL, MR. HERBERT DISCUSSES THE  
8 ALLOCATION OF SMALL MAINS. PLEASE ADDRESS HIS COMMENTS.**

9 A I agree with Mr. Herbert's testimony regarding the allocation of small mains. MIEC  
10 has historically supported Missouri-American's treatment of small mains. Large  
11 industrial customers with 12-inch mains simply do not use the distribution system  
12 designed to deliver water to residential customers with 5/8-inch meters.

13 **Q HOW DOES MR. HERBERT RESPOND TO YOUR PROPOSAL TO CONTINUE  
14 DISTRICT-SPECIFIC PRICING ("DSP")?**

15 A At page 12 of his rebuttal testimony, Mr. Herbert states that DSP is no better at  
16 identifying the cost to serve customers than consolidated or single tariff pricing.

17 **Q PLEASE RESPOND.**

18 A I strongly disagree. As stated in my direct testimony, consolidated pricing ignores the  
19 differences in costs of providing service in each non-interconnected district. DSP  
20 recognizes these cost differences and establishes rates based on cost causation.

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1 Q AT PAGE 10 OF HIS REBUTTAL TESTIMONY, MR. HERBERT STATES THAT  
2 DSP DOES NOT ELIMINATE INEQUITIES OR SUBSIDIES WITHIN A DISTRICT.  
3 HOW DO YOU RESPOND?

4 A I again disagree. DSP assigns district costs between customers recognizing all the  
5 benefits and costs customers impose on the district and contribute to the overall  
6 economies of the district operations. Mr. Herbert's example, whereby a customer's  
7 residence which is located next to a treatment plant should pay less than a residence  
8 miles away, is incomplete. For example, there are characteristics of the system  
9 which may benefit a customer closer to the water treatment plant that are produced  
10 by other customers located further away from the treatment plant. For example, while  
11 certain customers located near a water treatment plant need less distribution  
12 equipment than customers further away from the plant, there are other offsetting  
13 benefits. For example, the Company may install water towers or storage units that  
14 are used to meet peak hour demands and these facilities are often spread across the  
15 entire district. The Company may not be able to meet the near-plant customers' peak  
16 hour demands without access to these peaking assets. Customers near the plant  
17 would not have access to the peaking assets without access to the extended  
18 distribution system. Further, increasing the number of customers in a district can help  
19 create economies of scale for use of the water treatment plant that a smaller group of  
20 customers could not achieve on their own.

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1 Q AT PAGE 10 OF HIS REBUTTAL TESTIMONY, MR. HERBERT PROVIDES  
2 EXAMPLES OF COST DIFFERENCES THAT DSP DOES NOT SOLVE. DOES  
3 CONSOLIDATED PRICING SOLVE THE COST DIFFERENCES MR. HERBERT  
4 CITES AS EXAMPLES IN HIS TESTIMONY?

5 A No. In fact, consolidated pricing would make them worse. Under the Company's  
6 consolidated pricing proposal, not only could a customer pay for cost differences that  
7 exist within its own district system, but the customer would also pay for inter-district  
8 cost differences. For example, a customer in a low-cost district could pay for  
9 distribution system costs incurred in serving customers hundreds of miles away in a  
10 higher-cost district even though the two district systems are not interconnected.

11 Q IN HIS REBUTTAL TESTIMONY, DR. MCDERMOTT CONTINUES TO  
12 RECOMMEND CONSOLIDATED PRICING. COULD YOU PLEASE SUMMARIZE  
13 HIS REASONS FOR HIS RECOMMENDATION?

14 A Dr. McDermott continues to recommend consolidating pricing primarily for public  
15 policy reasons. He characterizes those who support DSP as relying on "narrowly  
16 defined cost of service concepts," with those concepts being those of embedded  
17 costs. Dr. McDermott questions whether embedded costs are the appropriate  
18 method for determining cost of service in this case. He actually argues that marginal  
19 costs are likely a better indicator of cost of service since it is his belief that marginal  
20 costs should not differ much across the Company's system.

21 Q HOW DO YOU RESPOND TO DR. MCDERMOTT'S REBUTTAL TESTIMONY?

22 A Dr. McDermott's rebuttal testimony attempts to minimize the significance of  
23 embedded costs in determining the rates of the Company's customers in its historical

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1 districts. Further, Dr. McDermott's marginal cost ignores economies of scale created  
2 through large water distribution systems, relative to those of small systems. As such,  
3 the marginal cost of service for a very large water district is likely not the same as the  
4 marginal cost of service for a very small water distribution system. Hence, Dr.  
5 McDermott's marginal cost of service principle is in error and without merit.

6 **Q SHOULD THE COMPANY ABANDON ITS EMBEDDED COST OF SERVICE**  
7 **STUDY PRECEDENTS USED IN WATER AND OTHER UTILITY RATE-SETTING**  
8 **CASES?**

9 **A** No. To ignore the embedded costs of the Company ignores how the Company has  
10 incurred costs to serve its customers in its various districts and also ignores the cost  
11 differences that do indeed exist to serve the Company's customers in its different  
12 districts. Determining rates for the Company's districts using a method other than  
13 embedded costs, such as marginal costs, would be a drastic departure from  
14 regulation in Missouri and would not reflect the Company's cost of serving its  
15 customers in its districts. Dr. McDermott is relying on economic principles which the  
16 Commission has not recognized in setting rates for Missouri ratepayers and his  
17 proposals should be given little consideration by the Commission.

18 **Q WHAT IS YOUR RECOMMENDATION WITH RESPECT TO RATE DESIGN?**

19 **A** As stated in my rebuttal testimony, I continue to recommend that the seven large  
20 districts with cost of service over \$1 million remain on DSP. These seven districts  
21 include: St. Louis Metro, St. Joseph, Joplin, Jefferson City, Parkville, Mexico, and  
22 Warrensburg. My recommendation best reflects cost-causation principles and

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1 recognizes the differences in the costs of providing water service to each of these  
2 districts.

3 Further, I recommend the remaining small districts be combined into a single  
4 water district and tier rates be designed based on the cost of service for the tiers in  
5 the "Small District System."

6 **Q DO YOU GENERALLY SUPPORT THE RATE DESIGN PROPOSAL FOR THE**  
7 **"SMALL DISTRICT" AS DESCRIBED BY AG PROCESSING WITNESS**  
8 **MR. JOHNSTONE IN HIS REBUTTAL TESTIMONY?**

9 A Yes. I generally support the entire rate design proposal as shown in Schedule 1 of  
10 Mr. Johnstone's rebuttal testimony.

11 **Q DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

12 A Yes, it does.

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