

No.:
Witness: Michael P. Gorman
Type of Exhibit: Direct Testimony
Issues: Class Cost of Service
Sponsoring
Parties: Missouri Industrial Energy Consumers
and Triumph Foods, LLC
Case No.: WR-2011-0337

**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

Direct Testimony of

Michael P. Gorman

On behalf of

**Missouri Industrial Energy Consumers
and
Triumph Foods, LLC**

December 12, 2011



Project 9498

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

In the Matter of)
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Company's Request for Authority)
to Implement a General Rate)
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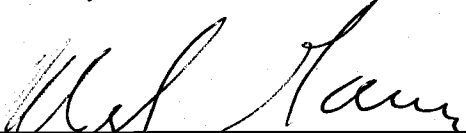
STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS)

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Affidavit of Michael P. Gorman

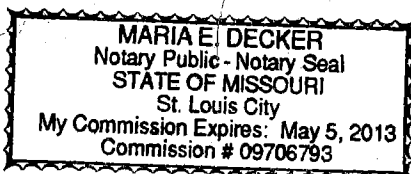
Michael P. Gorman, being first duly sworn, on his oath states:

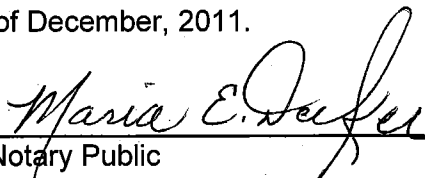
1. My name is Michael P. Gorman. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 16690 Swingley Ridge Road, Suite 140, Chesterfield, Missouri 63017. We have been retained by the Missouri Industrial Energy Consumers and Triumph Foods, LLC in this proceeding on their behalf.
2. Attached hereto and made a part hereof for all purposes is my direct testimony which was prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. WR-2011-0337.
3. I hereby swear and affirm that the testimony is true and correct and that it shows the matters and things that it purports to show.



Michael P. Gorman

Subscribed and sworn to before me this 12th day of December, 2011.





Notary Public

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

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)	

Direct 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**
- 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 DIRECT TESTIMONY ON CLASS COST OF**
4 **SERVICE ISSUES?**

5 A The purpose of my testimony is to respond to the Company’s proposal for
6 consolidated pricing for its operating districts throughout Missouri. For the reasons
7 described in my testimony, I recommend that the Company’s proposal for
8 consolidated pricing be rejected and that the Company continue district-specific
9 pricing for its operating districts.

10 **Q WHY IS THE COMPANY PROPOSING CONSOLIDATED PRICING FOR ALL OF**
11 **ITS DISTRICTS?**

12 A Company witness Dennis Williams states at page 26 of his direct testimony that if the
13 Company continues district-specific pricing, it would be faced with 27 different sets of
14 rates in the current case. He further states that “consolidation of the industry is likely
15 to continue and the problem of multiple sets of rates will only be exacerbated.”

16 **Q IS IT REASONABLE TO ADOPT CONSOLIDATED PRICING TO REDUCE THE**
17 **REGULATORY BURDEN OF DISTRICT-SPECIFIC PRICING?**

18 A No. Mr. Williams’ assertion that the Company is concerned about the number of tariff
19 rate options necessary to support various districts throughout the state merely reflects
20 the variations in cost of service and limitations on service terms and conditions
21 necessary to provide service in various districts throughout the state. Hence, a

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1 benefit to the current district-specific tariff structure is that customers pay prices that
2 align with the Company's cost of providing water service across districts.

3 Mr. Williams' attempt to reduce the Company's administrative effort by
4 proposing the same rate structure throughout the state erodes the efficiency of price
5 signals, and creates inter-district customer subsidies.

6 **Q DOES MR. WILLIAMS EXPLAIN IN HIS TESTIMONY WHY MULTIPLE SETS OF**
7 **TARIFFS ARE A PROBLEM FOR THE COMPANY?**

8 A No. Mr. Williams fails to explain why separate tariff rates for its districts create a
9 problem for the Company. He states that the Company desires to return to
10 consolidated pricing for the reasons indicated in the testimony of Company witness
11 Karl McDermott.

12 **Q WHAT REASONS DOES DR. MCDERMOTT PROVIDE IN HIS TESTIMONY FOR**
13 **THE COMPANY'S PROPOSAL FOR CONSOLIDATED PRICING?**

14 A Dr. McDermott recommends consolidated pricing primarily based on public policy
15 benefits. Moreover, Dr. McDermott claims at page 4 of his testimony that the
16 economic benefits of more closely connecting costs with prices (i.e., district-specific
17 pricing) are not likely to be significant in this case.

18 **Q DOES DR. MCDERMOTT PROVIDE ANY ANALYSIS RELATED TO THE FACTS**
19 **OF THIS CASE AND THE COMPANY'S SITUATION TO SUPPORT HIS CLAIM?**

20 A No, he does not.

1 **Q IS THE COMPANY'S PROPOSAL FOR CONSOLIDATED PRICING**
2 **REASONABLE?**

3 A No, it is not.

4 **Q PLEASE EXPLAIN WHY THE COMPANY'S PROPOSAL FOR CONSOLIDATED**
5 **PRICING IS NOT REASONABLE.**

6 A Consolidated pricing is inappropriate for several reasons. First, there is no common
7 or economic cost structure across the many Company districts throughout the state.
8 Specifically, many of the districts are not interconnected via using the same (or group
9 of same) water treatment plants. Water treatment plants serving the districts are
10 supplied from district-specific raw water sources (including both groundwater and
11 surface water), which impact water treatment costs. The distribution networks,
12 pumping equipment and even utilities serving the various territories are distinct across
13 the state, and the various geographic characteristics of each service territory impact
14 costs related to storage, pressure, pumping, chemicals and other costs associated
15 with providing water service in those areas.

16 Second, consolidated pricing ignores the differences in costs of providing
17 service in each non-interconnected district including, but not limited to, water
18 treatment and supply, labor force, and delivery. Consolidated pricing also ignores the
19 differences in rate base investment that have occurred to provide water service in
20 each operating district. Consolidated pricing is inconsistent with traditional cost of
21 service principles and abolishes the concept of cost-causation. In essence,
22 consolidated pricing results in price subsidies to customers in high-cost districts at
23 great cost to customers in low-cost districts.

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1 Moreover, the unjust cross-subsidies created by consolidated pricing could
2 erode the efficiency of the water system. These rate subsidies would erode the
3 economic incentive for customers in higher cost districts to be more efficient in
4 placing demands on the water utility because the prices they pay do not accurately
5 reflect the cost of receiving water service. Hence, customers with subsidized prices
6 may impose greater inefficient demand on high-cost districts which could cause
7 greater cost at the high-cost districts and increase customer subsidies to bring that
8 district price down to the consolidated rate.

9 **Q PLEASE ELABORATE ON HOW CONSOLIDATED PRICING CAN ERODE**
10 **SYSTEM EFFICIENCY.**

11 A Consolidated pricing could provide the Company disincentives for cost control within
12 high-cost operating districts because all costs would be averaged across the state. If
13 rates were to be consolidated, there would be no reason to maintain separate books
14 and records for each operating district. Due to the loss of transparent operating and
15 financial data for each operating district, it would be very difficult to evaluate the
16 efficiency and effectiveness of each operating district. As a result, the Missouri Public
17 Service Commission would lose some of its ability to exercise proper regulatory
18 oversight of the Company's operations. Consolidated pricing will not allow the
19 Company to properly manage its different geographical operating districts and will
20 prevent it from identifying high-cost operating districts in the future.

21 **Q DO YOU HAVE ANY OTHER CONCERNS WITH CONSOLIDATED PRICING?**

22 A Yes. Consolidated pricing greatly reduces the Company's incentive to perform due
23 diligence before acquiring new water systems and may also impact the price

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1 Missouri-American is willing to pay for new systems. New systems could be acquired
2 without adequate consideration as to whether the costs to operate those systems are
3 economical since those costs would be rolled into existing rates under consolidated
4 pricing.

5 **Q WHAT DO YOU RECOMMEND REGARDING THE COMPANY'S CONSOLIDATED**
6 **PRICING PROPOSAL?**

7 A I recommend that the Company's proposal for consolidated pricing be rejected and
8 that district-specific pricing be maintained.

9 **Q DO YOU KNOW WHAT THE INCREASES IN COST OF SERVICE WOULD BE FOR**
10 **EACH OPERATING DISTRICT UNDER DISTRICT-SPECIFIC PRICING?**

11 A Yes. Listed in Table 1 below are the revenue deficiencies for each operating district
12 identified by Company witness Paul Herbert in his direct testimony.

<u>Operating District</u>	<u>Amount</u>	<u>Percent</u>
Brunswick	\$376,136	102.9%
Jefferson City	\$2,462,636	42.2%
Joplin	\$2,858,832	15.8%
Mexico	\$990,506	28.1%
Parkville	\$2,023,886	39.6%
St. Joseph	\$4,443,150	21.8%
St. Louis Metro	\$28,319,126	15.9%
Warren County	\$24,236	6.8%
Warrensburg	\$587,010	15.9%
Total (All Districts)	\$42,229,498	17.9%

Source: Herbert Direct Testimony Workpapers.

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1 MIEC and Triumph believe the deficiencies identified in Table 1 above would
2 need to be adjusted consistent with the MIEC revenue requirement direct testimony.

3 **Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY ON CLASS COST OF**
4 **SERVICE ISSUES?**

5 **A** Yes, it does.

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