Missouri Public Service Commission

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January 19, 2001

FILED[3]
JAN 1 9 2001
Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

RE: Case No. EA-2000-308

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of an **STAFF'S INITIAL BRIEF.**

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Dennis L. Frey

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Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED[3]

JAN 1 9 2001

Missouri Public
Service Commission

In the Matter of the Application of the City of Rolla, Missouri, for an Order Assigning Exclusive Service Territories and for Determination of Fair and Reasonable Compensation Pursuant to Section 386.800, RSMo 1994.	)	Case No. EA-2000-308

STAFF'S INITIAL BRIEF

INTRODUCTION

On October 29, 1999, the City of Rolla ("City" or "Rolla"), through Rolla Municipal Utilities ("RMU"), filed with the Missouri Public Service Commission ("Commission"), an Application pursuant to Section 386.800 RSMo 1994[1], seeking an order that both authorizes RMU to acquire the facilities/customers of Intercounty Electric Cooperative Association ("Intercounty" or "Cooperative") within Rolla's newly annexed territory and establishes fair and reasonable compensation to Intercounty for the right to do so. This marks the first time a municipality has litigated this matter before the Commission.

Over the years, the Staff has participated in numerous cases involving territorial agreements, facilities exchanges and customer exchanges. During the months leading up to the hearing in this case, the Staff, in a familiar role in cases involving service territory, sought to act as a mediator and facilitator in an attempt, ultimately unsuccessful, to achieve a settlement of this

[1] Unless otherwise noted, all subsequent statutory references are to RSMo 1994.

13

case. However, in addition and for the first time, the Staff also has taken positions on the quantification of the costs involved, in connection with the statutory issue of "fair and reasonable compensation" to Intercounty for the exchange of customers and facilities.

Under the governing statute, in order to approve the Application of RMU in this case, the Commission must first find that the transaction is in the public interest. If the Commission so finds, it must then decide the matter of fair and reasonable compensation to be paid to Intercounty for the facilities and customers subject to transfer. The statutory language also indicates that the Commission, if it so chooses, may also draw a boundary delineating the exclusive service territories of the two utilities.

The Staff's brief begins by addressing the three legal questions raised by the Commission. (Note: Two of those questions are addressed in Issue II below.) Thereafter, to the extent considered practicable, the brief is organized largely along the lines of the list of issues filed by the Staff on November 14, 2000. Some modifications have been made in the interest of a coherent flow of presentation.

ARGUMENT

I. Can the Commission assign any part or all of the annexed territory as the exclusive service area of Intercounty for the future, and if so, would Intercounty be able to serve new structures?

Because this is the first time this matter has ever been litigated before the Commission, in addressing the Commission's legal questions, the parties are necessarily without a body of case law upon which to rely. Therefore, the parties are obliged to offer their own interpretations of the governing statute.

The Staff is persuaded that it is statutorily permissible for the Commission to assign any part or all of the annexed territory as the exclusive service area of Intercounty. Section 386.800.6 RSMo. states that "...the municipally owned electric utility may apply to the commission for an order assigning exclusive service *territories* within the annexed area...." (emphasis added). The legislature's use of the plural, "territories" authorizes the Commission to assign an exclusive service territory to more than one utility within the annexed area. That same provision also mandates that the Commission hold evidentiary hearings "...to assign service territory between affected electric suppliers inside the annexed area...". Subsection 4, in mandating negotiations between "...the municipally owned electric utility and the affected electric supplier...", makes clear that an "affected electric supplier" is an entity other than the municipal utility; *i.e.*, one that is "affected" by the municipality's annexation. Thus, if there were more than one such entity in the annexed area, the Commission could also partition the area among those entities.

As to whether the Commission may assign <u>all</u> of the recently annexed area to Intercounty, the Staff again believes that the answer is "yes." The statute does not limit the amount of the annexation area that may be assigned either to RMU or to Intercounty. Therefore, the Commission presumably may, for example, assign 75% to one party and 25% to the other, or more than 99% to one, and less than 1% to the others. It makes little sense, then, to argue that both entities must be permitted to serve <u>some</u> share of the annexation area.

With regard to the question whether the assignment to Intercounty of an exclusive service territory within the annexation area would entitle the Cooperative to serve new structures, the Staff asserts that the answer is again "yes." In fact, that is essentially what the term "exclusive service territory" means. In considering this question, it is helpful to consider Chapter 394 of the

Missouri statutes, which regulates rural electric cooperatives. Pursuant to Section 394.312, the cooperatives frequently enter into territorial agreements, often with regulated utilities, the result of which, upon approval by this Commission, is normally to specify exclusive service territories as between the utilities that are parties to the particular agreement. The territorial agreement will specify which utility will provide service to customers, both new and existing, or it may be accompanied by a customer exchange, but the primary purpose of the agreement is to allow the parties to manage their growth in business within their respective territories in a climate of orderliness and certainty.

Analogously, under the governing statute in the instant case, the parties were permitted to enter into a territorial agreement to specify exclusive service territories within the annexation area. The parties having failed to reach such an agreement, the statute requires the Commission to specify an exclusive service territory, or territories, with the concomitant right to serve new customers therein.

II. If the Commission rules in favor of the proposed transfer of facilities and customers and accordingly, establishes fair and reasonable compensation to Intercounty, does the City of Rolla retain the right to determine whether or not it will go through with the transaction?

In the course of answering this question, the Staff will also answer the Commission's third question; *i.e.* "What does the final sentence in subsection 6 of the statute mean?" Indeed Staff's answer to Question II above hinges on that very sentence.

With regard to Question II, the Staff takes the position that, contrary to the opinion expressed by an RMU witness (Tr. 389, lines 5-15), Rolla is not *automatically* entitled to elect not to go through with the transaction in the event that the Commission approves it and the City does not like the Commission's determination of fair and reasonable compensation. The final sentence in subsection 6 reads as follows: "The payment of compensation and transfer of title and operation of the facilities *shall* occur within ninety days after the order and any appeal therefrom becomes final unless the order provides otherwise." (emphasis added).

In Staff's view, there are at least two viable interpretations of this sentence. Under one interpretation, the "shall," mandates the transfer of title and operation of the facilities. Thus, if the Commission approves the transfer, it is required also to order it. The only latitude the Commission has under this interpretation concerns the question whether the transfer *shall* occur "within ninety days after the order and any appeal therefrom becomes final," or whether the transfer occurs within some other, presumably longer, timeframe.[2]

An alternative interpretation of the sentence, however, would allow the Commission, should it decide to approve the transfer, to permit Rolla to elect a return to the status quo if the City is not happy with the Commission's determination of fair and reasonable compensation. This interpretation obtains if one interprets the qualifying clause, "unless the order provides otherwise." as extending also to the "shall occur" phrase. Under this interpretation, then, the transfer need not occur if the Commission so orders. In other words, the Commission may simply authorize, but not order, the transfer, and Rolla would be free to decide whether or not to go forward with it.

Clearly, the second interpretation, under which the Commission may elect merely to authorize the requested transfer, affords the Commission greater authority and wider latitude in rendering its decision. Under either interpretation, however, Rolla does not have the automatic right to elect not to go through with the transaction.

[2] In the instant case, as discussed in the testimony of Staff witness Ketter, if the Commission orders the requested transfer of facilities, it makes good sense for the Commission also to order a substantially longer time frame to accomplish the transfer. Among other things, this will permit a reasonable and orderly transition, as well as a competitive bidding process to govern the cost of detaching and reintegrating Intercounty's system. (Tr. 550, lines 14-23).

According to Section 394.312.2, Intercounty may serve retail customers within Rolla's city limits pursuant to a territorial agreement. Likewise, under Section 386.800, the governing statute in this case, the parties may agree to such an arrangement. However, in Staff's opinion, Section 386.800, also provides that, upon the request by the municipality for Commission assistance, the Commission shall establish the service territories in the annexation area. In effect, by involving the Commission, Rolla has set in motion a process that might be considered analogous to binding arbitration. Of course, under section 386.800, RMU retains the right to appeal the Commission's decision.

III. Is the City of Rolla's request for an assignment of the exclusive territory and transfer of Intercounty Electric Cooperative Association's ("Intercounty") facilities in the public interest?

The Staff's position is that the acquisition by RMU of the facilities and customers at issue is in the public interest. RMU has electric facilities close to the area in question and will be capable of integrating this new area into its operations with no adverse impact on rates or quality of service. (Ketter Rebuttal, Ex. 13, p. 16, lines 9-18). As noted by RMU witness Watkins, RMU will be able to respond promptly to an outage because its crews are located right in the City. (Watkins, Direct, Ex. 5, p. 16, lines 5-6). Moreover, RMU's acquisition of the facilities in the annexed area will have no significant adverse impact on Intercounty's operations, rates for service and quality of service. Neither will it have an adverse impact on the electric customers of RMU in the non-annexed portions of Rolla. Further, RMU's new wholesale electric supplier agreement[3], and related wheeling agreements, if any, or RMU's lease/purchase of trailer mounted generation equipment should not have any effect on customer rates or on service

[3] Rolla changed its wholesale electric supplier, effective December 31, 2000. RMU expects the power costs under this new contract to be comparable to the (former) Union Electric rates.

reliability. According to an independent auditor, RMU has adequate reserves to cover the purchase of the subject Intercounty facilities. (Marmouget Surrebuttal, Ex. 1, p. 4, lines 7-10; Tr. 113, lines 9-13).

The annexation by the City is already a fact. As a result, Intercounty is now statutorily prohibited from setting new meters in the recently annexed area. Denial of the City's Application in this case would therefore cause an unnecessary duplication of facilities in order for both utilities to serve in the same area, as RMU would be extending its facilities to serve new customers in the newly annexed area. In addition to the obvious economic inefficiencies, the result of such duplication would be heightened concern regarding the safety of the public and utility workers, as well as aesthetic considerations. (Tr. 212, lines 6-12).

With respect to cost considerations, absent the requested transfer, Intercounty would, in effect, be left to provide service to an area with reduced efficiency, as the Cooperative finds itself unable to fully utilize the facilities stranded within the city limits. This is in contrast to the prospects for RMU, which can expect to take advantage of growth within the area of annexation. Indeed, the evidence indicates that the area is largely (75%) undeveloped. (Watkins, Direct, Ex. 5, p. 15, lines 6-7). Staff is also persuaded by the fact that rates are not really an issue in this case, in the sense that the Intercounty members subject to transfer will not be facing higher rates for electricity, and can likely expect to receive service at a somewhat lower cost. Staff witness Ketter's prefiled testimony presents a comparison of current rates.[4] (Ketter Rebuttal, Ex. 13, p. 15 lines 19-23, p. 16, lines 1-7).

Furthermore, duplication of facilities would create situations in which one utility's line crosses the other's, as well as where one utility's line runs down a street in front of the properties

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[4] No adjustments are made for capital credits or any rebates.

and the other's runs behind those same properties. The result of such circumstances, in addition to their negative impact on aesthetics, would be heightened concerns about safety. The National Electrical Safety Code, which both utilities follow, prescribes minimum distance between facilities for safety for workers and the public. The presence of two sets of electric facilities, however, presents an additional hazard that should be avoided if possible, to the overall benefit of utility workers and the public.

The Staff is of the opinion that the statute was enacted for the very purpose of addressing these realities in a common-sense way. Although a number of Intercounty customers have expressed a desire to retain their membership in the Cooperative, the Staff believes that overall, the subject transfer of facilities and customers is in the public interest, and therefore recommends that the Commission grant the City's request.

A. ***Should Intercounty's position on payment of a gross receipts tax or payment in lieu of tax, and other services, and any reliance of the City of Rolla on Intercounty's position, be considered with respect to the interest of the public in this case?***

Intercounty and RMU were unable to come to an agreement on a mechanism by which the City could collect a payment in the nature of a tax or fee from the 286 Intercounty customers in the newly annexed area in the event they were to remain with the Cooperative. Historically, over the past five years, the transfer of funds from RMU to the City has been at the rate of 5.8% of gross revenues. (Tr. 401, lines 2-4). The annual dollar impact of this issue, then, is on the order of $22,000 (*i.e.*, 5.8% x annual revenue of $383,537 [$1,534,146/4] = $22,245 per year), a rather modest figure in comparison to that of some of the other matters in dispute. Nevertheless, in Staff's opinion, this question, along with the dispute over the Plan of Intent, discussed immediately below, constituted two of the major reasons that the parties ultimately were not able to reach an agreement.

Essentially, Rolla wanted to collect a payment in lieu of tax ("PILOT") from Intercounty (or directly from the 286 Intercounty customers). The Cooperative stated that it would be willing to agree to a "franchise tax," to be imposed uniformly on all residents within Rolla's borders, but that it is the City's, and not Intercounty's responsibility to set assessments or taxes. (Strickland, Rebuttal, Ex. 11, p. 17, lines 5, 18-19). Intercounty is concerned that its payment of a PILOT would either require the Cooperative to spread the cost of such a payment to all of its members, the vast majority of whom do not reside within the limits of the City, or to selectively pass it through to the members residing in the annexed area, thereby potentially exposing Intercounty to liability. (Strickland Rebuttal, Ex. 11, p. 17, line 20, p. 18, lines 1-9). Rolla balked at that idea, however, based on its view that it lacks the statutory authority to impose such a tax on a rural electric cooperative. (Watkins, Direct, Ex. 5, p. 17, lines 19-22, p. 18, lines 1-9).

There ensued charge and countercharge about the lack of good faith on the part of one or the other party. (Strickland Rebuttal, Ex. 11, p. 13, line 10; Watkins Surrebuttal, Ex. 7, p. 15, line 14). In the opinion of the Staff, the process of attempting to come to an agreement simply produced some misunderstandings between the parties. In particular, Staff believes that the evidence does not support a conclusion that Intercounty agreed to the payment of a PILOT and then reneged on its promise, an act that could constitute bad faith. Neither is there persuasive evidence that Rolla suffered significant detrimental impact by relying on its understanding of the existence of an agreement. Accordingly, the Staff does not believe that the interest of the public is implicated by the breakdown of negotiations with respect to the issue of the payment of a franchise tax or a PILOT.

B. Should the City's Revised Plan of Intent be considered with respect to the interest of the public in this case?

The Staff believes that this matter is relevant to the Commission's consideration of the public interest. However, no credible evidence has been offered to support the allegation in the prefiled testimony of Mr. Priest, a resident of the newly annexed area, that the service provided by RMU or that its management is not responsive to its customers. Similarly, the evidence of any detrimental reliance on the part of residents is virtually nonexistent and therefore cannot outweigh the obvious overall interest of the public in having its electric power provided as efficiently and inexpensively, as safely, and as unobtrusively as possible. The Staff therefore recommends that, notwithstanding the allegations raised by those objecting to the transaction, the Commission should approve the transfer of facilities and customers from Intercounty to RMU.

IV. Should the Commission assign the annexed area, in whole or in part, to the City of Rolla as its exclusive territory?

RMU and Intercounty were not able to agree on a partition of the annexation area. As noted above, Staff takes the position that the statute empowers the Commission to draw a boundary line to delineate exclusive service territories of both Intercounty and RMU within the newly annexed area. However, the Staff believes that duplication of facilities can be minimized only by the assignment of exclusive service territory to RMU, and therefore recommends that the Commission rule in favor of such assignment of exclusive service territory.

V. If the Commission determines that the annexed area, in whole or in part, should be assigned to the City of Rolla as its exclusive territory, what is the amount of "fair and reasonable compensation" to be paid Intercounty for its facilities?

The Staff is unable to quantify its total recommended compensation to Intercounty because it has called for a competitive bidding process to establish the appropriate amount of compensation for many of the items listed in Section V. - C. below, dealing with the costs of detaching facilities and reintegrating the system. In the event that Intercounty ultimately does this work itself, Staff supports recovery of the reasonable costs associated with those particular activities. Accordingly, Staff recommends a total compensation by RMU to Intercounty of $1,836,762 PLUS the reasonable costs of activities listed in Section V. – C. below.

The statute sets forth five general cost categories that should be considered in establishing "fair and reasonable compensation." The parties have narrowed the list to four categories that may be applicable in this case; namely, (1) reproduction cost, new, less straight-line depreciation of the facilities in question; (2) 400% of gross revenues from the 12-month period preceding annexation; (3) the cost of detaching Intercounty facilities and reintegrating the Cooperative's system; and (4) any other costs reasonably incurred in connection with the transaction. The parties agree that the fifth category, involving taxes, is not at issue in this case. Each of the four categories is discussed below:

A. Reproduction Cost, New, less Straight-Line Depreciation

1. What is the present day reproduction cost, new, of Intercounty's properties and facilities, serving the annexed area?

The appropriate reproduction cost, new, of the assets in question is $742,131. This cost is the cost to build the facilities in question at today's prices. (Ketter Rebuttal, Ex. 13, p. 8, lines 14-18). The Staff used the reproduction cost originally provided[5] by Intercounty to the City, which is the same value used by RMU. (Ketter Rebuttal, Ex. 13, p. 8, line 11). Subsequently, Intercounty came up with a new estimate of reproduction costs provided by its consultant, Mr. Ledbetter, an Intercounty witness. Mr. Ledbetter relied on his experience with a construction project in Shawnee Bend, Missouri (Ledbetter Rebuttal, Ex. 9, lines 11-12), which is located at the Lake of the Ozarks, whereas the original Intercounty numbers reflected its historical experience in and around the City of Rolla.

On cross-examination, Mr. Ledbetter was unable to shed much light on differential labor rates between the two areas. (Tr. 426-428). As was pointed out in the testimony of RMU witness Bourne, the Lake of the Ozarks, a huge lake has, virtually by definition, altogether different terrain and hence problems associated with installation of power supply facilities than does the area around the City of Rolla. (Tr. 209, lines 3-24). Moreover, given the resort-area character of the Lake of the Ozarks, it is certainly possible that the wage scales as well as the costs of materials are significantly higher there than they are in Rolla. Accordingly, the Staff supports the value used by RMU and originally by Intercounty as the appropriate for reproduction cost.

2. ***Should Intercounty's district office building located at 1310 South Bishop Ave. (Highway 63), Rolla, Missouri, be included in the calculation of fair and reasonable compensation, and if so, in what amount?***

Intercounty is also proposing that its district office building, valued by the Cooperative at approximately $1 million, be included, over RMU's objection, in any sale of facilities ordered by the Commission. The Staff recommends that RMU not be required to purchase the Intercounty office building. The local office can continue to be useful to Intercounty's 113 members located within the city limits, as well as others located around the area. Indeed, Intercounty has only two district offices and one central office to service the whole of its approximately 28,000 customers. (Tr. 492, lines 1-6). It is difficult to imagine that the subtraction of 286 members from that total pool will seriously detract from the subject office building's usefulness to Intercounty. (Ketter Cross-Surrebuttal, Ex. 14, p. 3, lines 7-9). Staff agrees with Rolla that the statutory reference (Section 386.800.5(1)) to "...the properties and facilities serving the annexed areas..." does not contemplate an office building; rather, it refers to elements and components of the actual power

[5] The "original" value was actually adjusted for overhead not initially included in Staff's Rebuttal testimony.

delivery system. (Watkins Surrebuttal, Ex. 7, p. 27, lines 1-3). Intercounty witness Strickland indicated at the hearing that, in the event the Commission approves the sale and transfer sought by the City, the Cooperative intends to move its office to a new location. (Tr. 492, lines 1-6). In that event, nothing would prevent Intercounty from selling its office building to an interested buyer.

Intercounty argues that its decision to locate its district office building within the newly annexed area was based on the City's Plan of Intent. (Strickland Rebuttal, Ex. 11, p. 11 line 21, p. 12, lines 1-2). The Staff believes that this should not be a consideration in the Commission's finding with respect to the office building. Further, even if Intercounty did rely on RMU's announced intention regarding Intercounty's existing customers in the annexation area, other considerations almost certainly factored into the Cooperative's final decision as well. Under the circumstances, then, Rolla should not be forced to purchase a building it does not want. Accordingly, the value of the subject office building should not be included in the calculation of fair and reasonable compensation.

In connection with its proposed sale of its office building to RMU (discussed earlier), Intercounty is also requesting payment of $53,000 for the associated cost of reintegrating its telephone, fiber optic, telephone, and communications systems. Because the Staff opposes inclusion of the office building in the inventory of facilities to be transferred, the Staff likewise recommends that the Commission deny recovery of these estimated associated expenditures. (Ketter Cross-Surrebuttal, Ex. 14, p. 3, lines 13-20). (Further discussed in Section V. – C.)

> 3. ***What particular approach should be adopted by the Commission in order to calculate depreciation in this case?***

A determination of depreciation is necessary for the purpose of reducing the present-day evaluation of the subject facilities in order to reflect their age. (Ketter Rebuttal, Ex. 13, p. 8, lines 19-20). The parties were hampered by a lack of information in their efforts to develop a value for an amount of depreciation of Intercounty's assets subject to transfer. In particular, the data showing the age of the equipment involved simply is not available. As a result, the three primary parties filing testimony, Intercounty, RMU and the Staff, all developed different methodologies for estimating the appropriate dollar value to be assigned to depreciation. Although each of the parties believes that its method is the best, the fact is that all of them have shortcomings, and not surprisingly, Rolla's method suggests the most advanced age for the facilities it wishes to purchase, while the Intercounty approach suggests the youngest age of such facilities. Staff's approach yields a value somewhere in between.

In order to estimate depreciation, four essential elements needed to be defined; namely, the reproduction (or replacement) costs of the subject facilities; the number of years over which they are scheduled to be depreciated on a straight-line basis, to establish the depreciation rate; some measure of the age of the facilities; and a date as of which that age is measured. The parties are in general agreement only as to the depreciation rate of the subject equipment; *i.e.*, it is to be depreciated at a rate of 2.8% per year. As discussed above, for the reproduction cost, Staff and RMU used the average replacement cost in the Rolla area, including overhead loading, while Intercounty ultimately relied on numbers generated from the experience of its consultant with construction work at the Lake of the Ozarks. As a cut-off date for depreciation of the assets, Staff and Intercounty used the known effective date of the annexation, which is June 8, 1998. RMU, however, used an estimated date of the transfer of facilities (*i.e.*, March 2001) for its cut-off date.

The most daunting task, given the absence of definitive data, is the determination the actual age of the facilities subject to transfer. Staff developed its estimated age based on the installation dates of the transformers in the annexed area, which dates are known. The result was an average age of the transformers of 19.74 years. This, then, was considered to be the average age of all facilities in question. Multiplying the average age by the yearly depreciation rate of 2.8% yields an overall depreciation of 55.27% (19.74 years x 2.8/100). Applying that percentage to $742,131 (the replacement cost, new, of the assets at issue), yields a total depreciation of $410,176 and a remaining replacement value, new, of $331,955 ($742,131 minus $410,176).

RMU employed a methodology that involved estimating the age of the facilities based upon the dates that houses in the area were added to the tax roles. RMU witness Bourne estimated that 70% of the houses were old enough to fully depreciate the distribution facilities serving these houses. The remaining 25% of the houses were estimated to be older than 25 years. Mr. Bourne used these approximations to develop a remaining life of the facilities which yielded a remaining replacement value, new, of $66,792. (Bourne Surrebuttal, Ex. 4, Sch. RB-5).

A problem arises, however, because RMU did not account for any capital improvements/replacements of the subject facilities in subsequent years. As justification for the omission, at the hearing RMU offered its opinion that in requiring the payment of 400% of annual gross revenue, the legislature was recognizing and providing for the problem of capital improvements. (Tr. 116, lines 19-21). The Staff considers this argument to be baseless and therefore wholly unpersuasive, and recommends that the Commission reject it.

Intercounty, on the other hand, used a system-wide depreciation figure to calculate the percentage of plant that has not yet been depreciated. This percentage was then applied to Intercounty's adjusted valuation of the subject facilities, new, and a remaining value of said facilities of $749,960 was calculated. (Ledbetter Rebuttal, Ex. 9, Sch. JEL-1). This amount reflects the valuation of the electric distribution facilities. Similarly, Intercounty applies this depreciation procedure also to the office building at issue. Intercounty's method is flawed in that it uses too broad a pool of assets in the calculation, including such assets as vehicles, offices and office equipment, and other utility equipment. Thus, Intercounty's calculation is reflective of the Cooperative as a whole, rather than the particular equipment whose transfer is at issue. In addition, the method is sensitive to inflation; that is, recent capital expenditures, because they were made with inflated dollars relative to those made much earlier, will suggest a younger overall plant than is really the case. (Ketter Cross-Surrebuttal, Ex. 14, p. 530, line 8).

The Staff believes that its methodology, though still an approximation, provides the best estimate of the average age of the facilities subject to transfer, using the statutorily mandated straight-line depreciation, and therefore urges the Commission to reject the other two approaches in favor of Staff's. Although Staff did not have a particular result in mind when developing its methodology for calculating depreciation, it might be noted that the Staff result lies between those produced by the more extreme approaches of the two contending parties.

B. 400% of Gross Revenues from 12-Month Period Preceding Annexation, Normalized for Representative Usage.

To develop an estimate for this component of fair and reasonable compensation, the Staff analyzed the customer list and associated revenue from Schedule RB-1, attached to RMU witness Bourne's Direct testimony. (Bourne Direct, Ex. 3NP, Sch. RB-1). The schedule contains a summary of monthly information provided by Intercounty, based on the actual monthly bills for the active accounts during the 12-month period preceding annexation (July 1997 to June 1998). (Ketter Rebuttal, Ex. 13, p. 11, lines 3-11). In all locations where there was no usage in some periods, the data indicated that tenants were moving in and out of apartment houses. Staff considered this type of activity to be normal. Further, there were no new metering points in the newly annexed area that would have been potential candidates for normalizing (*i.e.*, estimating increased revenues to include twelve months' usage of electricity). Staff therefore found no reason to adjust the revenue figures, as originally provided by Intercounty. Accordingly, Staff estimates 400% of gross revenue at $1,534,146.

The Staff's revenue estimate differs from that of Intercounty in one respect. The Cooperative looked at revenue streams from meters associated with buildings that were not occupied for an entire year and "filled in" the vacant periods with revenue. (Tr. 448, lines 7-14). As noted above, Staff considers this to be a distortion of the normal situation and therefore recommends that the Commission reject Intercounty's estimate.

RMU agrees with Staff that the identified revenue gaps should be considered normal. On the other hand, RMU excluded from the revenue stream the revenues from two structures that no longer exist; namely CT Farm and Country Store and Charles Moreland. (Bourne Direct, Ex. 3NP, p. 7, lines 14, 19) RMU reasons that, should those buildings be reconstructed in the future, Intercounty is statutorily prohibited from serving them, and that therefore it is appropriate, as part of the normalization process, to exclude the revenues from those structures appearing in the 12-month period in question. While not denying that RMU's argument has merit, Staff took the position that all structures that were existing and occupied, and had meters in place during the year at issue should be included in the revenue stream. (Tr. 544, lines 16-19).

Staff takes issue with RMU's claim that the capital credits, which in the past Intercounty paid out to its members, should be included as a reduction to the Cooperative's annual revenue figure. (Watkins Surrebuttal, Ex. 7, p. 25, lines 8-22) The statute clearly calls for a computation based on "gross revenues less gross receipts taxes." (Section 386.800 sub5.(3)). It is difficult to reconcile such language with a proposal to subtract dollars that are calculated and distributed essentially after the fact and at the discretion of the board of directors, from what would, in fact, be considered gross revenue of the Cooperative. Indeed, at the hearing RMU witness Watkins defined the term "gross revenues" as "the net amount that customers in the area paid in the preceding twelve months." (Tr. 235, lines 18-20). The Commission should reject this creative claim by RMU and instead base the revenue component of fair and reasonable compensation on the gross revenues that Cooperative realizes through its rates.

For the reasons stated, the Staff recommends that the Commission adopt Staff's 400% of gross revenues estimate of $1,534,146.

C. Detachment of Facilities and Reintegration of the Intercounty Electric System

Intercounty currently has facilities that pass through the annexed area that are necessary in providing service to other Cooperative members. As noted earlier, the statute provides that Intercounty may recover the cost of detaching such facilities and reintegrating the Cooperative's system outside of the annexation area. Specifically, the parties in their list of issues, categorized these costs as follows:

a) Intercounty's engineering costs related to the detachment of facilities and reintegration of the system

b) Intercounty's costs for detachment of its main tie lines

c) Intercounty's costs of pole and line construction for reintegrated lines

d) Intercounty's transfer of service costs, including final meter readings and crew time

e) Intercounty's transfer of facilities costs and demolition costs for removal of facilities

f) Intercounty's costs of acquiring and clearing right of way and obtaining right of way easements

g) Intercounty's costs to maintain service to stranded customers by the erection of new facilities

h) Intercounty's costs of reintegrating telephone, fiber optic, computers and communications systems

For the most part, Staff recommends that these costs be determined based on a competitive bidding process among outside contractors. In any event, however, Staff takes the position that Intercounty is entitled to reimbursement of its reasonable reintegration costs. (Ketter Rebuttal, Ex. 13, p. 12, lines 19-22; p. 13, line 19-23, p.14, lines 1-3)

There are two exceptions. First, for Intercounty's transfer of service costs including final meter readings and crew time [item (d)], Staff concurs with and has adopted Intercounty's cost estimate of $24,000. These are costs that would be incurred only as a result of the transfer to RMU of current Intercounty members situated in the newly annexed area. (Ketter Cross-Surrebuttal, Ex. 14, p. 3, lines 21-23, p. 4, lines 1-3).

Second, Staff does not believe that Intercounty is entitled to reimbursement for the costs of reintegrating telephone, fiber optic, computers and communications systems. As noted earlier, these costs, estimated by Intercounty at $53,000 would result if the Commission were to order the purchase by RMU of Intercounty's district office building, located in the annexed area. Staff is recommending against such a purchase and transfer. (Ketter Cross-Surrebuttal, Ex. 14, p. 3, lines 13-20). Assuming that the building remains with Intercounty, the Cooperative would not incur these particular reintegration costs and should therefore not be entitled to compensation. However, in the event that the Commission orders such sale and transfer, Intercounty should be entitled to reasonable compensation for these costs.

VI. Other Costs Reasonably Incurred in Connection with the Transaction

This category is intended to allow for the recovery of additional types of costs associated with the subject transfer that were not anticipated by the legislature. In general, Staff was opposed to the inclusion of virtually all of the specific items listed. A discussion of each follows.

A. Should the condition of Intercounty's easements, or lack thereof, in the compensation, and if so, in what amount and manner?

This cost element arose as a result of RMU's concerns about the legal status state of the easements currently enjoyed by Intercounty. (Bourne Direct, Ex. 5, p. 17). "Mr. Bourne's concerns center on the style of easements, blanket easements, and the problems that may be encountered in dealing with property owners in cases where the initial easement has not been properly recorded." (Ketter Rebuttal, Ex. 13, p. 14, lines 18-20). RMU has asked for an offsetting adjustment to fair and reasonable compensation of approximately $400,000, in recognition of potential future legal difficulties in connection with such easements. (Tr. 169, lines 14-15).

Staff agrees with Intercounty that there should be no adjustment for existing easements, or the lack thereof; that where easements are concerned, RMU must take them as it finds them. (Ketter Rebuttal, Ex. 13, p. 14, lines 22-23, p.15, line 1). First, RMU's estimate is purely speculative. There is no certainty that any of the estimated costs will materialize. The Staff would submit that the Commission should not be in the business of establishing fair and reasonable compensation on such a thin reed. Second, the statute does not seek to compensate Intercounty for the value, whatever that may be, of any of its existing easements. It seems fair, then, that no deduction be permitted from the value of an item never valued in the first place. Finally, it is RMU that seeks to purchase the facilities and customers of Intercounty. The Staff believes that the status of any easements is simply an issue that RMU must factor into its strategy regarding the matter of providing electric service in the newly annexed area.

B. Should the Commission order PCB testing of Intercounty's facilities in conjunction with the transfer, and if so, in what manner?

Intercounty proposed in prefiled testimony that RMU test all of its equipment (transformers, capacitors, regulators, etc.) in the newly annexed area for the presence of PCB (polychlorinated biphenyls) prior to any ordered transfer to RMU. If PCB contamination is found, Intercounty would retain ownership and responsibility for disposal, with RMU being responsible for the replacement of such hardware. (Nelson Rebuttal, Ex. 10, p. 22, lines 3-14). RMU then countered with its own proposal to the effect that "the only reasonable approach is for Intercounty to test its facilities prior to the transfer so Intercounty knows for sure whether it has any liability or not." (Watkins Surrebuttal, Ex. 7, p. 33, lines 17-19). RMU further states that Intercounty should be required to pay to determine the PCB status of its equipment, alleging that Intercounty "has not followed good business practices," (Id. at lines 20-23) that RMU is otherwise being made to pay for Intercounty's "negligent" failure to test. (Watkins Surrebuttal, Ex. 7, p. 34, lines 3-4). At present, Intercounty only tests on removal of the equipment. (Id. at lines 1-2).

The Staff sees no need for the Commission to order either party to test the equipment prior to transfer. The evidence indicates that Intercounty's practice of not conducting PCB testing until it removes a piece of equipment is not unlawful. (Tr. 302, lines 20-23). Neither does the Staff necessarily agree that this practice is "negligent" nor that RMU is otherwise being made to pay for Intercounty's failure to test. Indeed, only RMU's own policy with respect to PCB testing can force it to test any equipment acquired from Intercounty. To instead compel

Intercounty to test the facilities would be to impose on the Cooperative, RMU's own management philosophy, even as RMU seeks to compel the sale of those facilities.

As Intercounty witness Nelson suggested, Intercounty has so-called cradle-to- grave responsibility for the equipment subject to transfer, should any PCB problems arise. (Nelson Rebuttal, Ex. 10, p. 22, lines 7-10). Thus, if the Commission orders the transfer of the facilities, and RMU subsequently identifies PCB-related problems with any of the transferred equipment, Intercounty will, upon notification, be legally responsible for promptly disposing of the defective equipment, at the Cooperative's expense.

*C. **Should joint use fees collected pursuant to Intercounty's pole attachment agreements be considered in the calculation of fair and reasonable compensation?***

These are incidental fees collected by the Cooperative to offset incremental costs incurred as a result of allowing another utility to attach cable to one of its poles. These fees should be set at a level to allow Intercounty essentially to recover such incremental costs. Since a transfer of the poles will mean the elimination of the costs, the elimination of the associated revenue should not have a significant impact on Intercounty. Moreover, the record contains no evidence as to the dollar value of this issue. Therefore, the Staff recommends that joint use fees not be included as part of fair and reasonable compensation.

D. Should the equity owed to the Intercounty members in the annexed area be considered in the calculation of fair and reasonable compensation?

In his prefiled testimony, Intercounty witness Strickland proposed that Intercounty be reimbursed in the amount of $402,649.39 for the retirement of the patronage obligation to the annexed members (a.k.a. "capital credits"). Each member of the Cooperative is allocated a proportionate share of any excess revenue that may accrue at the end of each operating year. In any given year, the Cooperative's board of directors determines the extent to which it will pay out accrued capital credits based on its then-current financial condition.

Staff is opposed to inclusion of this amount in fair and reasonable compensation. These are monies to which the affected members are, at some point, entitled. The payout is at the discretion of the Cooperative's board, and is a continuing obligation of the Cooperative. The Staff sees no reason why RMU should be required to fund such obligation of Intercounty. Staff therefore recommends that the $402,649.39 in capital credits identified by Intercounty as associated with the members subject to transfer to RMU not be included in the amount of fair and reasonable compensation to Intercounty.

E. Should Intercounty's additional wholesale power costs be considered in the calculation of fair and reasonable compensation?

The Staff believes, in principle, that costs such as these are eligible to be included in fair and reasonable compensation, but only if such costs are properly quantified. Intercounty's wholesale power costs include demand charges based on peak demands set by existing customers. The anticipated growth in Intercounty's membership will mitigate any long-term effects of the loss of the 286 Intercounty members. In the instant case, while Intercounty made a belated attempt to offer its own estimate of additional wholesale costs as a result of this transaction, the Commission denied the Cooperative's motion to file. As a result, there is no evidence of record regarding this matter, and the question is therefore moot.

CONCLUSION

For the reasons presented hereinabove, Staff recommends that the Commission: a) order the transfer to Rolla Municipal Utilities of Intercounty's facilities and customers in the city of Rolla's newly annexed area; b) establish the newly annexed area as the exclusive service territory of RMU; and c) order a compensating payment by RMU to Intercounty in the amount of $1,890,101 PLUS the reasonable costs of activities associated with detaching facilities and reintegrating Intercounty's system.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 19th day of January 2001.

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