BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

CASE NO. HR-82-179

In the matter of Missouri Power & Light Company of Jefferson City, Missouri, for authority to file tariffs increasing rates for steam service provided to customers in the Missouri service area of the company.

CASE NO. ER-82-180

In the matter of Missouri Power & Light Company of Jefferson City, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the company.

CASE NO. GR-82-181

In the matter of Missouri Power & Light Company of Jefferson City, Missouri, for authority to file tariffs increasing rates for gas service provided to customers in the Missouri service area of the company.

APPEARANCES: Gary W. Duffy, General Attorney, and Randall B. Palmer, Attorney at Law, P. O. Box 780, 101 Madison Street, Jefferson City, Missouri 65102, for Missouri Power & Light Company.

J. Kent Lowry, Attorney at Law, Hendren & Andrae, P. O. Box 1069, Jefferson City, Missouri 65102, for the City of Canton, Missouri.

George A. Pickett, Attorney at Law, 116 North Main, Plattsburg, Missouri 64477, for Cities of Plattsburg, Lathrop, Polo, Maysville, Hamilton, and Breckenridge, Missouri.

Mark W. Comley, Assistant Attorney General, 8th Floor Broadway State Office Building, P. O. Box 899, Jefferson City, Missouri 65102, for State of Missouri.

Martin J. Bregman, Assistant Public Counsel, 1014 Northeast Drive, Jefferson City, Missouri 65101, for the Office of the Public Counsel and the Public.

William C. Harrelson, Deputy General Counsel, Eric K. Banks, and Mary Ann Garr, Assistants General Counsel, P. O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REPORT AND ORDER

On January 8, 1982, Missouri Power & Light Company, hereinafter referred to as MPL or the Company, filed with the Missouri Public Service Commission, hereinafter referred to as Commission, revised tariffs designed to increase rates for electric, natural gas, and steam service for the public. The tariff sheets bore a requested effective date of February 8, 1982, and were designed to increase the Company's billed electric revenues by approximately $11,000,000 annually, its billed gas revenues by approximately $1,500,000 annually, and billed steam revenues by approximately $65,000 annually, all exclusive of applicable gross receipts or sales taxes. Those amounts represent increases of approximately 12.4 percent, 5.6 percent, and 14.9 percent respectively.

By an Order issued on January 19, 1982, the Commission suspended the effective date of those tariffs for 120 days. By an Order issued on March 1, 1982, the Commission suspended the tariffs for an additional six month period to December 8, 1982, unless otherwise ordered, and established a schedule of proceedings for the filing of evidence and the conduct of hearings in this matter.

Applications to intervene were filed on behalf of the City of Canton, hereinafter referred to as Canton, the Public Water Supply District No. 1 of Callaway County, the City of Mexico, the State of Missouri, and the Cities of Plattsburg, Polo, Breckenridge, Cowgill, Braymer, Hamilton, Rayville, Lathrop, Maysville and Weatherby, hereinafter referred to as the Cities. Prepared testimony and exhibits were filed by Company, the Commission Staff, Canton, and the Cities.

Pursuant to an Order of the Commission issued on March 1, 1982, Company notified its customers, including its customers being served for fixed terms at fixed rates, of the time and place of the hearings.

Pursuant to the Commission's Order, a prehearing conference was convened in the offices of the Commission on July 26, 1982, and continued until July 29, 1982. As a result of negotiations conducted during the prehearing conference, the parties reached resolution of certain of the issues. Included in the agreements was a proposal to conduct a true-up hearing on or after November 12, 1982, for the purpose of updating the level of certain levels of plant in service, depreciation reserves, capital structure, and expenses at October 31, 1982.

The hearing was held, as scheduled, between August 2 and August 6, 1982. During the course of the hearing it was determined that the true-up hearing would be held on October 15, 1982, for the purpose of bringing forward the amount of Company's accounts at September 30, 1982. By an Order issued on August 26, 1982, a briefing schedule was adopted whereby all parties were to file briefs on or before September 13, 1982, and reply briefs were to be filed on or before September 23, 1982.

Timely briefs were filed by all parties except Canton, and the Cities. Brief on behalf of the Cities was filed on September 20, 1982, and the City of Canton filed its brief on September 22, 1982.

On September 23, 1982, the Office of Public Counsel (Public Counsel) filed Public Counsel's Motion to Strike Brief or in the Alternative to Grant an Extension to Reply. On September 28, 1982, Public Counsel filed a Supplemental Reply Brief pertaining only to municipal fixed rate contracts.

Due to the untimely filing of briefs on behalf of Canton and the Cities, the Public Counsel's Supplemental Reply Brief has been accepted and incorporated into the record of this case.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact:

The Company. The Company is a public utility as defined in Chapters 386 and 393, RSMo. From its headquarters at Jefferson City, Missouri, the Company is engaged in distributing electric energy and the sale of natural gas in a service area of approximately 13,000 square miles in the State of Missouri. The Company also provides steam heat to certain buildings owned by the State of Missouri in Jefferson

City.

The Company serves approximately 95,000 electric retail customers in 183 communities and surrounding rural areas, six electric wholesale municipalities and approximately 36,000 natural gas customers in 38 communities and surrounding surburban areas.

Elements of Cost of Service. The Company's rates to be authorized herein are generally equal to its cost of service or its revenue requirements, with those terms frequently being used interchangeably. As elements of its revenue requirements, the Company is authorized to recover all of its reasonable and necessary operating expenses, including depreciation and taxes, and in addition, a reasonable rate of return on the value of its property used in public service. It is necessary, therefore, to establish the value of the Company's property and to establish a reasonable percentage of earnings to be applied to the value of its property or rate base which, when added to the operating expenses, results in the total revenue requirements of the Company. By establishing the Company's reasonably expected level of earnings, it is possible to determine the existence and extent of any deficiency between its present earnings and any additional revenue requirement to be allowed in any rate proceeding.

The Test Year. The purpose of using the test year is to create or establish a reasonably expected level of earnings, expenses and investment during the future period in which the rates, to be determined herein, will be in effect. All of the aspects of the test year operations may be adjusted upward or downward to exclude unusual or unreasonable items, or to include known and measurable additions. Those adjustments are used to arrive at a proper allowable level of all of the elements of the Company's operations.

The Commission Staff has submitted data for the 12-month period ending March 31, 1982, updated for known and measurable changes through June 30, 1982. Since the Company had filed its evidence earlier, its case was based on an earlier test year, however, it has been agreed that the Staff will perform a true-up audit for the purpose of utilizing certain data as of September 30, 1982. The true-up hearing has been held as scheduled and certain aspects of the test year operations have been modified to include known changes through September 30, 1982.

NET OPERATING EXPENSES.

Several adjustments to the Company's net operating expenses have been proposed. Any adjustments to operating revenues or expenses, generally, represent a reduction or addition to the Company's net operating income after giving effect to the income tax liability. All of the adjustments, discussed herein, reflect the evidence presented at the true-up hearing, where appropriate.

A. Liability Insurance. MPL proposes to increase test year electrical jurisdictional expenses by $43,958, gas expenses by $12,917 and steam heat expenses by $6 to reflect an additional premium imposed on it by a liability insurance carrier. The Staff and Public Counsel oppose the adjustment.

In 1978 MPL considered the bid proposals of two liability insurance carriers. The Company elected to place its coverage with the Associated Electric/Gas Insurance Services Limited (AEGIS), a mutual insurance company formed by electric and gas utilities in the United States.

The AEGIS policy contained a provision for retrospective assessment of an additional amount of premium if the Company had a poor loss record of a stated level. The policy provided for an assessment of 50 percent of the annual premium of approximately $110,000. The AEGIS policy was approximately $14,000 lower in cost than its competitor and also provided for a refund of up to $17,000 if the Company's loss experience was good. Based on its past loss record, the Company elected to take the AEGIS policy in view of the known and potential premium savings during the policy period commencing June, 1978.

Unfortunately an accident resulted in a serious injury to a man coming in contact with one of the Company's distribution lines during the latter part of 1978. As a result of a lawsuit, AEGIS, in 1982, assessed the retrospective premium in the amount of $55,250 and $2,210 in associated excise taxes. The payment was made to

AEGIS in June of 1982. Due to the extent of the injury the Company is exposed to a second payment since the policy provides for retrospective assessment of up to 100 percent of the premium for the period during which the loss occurred.

The Company's vice-president stated that the retrospective premium feature is common in the utility industry and the Company adopted it as the most apparently economical alternative available. He further stated that liability coverage for a utility company is difficult to place. This is one of the reasons for the creation of AEGIS. The Company proposes to include the payment in expenses because it was incurred in the test year much the same as a current legal expense resulting from a prior occurrence. The Staff does not propose to include the payment because it was brought to the Staff's attention after their evidentiary filing date in this matter. The Staff also chose not to include the expense as not being regularly recurring. In addition, the original choice of carrier is criticized as an inadequate business decision.

Based on the Company's prior loss record it could reasonably anticipate a $17,000 refund in addition to the initial $14,000 premium saving. If the Company's good loss record had continued, the ratepayers would have received the benefit of the saving. Therefore, it appears to the Commission that the expense is reasonable.

Recognizing the uncertainty of a repetition of the contested cost, the Commission is of the opinion that it should be recognized and amortized over a period of five years. Such a recognition is consistent with the allowed recovery of other extraordinary items of expense.

B. Casualty Loss. The Company proposes to amortize over five years the $300,000 in expenses relating to settlement of property damage claims from a fire in Mexico, Missouri, in January, 1981. The proposed amortization would increase the test year expenses for gas service by $60,000.

The amount in controversy represents the Company's self-insured retention under its general liability insurance policy in effect at the time of the January, 1981 occurrence. The $300,000 expense is, in effect, a deductible for the numerous property damage claims arising from a single occurrence. The Staff proposes to disallow the amortization because the costs may be determined to be a result of the Company's violation of the Commission's safety rules.

The Commission's General Counsel has filed an action for penalties based on claimed violations of the Commission's rules. The Company has filed a motion to dismiss but the matter has not been determined by the Cole County Circuit Court where the action is pending.

The Company criticizes the Staff's position on two grounds. Company is first of the opinion that the Staff's proposal constitutes an unwarranted prejudgment of guilt in a matter still to be determined by the courts. Company is also of the opinion that the Staff's proposal constitutes a double penalty in view of the pending penalty action seeking $100,000.

In the Commission's opinion the disallowance in question would violate the generally accepted rule that the expense incurred in settlement of liability claims is a normally expected business cost. To decide otherwise would be inconsistent with recognizing liability insurance premiums as a legitimate business expense.

The Staff is unaware of any imprudence, misconduct or mismanagement in the claim settlement process. The expense should be recognized and the proposed five-year amortization is a reasonable period for the recovery.

C. Bad Debt Write-off in Steam Operations. The Company proposes to include in test year steam expenses the amount of $11,469 resulting from gross receipts taxes not being paid by the State of Missouri on steam service. The Staff opposes the adjustment on the grounds it is nonrecurring. The State of Missouri supports the Staff.

As authorized by Missouri Law, Jefferson City levies a tax on the gross receipts of utility companies serving customers within its city limits. City levies a tax at the rate of 7 percent and the Company adds that amount and itemizes it on the bills delivered to its customers.

Jefferson City changed its ordinance relating to gross receipts tax in

August of 1980. One feature of that ordinance was the institution of the ceiling of $15,000 per year per utility service per customer location. The ordinance provided that state-owned buildings were to receive the same treatment with regard to the ceiling. There would presumedly be a $15,000 ceiling on gross receipts taxes each year for electric service, a $15,000 ceiling for gas service, and a $15,000 ceiling for steam service.

On July 21, 1980, the Company received a letter from the Commissioner of Administration of the State of Missouri stating that the Missouri General Assembly had appropriated only $15,000 to meet the gross receipts tax with regard to buildings which the Division of Design and Construction refers to as the "Capitol Complex". Company was also informed that the State would not be able to pay all of the bills and would be deducting any amounts for gross receipts tax once the $15,000 appropriation was exhausted. Commencing with the bill due on October 1, 1980, the State deducted the amounts shown for gross receipts taxes.

The Company has pursued numerous avenues attempting to secure payment of the additional amounts. Judgments have been procured against the State of Missouri but the Company has not been able to enforce the judgments. Jefferson City has continued to levy the gross receipts tax and the Company has continued to pay the tax although it has not recovered the amounts from its only steam customer, the State of Missouri.

The Staff proposes to disallow the expense because it is nonrecurring. The opinion is founded partly because there has never been bad debt write-off in the steam operation other than the one that occurred in March of 1982. The Staff's opinion is also bolstered by the assumption that the State and the City have now come to an agreement in the amount of gross receipts tax that should be paid on the State's bill, as a result of the recently enacted ordinance.

The State of Missouri also opposes the inclusion, contending that MPL now has assurances that the gross receipts tax will be paid in the future. For the year ending June 30, 1983, the Missouri General Assembly appropriated and transferred funds in the amount of $45,000 for the payment of the utility surcharge levied by Jefferson City. The Company's vice-president stated that, although frequently late, the bills being paid by the State now include the gross receipts tax.

In spite of the present payments the Company is of the opinion that it does not have any assurance that the gross receipts taxes will continue to be paid by the State. In addition to the expenses sought in this case, the Company still has $17,971 of gross receipts tax unpaid by the State still to be written off as bad debts.

Even if the tax continues to be paid the Company must write-off, as bad debts, an additional amount exceeding the expense claimed. The instant controversy involves the factual dispute as to whether the Company has assurances that the gross receipts tax will be paid in the future. In the Commission's opinion the nonpayment of the tax is unlikely to occur again and would ordinarily be the proper subject of an amortization. The Company's proposal to recover only a portion of the total loss in the instant case is, in effect, a substitute for amortization and is a reasonable resolution of the issue.

Generally speaking the cost of bad debts is included in the general cost of service and paid by the rest of the ratepayers. In the instant case the only steam customer is the one causing the bad debt in question. Its inclusion as an expense will prejudice no ratepayer not having the responsibility for the expense.

The proposed bad debt expense, as part of the Company's cost of service, should be allowed.

D. Contract Tree Trimming. The Company proposes to include $180,788 in jurisdictional electric expenses to reflect a five-year average of contract tree trimming expense. Staff opposes the adjustment.

The Staff proposes to disallow the tree trimming expense to recognize the cancellation of tree trimming contracts. It is the Staff's contention that MPL has discontinued the use of contract tree trimming and has no idea of when the practice may be resumed. The disallowance only concerns tree trimming on the Company's distribution system. The Staff proposes to allow expenses for tree trimming for transmission facilities because the Company has outstanding contracts for such service.

The Company seeks an allowance of a five-year average for tree trimming expense, as was allowed by the Commission in Case No. ER-80-286. In that case the Commission used a five-year average to reflect the substantial fluctuation in the contract tree trimming expenses from year to year. It was believed by a Company witness that method was a means of normalizing what appeared to be an unpredictable expense.

At the time of the hearing Company had one outstanding contract for distribution system tree trimming in its Mexico district. Services under that contract ceased on approximately August 31, 1982. There were no other distribution system tree trimming contracts for the remainder of 1982 or for 1983. All other distribution system tree trimming contracts have been cancelled.

MPL contends that failure to recognize a five-year level of similar expense in this case results in inconsistent policy for ratemaking. The Company points out that the five year average allowed in the last case was less than the Company's actual expenditures. The Company witness conceded that during the last case it had outstanding tree trimming contracts for 1981 and additional contracts were in the process of being prepared.

The Company cancelled a contract for 1982 tree trimming due to the depressed economy with fewer housing starts and little new commercial or industrial activity. The cancellation was made with the understanding that tree trimming would be accomplished using the Company's own crews. Each district dedicated man-hours to distribution tree trimming that would ordinarily have been performed by the contractors.

Health problems among MPL's line department employees in Mexico made it apparent that the necessary work in that district could not be accomplished without continued use of contract tree trimming. The Company hopes to resume the use of contract tree trimming crews when the economy improves and there is proper employment for line crews in construction of distribution systems.

Contract tree trimming is less expensive and more efficient than the use of the Company's crews. The Company engaged in the tree trimming by its own crews as a means of retaining its trained line work force. To provide continuous work to its trained work force, a company decision was made to employ it in distribution tree trimming. Any equipment required to perform the tree trimming is being leased. The Company has no idea when the economy will improve to an extent which will permit the resumption of contract tree trimming.

The proposed allowance for distribution tree trimming is improper because there are no outstanding contracts for such services and there are no reasonably foreseeable circumstances under which such contracts will be executed.

The Company's tree trimming costs are being allowed as a part of its total allowance for labor and wages. Although such use of line crews is inefficient, and certainly not to be encouraged, it is accounted for elsewhere in the Company's expenses. To also provide an allowance for contract tree trimming, which may not occur, will result in a dual recovery of the same expense. One segment of that dual recovery would be for inefficient use of employees in an effort for which they are overtrained and ill-suited to perform. The other portion of the dual recovery is for an expense that is not known to materalize with any degree of certainty. Such speculation hardly rises to the status of a known or measurable change. The Staff's failure to make an allowance for contract distribution tree trimming expense is proper.

E. Group Hospitalization Costs. The Company proposes to adjust the Staff's allowance for group hospitalization expenses by an additional $125,444.46. This adjustment would result in additional jurisdictional expenses for electric service in the amount of $70,153, $18,340 in gas expense amd $753 in steam expense.

On January 1, 1980, the Company organized a self-insurance program, using a third party administrator with the overall plan run by six trustees. Three of the trustees are Company representatives and three are members of the labor units within the Company. The trustees' responsibilities include overseeing the administration and setting of premiums. The Company adopted a self-insurance plan for the purposes of reducing the necessary reserves and reducing the administration costs. The latter change resulted in a savings of $20,000 in 1980.

The Company is obligated to pay 69 percent of the premiums with its employees being obligated to pay the remaining 31 percent. In the last quarter of each year the Trustees establish the premium levels to be paid commencing January 1 of the following year. For both 1981 and 1982 the trustees determined that the premiums would be increased by 20 percent.

The Commission Staff has used actual hospitalization costs for a 12-month period ending March, 1982. Those expenses were divided by 12 to arrive at an average monthly cost. Those actual average costs were arrived at by using a test year, three-fourths of which was in a period when the premiums were 20 percent lower than at the present time. The Staff did not annualize those actual expenses.

The Staff's method of calculating group hospitalization costs is not representative of the actual cost of the plan. The additional premium is fixed and will not return to the level prior to January 1, 1982, used in the Staff's allowance. The hospitalization premium does not represent a budgeted figure since the level has already been established by the trustees for calendar year 1982.

Although the Company expects that at least a 20 percent increase in premium will be voted by the Board of Trustees effective on January 1, 1983, Company is not asking for that undetermined premium level to be reflected in its rates. Company is merely asking for the premium level established in October of 1981, which will be in effect during calendar year 1982 since that is known and measurable.

As the Commission stated in the Company's prior rate case, ER-80-286 "actual figures should be used, since they are available." The Commission is of the opinion now, as then, that since the additional contribution is fixed, it should be allowed since it will be charged during the future period when the rates to be set in this case will be in effect.

Resolution of the issue in this manner should not be interpreted as blanket future approval of hospitalization provisions, merely because they are known. The Staff is encouraged to continue to monitor this expense as a protection against any possibility of an unreasonably excessive level of premiums being adopted by the Board of Directors in anticipation of the Commission's approval of any level which may be selected. Such approval will not be forthcoming in the absence of prudence or restraint in establishing future premium levels. In the instant case there is no contention that the involved premium levels are unreasonable or excessively high.

F. Edison Electric Institute (EEI) Dues. The Company proposes to include in Missouri jurisdictional electric expenses the amount of $23,729 for dues to EEI, a voluntary organization, whose membership is made up of electric utilities throughout the United States.

The Commission Staff, supported by the Public Counsel, proposes to disallow those dues primarily because of EEI's extensive lobbying activities. While EEI reports only two percent of its expenditures go for lobbying, under the Federal Regulation of Lobbying Act, that Act requires only the reporting of direct contact with members of Congress.

Based on the Staff's review of EEI's 1980-81 Progress Report, the Staff formed the opinion that EEI incurs costs in much larger proportions than the two percent reported under the Federal Regulation of Lobbying Act. Since the Staff is unable to quantify the precise amount of EEI's budget attributable to political and public relations efforts the entire amount is proposed to be excluded.

The Company agrees that EEI spends more than two percent of its resources on lobbying types of activities. EEI has used some of its resources to advocate the use of forward test periods, higher rates of return on equity, construction work in progress in rate base and fuel adjustment clauses.

Many of the alleged benefits which the Company receives from EEI could be obtained from other sources. Some of the efforts of EEI and the Electric Power

Research Institute (EPRI) overlap and some of the assistance rendered by EEI could be obtained from EPRI. The Commission Staff has not proposed to disallow the expense associated with EPRI in the instant case.

The Company has been able to refer to only one benefit to the ratepayers attributable to EEI's lobbying efforts. Company expects, in the near future, to recognize a savings of several thousand dollars as a result of the potential modification of a filing required by Section 133 of the Public Utility Regulatory Policies Act. This only known potential benefit to the ratepayers has not yet occurred.

From the instant record it is apparent that EEI dues support lobbying activities to an unknown extent in excess of two percent of the organization's budget, and generally those expenses do not benefit the ratepayers. It is also apparent that the Company receives benefits in an impossible to quantify amount in the form of information from EEI. Some of the EEI assistance would be available elsewhere, but a portion would not be.

In ER-81-42, Re: In the Matter of Kansas City Power & Light Company, page 24 (June 17, 1981), the Commission stated the following:

> The rule has always been that dues to organizations may be allowed as operating expenses where a direct benefit can be shown to accrue to the ratepayers of the company. Conversely, where that sort of benefit does not appear, disallowance of the dues is required. It follows that the mere fact that an activity might fall within the very broad general definition of lobbying as used by Public Counsel should not necessarily mean that it is an improper expense for ratemaking purposes. This question is one of benefit or lack of benefit to the ratepayers.

In recent months the Commission has cited the foregoing case with approval. See: Re: In The Matter of Missouri Public Service Company, ER-82-39, WR-82-50 (June 21, 1982); Re: In The Matter of Union Electric Company, ER-82-52 (July 2, 1982); Re: In The Matter of Kansas City Power & Light Company, ER-82-66 (July 14, 1982).

The Commission still believes the question is one of benefit to the ratepayer. In the instant case there appears to be some possible benefit, but until the Company can better quantify the benefit and the activities that were the casual factor of the benefit, the Commission must diallow EEI dues as an expense. The Commission also points out that the Company needs to develop some method of allocating expenses between its shareholders and the ratepayers once the benefits and activities leading thereto have been adequately quantified.

Advertising. Included in the Company's test year electric expenses is the amount of $4,586 related to advertising expenses sponsored with other regulated electric companies. Also included is $1,620 in electric expense and $312 in gas expense related to the Company's Energy Question advertising program. The Staff and Public Counsel oppose the allowance of those items as expenses for ratemaking purposes.

The Staff proposes to disallow the cost of some Company advertisements, contending their theme is goodwill in nature. Goodwill advertising is characterized by the Staff as any which has as its main thrust the enhancement of the Company's view in the eye of the public.

The Company defends the inclusion of the advertisements by characterizing them as informational in nature. The Staff describes informational advertising as that which states facts the ratepayer should be aware of. The Company developed the Energy Question advertising in response to recommendations of the Commission's management audit staff. The two ads remaining in controversy are intended to answer questions frequently asked by the Company's customers.

Although no studies have been performed, the Company's vice-president for public affairs expressed the opinion the ads are performing their intended purpose. In recent years the increases in utility costs have generated corresponding inrceases in customer inquiries. In spite of those increases, the Company's level of employees has remained almost constant for the past five years. The Company vice-president knows of no way to measure the success of the advertisements since it is impossible to establish the number or identity of customers which might have made a direct inquiry in the absence of the information furnished by the advertisements.

The two remaining Energy Question ads explain seasonal high bills and detailed the various causes of rate increases in recent years. The series of ads jointly sponsored with the other electric utilities explain what portion of the customer bill is represented by taxes; assist in the attempt to secure industry in Missouri; and explain that the largest cause of rate increases is the cost of fuel.

Although the ads in question may result in a better company image, the ads generally appear to disseminate information of use to Company's customers. That is especially true of the ads designed in response to the requests by Commission Staff members. Certain of the other ads are designed to allay customer concerns about the future availability of electricity and the fuels needed to generate it. Although some of the ads may have a dual effect the contents are of sufficient concern to the ratepayers to qualify as being informational in nature and the cost should be allowed.

RATE BASE

A. Duplication of REC Facilities. The Staff proposes to eliminate from electric rate base the amount of $48,690, plus related electric revenues of $2,930 and electric expenses of $3,479 relating to an electric line which the Staff maintains duplicates the facilities of a rural electric cooperative.

The decision to build the line was made in 1979 in response to a request for service by the Company's vice president of operations, C. E. Brinkmann. The extension is approximately 1.8 miles in length from the Company's then existing facilities near Russellville. The line terminates in a fork with the vice-president's trailer and deep well being at one end of the line. There is a total of five customers being served by the line with one of those customers being located on the other end of the fork and three being on the single portion of the line.

The total revenues on the line during the test year were approximately $2,930. The test year expenses associated with the line were $3,479, resulting in a net less of $549 above the absence of any return on the investment.

The Staff proposes to exclude the line on the basis of its duplication with existing Rural Electric Cooperative (REC) facilites and as an unnecessary expenditure. The Staff witness proposing the disallowance had not viewed the line, but the Company's Director of Engineering and System Planning established that two and possibly three of the existing customers, other than the vice-president, had previously received service from the REC. The line was placed underground partly to avoid crossings of the existing REC line.

The Staff had tendered a data request to the Company seeking any studies which would indicate that the area's load growth would support the new plant investment. The Company responded with a copy of a letter from a Company employee, Mr. Sefrit, dated February 8, 1979. The letter was in reference to "service to property owned by Mr. C. E. Brinkmann" and states as follows:

> "This line is necessary to serve property purchased by Mr. C. E. Brinkmann on Cliburn Road, rural Russellville.
>
> "The properties on both sides of the road along which the line would be constructed show possibilities for subdivision development in the future.
>
> "There is one customer along the proposed route who now has Three Rivers Electric service and who might be interested in MPL service if it was available. In addition, if the line were constructed, a tap off the line plus a 2112 foot extension would provide service to another MPL employee, three additional customers and a Church. The above mentioned employee, Gail Wiser, has previously requested service in the event a line of this nature were to be built.
>
> "We recommend this line be constructed and the monthly minimum be waived for a period of time until the new residence is constructed."

The Company defends the extension because of the area's potential for growth. The Company points out that it has many lines that duplicate, or nearly duplicate, REC facilities and many of its extensions operate at a loss for temporary periods.

In the Commission's opinion the evidence in this matter establishes that the primary motive for construction of the line in question was to respond to a request for service from the Company's vice-president. There appears to have been little unfilled need for service in the area at the time the line was built and that condition is little changed three years later.

To extend service, at a loss, into an area where service does not exist may be justified. Such justification does not exist for the competition and acquisition of the customers, at a loss, when service exists from another source.

The presentation of this issue reveals several evidentiary deficiencies on the part of both parties. The outcome hinges more on the Company's failure to sustain its burden of proof concerning the reasonableness and necessity of the line than on the Staff's justification to exclude the line. Mr. Sefrit, and the Company employee knowledgeable about the extension was not called, although still with the Company. The Company's witness in the matter professed little firsthand knowledge of the situation.

In the Commission's opinion the proposed inclusion of the line in rate base should be disallowed and the corresponding adjustment to revenues and expenses should be made. The Commission recognizes that it may be proper to include some portion of the line in rate base and such an inclusion could be allowed as a result of a future proper presention of an acceptable allocation.

B. Transmission Allocation. The Staff proposes to allocate 91.69 percent of the Company's electric transmission plant to the Missouri jurisdictional rate base. The Company contends the proper figure is 95.86 percent. If the Company's allocation is adopted the Staff's miscellaneous annualized revenues should be increased by $103,755.

The Company provides firm power on a wholesale basis to the cities of Owensville, Centralia, Kahoka, Linneus, Marceline and Perry. Those sales are not within the jurisdiction of the Commission but are regulated by the Federal Energy Regulatory Commission (FERC). A portion of the Company's transmission plant is allocated to the FERC wholesale jurisdiction. In addition, the Staff proposes to assign an additional $1,825,000 of plant to Missouri Edison Company and Missouri Utilities Company.

Both Company and Staff use the 12 coincident peak method for their allocation. The Staff saw fit to include peaks caused by Missouri Edison and Missouri Utilities whereas the Company did not. In recent years the Company's retail jurisdictional percent of plant has been approximately 96 percent with the remainder of the total being allocated to the wholesale class of customers under the FERC jurisdiction. The Staff has also used the 12 coincident peak method to allocate 95.86 percent of production and transmission plant to retail and 4.14 percent to the wholesale class of customers. It is the Company's contention that approximately the same allocation should be used for both production and transmission plant.

Missouri Utilities Company's transmission system connects with MPL's system near Boonville, Missouri. MPL has a large substation east of Boonville which is adjacent to an even larger substation where transmission lines of Union Electric Company and Kansas City Power & Light Company meet. This is a purchase point for MPL from Union Electric. In that area are facilities which are used both for delivering power to Missouri Utilities and serving MPL's customers in Boonville. The facilities are used by both companies and eliminate the need for duplicate lines.

MPL has executed an Electric Service Agreement with Union Electric whereby MPL agrees to provide a transmission service from Union Electric to Missouri Utilities and to deliver up to 5,000 kilowatts at any one time. The price for the service is set at 1.9 mils per kwh delivered. The Company's Director of Industrial Engineering and System Planning stated that but for a 69 kv circuit on 1.3 miles of line in Boonville, MPL's facilities would be the same if the interconnection with the Missouri Utilities did not exist. MPL's investment in the facilities for Missouri Utilities amounts to $10,000.

Another portion of the facilities in question includes several substations and lines where MPL and Missouri Edison's service areas border in northeastern Missouri. At one time Missouri Edison Company was a wholesale customer of MPL. At that time MPL was a generating utility and had sufficient capacity to serve its own load and that of Missouri Edison. The fact that both MPL and Missouri Edison are owned by Union Electric Company made it possible to develop the transmission network on a one system approach. By 1975 Union Electric was supplying 75 percent of Missouri Edison's load and MPL was supplying only 25 percent. At the present time Missouri Edison is a customer of Missouri Utilities and not of MPL. The companies have executed a Facility Use and Operating Agreement which provides that both MPL and Missouri Edison would continue to own, operate and maintain its respective portion of the facilities for the benefit of both. The Company contends that these interconnection points are much less expensive investments than if each company had been required to build transmission lines to the periphery of their service areas. Although power generally flows from MPL to Missouri Edison or Missouri Utilities, power can flow both ways at each interconnection point.

It is the Staff's contention that the agreements between the companies constitute firm wheeling commitments on the part of MPL. Therefore, the Staff contends that the transmission capacity and facilities are designed and constructed to meet MPL's commitment to Missouri Edison and Missouri Utilities and a portion of the transmission plant should be allocated to those companies. Wheeling is generally defined as a generating utility transmitting power over the transmission lines of another utility for ultimate delivery to a third utility.

The Staff's position does not take into consideration MPL's numerous interconnections with other electric companies. If all of the interconnected companies wheeled power over MPL's lines in the test year it would be proper to allocate a portion of MPL's transmission system to all of those companies in proportion to their kw demand. If the volume of wheeling changed company's transmission plant would have to be reallocated.

It is MPL's position that the power flows at the interconnections do not constitute wheeling because only two utilities are involved, and there is no contract which specifies the amount of power supposedly to be wheeled, the duration of the supposed wheeling, or the charge to be made for the supposed wheeling service. The Staff witness has conceded that MPL is not committed to providing Missouri

Edison Company with a specific amount of power through the interconnections. It was also acknowledged that if the mutual support function was not built into the design of the MPL and Missouri Edison systems at their common border, both companies would have to build facilities to achieve the same level of service reliability now enjoyed with that design.

The allocation proposed by the Company has been accepted for some time by this Commission and by FERC. If this Commission did not recognize a portion of the Company's plant for ratemaking and FERC declined to accept a reallocation, a part of the Company's plant would not be recognized for either ratemaking jurisdiction.

MPL receives revenues from Union Electric for transmitting power to Missouri Utilities and it also receives revenues from Missouri Edison for the facilities described in Facility Use and Operating Agreement. The test year revenues from the Missouri Utilities transaction amounted to $26,721.60. Revenue from the Missouri Edison facilities amounted to $78,420.60. These revenues are the result of agreements filed with and approved by FERC. The Company contends that assessing an additional 4.17 percent of its transmission plant to Missouri Utilities and Missouri Edison would presume that the Company received possibly $300,000 per year from those companies instead of $105,000.

It appears that MPL, by including both the facilities and the revenues, achieves adequate protection for its retail customers. As an example, Company's Pike substation was constructed for Missouri Edison at a cost of $273,000. Company is being reimbursed by Missouri Edison in accordance with a Facilities Charge Agreement at the rate of $40,950.12 annually. It is estimated by the Company that it earns 20.16 percent return on equity from the involved transactions. It is the Company's position that the present allocation is more advantageous to its retail customers since it is not likely to earn that rate of return on any other transaction.

In the Commission's opinion the Company's proposed allocation method is a reasonable approach. The Commission has addressed a similar problem in the recent Union Electric rate Case, ER-82-52. It was determined therein that frequent changes in allocation methods are undesirable and will lead to instability of rates as well as creating circumstances where a company is unable to recover all of its cost of service. If different allocation methods are used by the different regulatory jurisdictions there is a likelihood of under- or over-recovery.

The Commission remains willing to adjust a company's allocation factor in a proper case but the instant record does not present a proper opportunity. The Commission, as in ER-82-52, encourages the parties to raise the issue in future proceedings, especially if negotiations and proceedings with FERC are instituted to achieve an acceptable three-way allocation, or in the event such allocations fail and a party still believes that more or less plant should be included in intrastate rate base. In the absence of such a showing the company's proposal to continue the presently accepted allocation should be adopted. The corresponding increase in miscellanous revenues should also be recorded.

Electric Revenues and Customer Levels. The Commission's Staff proposed to use the level of electric revenues and purchase power costs as of June 30, 1982, for test year purposes. The Company requested the use of data for the 12 months ending September 30, 1982.

The Staff used the actual kwh sales through June 30, 1982, as the basis for a normalized level of sales. The use of the later period was opposed, and the Staff contended, there would be insufficient time to perform a detailed analysis of the September 30th data for presentation at the true-up hearing on October 15, 1982. It was the Staff's contention at the time of the hearing, and in its brief, that inadequate time would be available to normalize the level of sales if abnormal weather conditions, such as a heat storm or extremely mild weather, occurred prior to the end of September. That contention was not elaborated on at the true-up hearing and the Staff jointly sponsored Exhibit 45 which portrays the verifiable level of revenues as of September 30, 1982.

The most recently available data should be used for a number of reasons. First, the electric revenues and purchased power costs used should closely approximate the level which will occur during the period in which the new rates are in effect. Use of the latest available data will also more correctly match plant in service and customer levels which the Staff proposes to present at the true-up hearing. While Staff, at the hearing, raised the possibility that normalization may be necessary if a period other than one ending June 30 were used, it did not so state at the true-up hearing, which was held after the summer's experience was available. Finally, the use of the proper revenue and power cost is important to the Company because of its relatively small rate base as a result of being a distribution company.

PC has offered two alternatives, one of which is the use of March 31, 1982, for the electric revenue test year. If a later test period is used, PC proposes that additional revenues associated with the later test year should be spread on a per kwh basis. The proposed spread of additional revenues should be more properly placed in the Company's pending rate design case and should be rejected in the instant case.

The Commission has recognized the desirability of using current data in its order issued in this matter on October 5, 1982. The parties were directed to present, at the true-up hearing, a level of electric revenues and purchased power costs for the 12-month period which includes the most recent end-of-month period that can be reasonably verified. At the true-up hearing, updated figures have been presented. In the Commission's opinion the record supports the adoption of a test year revenue adjustment for the period ending September 30, 1982, in the amount of $532,885. There is a disagreement between Company and Staff regarding the method of counting the Company's customers. Both agree, however, that the level should be established at September 30, 1982, based on data presented at the true-up hearing.

The Staff has used a two-month average by comparing March and April of 1981 with the same two months in 1982. The count was later updated through the three months ending June 30, 1982. The Staff's calculation indicates that the Company added 1,866 electric customers in one year then lost 325 customers in the succeeding three months.

The Staff used data extracted from the Company's computer run. Through confusion in communication the Staff witness was informed by one Company employee that the 1981 data was in error while another employee created a belief that the information was reliable. The Company's 1981 method of counting customers included final bills rendered. The method was changed in 1982 to exclude final bills. In December, 1981, Company employees realized that the customer count coming from the computer was unreliable. By using that data the Staff's method has compared two years of customer count employing different methods, with one of the years' data being unreliable.

The Staff attempted to verify its analysis by a telephone survey of city officials in the Company's service area. The survey generally attempted to establish the number of buildings or mobile homes added to the cities. The identity of some of the parties being called was not verified. Other shortcomings of the survey raised serious doubts concerning the reliability of the results.

The Company, realizing its computer customer count was in error, employed the alternate method of using its meter records. The meter counts are maintained by the meter shops in each district and are independent of the customer counts contained in the computer run. The meter records account for every meter from the time it is purchased until the time it is retired. MPL has added only 1,030 meters in service in the two years ending March, 1982. The Company's method takes into account its records which show approximately 2,200 customers with more than one meter at a location, which is accounted for as one customer.

The meter shop records appear to be the most reliable alternative available for the purpose of establishing the Company's level of customers. Since a meter is required to serve a customer, any increase in the number of meters should accurately reflect increased customers. MPL and the Staff presented current data at the true-up hearing and the customer level reflected by the meter records at September 30, 1982, has been used in calculating the revenue adjustment.

The Staff has requested the Commission to order the Company to develop a plan that enables the Company to provide an accurate customer count. In the Company's reply brief, it contends that such a plan has been presented in the testimony of one of its witnesses. The witness stated that since January, 1982, MPL has been in the process of revising its customer count. Final bills have been eliminated from the count. Efforts to reduce the number of items in the variance file are being employed. The Company is also developing a new application which will scan the data base to determine the number of active meters. This will then be checked against the customer count to determine if there are any discrepancies. The Company contends that the Company's plan has already been illustrated and setting a timetable would serve no useful purpose.

In the Commission's opinion a plan without a schedule does not accomplish the purpose of rectifying a problem within a reasonable time. The Company shall propose a plan in sufficient detail, and on a schedule, adequate to alleviate the customer account confusion prior to the consideration of any future rate requests.

Flat Rate Contracts For Municipal Service. The Commission Staff, supported by Public Counsel, proposes that the Commission void the fixed rates contracts for street lighting and municipal use and place such municipal service under the appropriate filed rate of the Company. Canton and the Cities oppose the proposal. MPL took no position on the issue.

In the past, when the Company secured an electric franchise with a municipality, it would sign a companion agreement agreeing to provide electric service to the city buildings, pumping stations, ball parks, and other city functions at a flat rate, for the term of the franchise. The Commission Staff has presented a study recommending that the fixed rate contracts outstanding with approximately 29 municipalities should be declared void and that the power sold to those municipalities should be delivered at the municipal service rates contained in the Company's tariff.

The Company renders service to approximately 183 municipalities, the majority of which are paying for power at the municipal service rate. The Staff has not proposed to terminate a few existing contracts which will expire by January 1, 1983.

The fixed rate contracts provide for the delivery of power at a rate varying from 1.5 cents to 2 cents per kwh. The present municipal service rate is 3 cents per kwh. During 1981 the average cost for commercial use was 5.86 cents per kilowatt hour. The Company's average cost for power during 1981 was 2.83 cents per kilowatt hour. That amount does not include the other operating expenses, return on investment or taxes. Thus, the municipalities with fixed rate contracts are currently paying a rate substantially below that paid by similar customers and actually below the cost to MPL of the power it resells to the cities.

The Staff, supported by the Public Counsel, contends that it is unfair that 29 cities have their municipal electric operations subsidized by the remainder of the Company's ratepayers. During the 12 months ending February 28, 1982, the Company received $195,093.93 from the 29 municipalities having fixed rate contracts. The same number of kilowatt hours delivered under the municipal service schedule would result in an increase in revenues of $128,882.82. For the cities with fixed rates for street lighting, the revenues for the same time period was $290,902.08, and if that power had been delivered under the municipal street light schedule, the revenue would have been increased by $51,497.04.

Staff and Public Counsel have cited extensive authority for the proposition that the Commission has the authority to void the contracts. The briefs of the municipal intervenors concede the Commission's power to abdicate and void the fixed rate contracts.

The arguments presented by Canton and the Cities generally fall into two categories. Those parties have addressed the propriety and the extent of any subsidy that they may be receiving. Those parties also describe the difficulties inherent in paying additional rates as a result of the budgetary process and the Hancock Amendment.

The Cities argue that the Company's rates contain many subsidies in one form or another and that those subsidies should be allowed to continue. The subsidies are also justified by the contention that the cost to the average residential customer is less than $1 per year. That contention of the Cities seems to indicate a misunderstanding of the signficance between a favorable rate and a rate that results in service below cost. Present municipal service schedule is at a very favorable rate and is very little above cost. It is a completely different matter to permit a situation whereby every kilowatt hour of power delivered by the Company results in a loss which must be paid by other ratepayers. Also, as pointed out by the Staff and the Public Counsel, many of the issues tried in this case represent a lower value than the subsidy presented by the municipal flat rate contracts.

Some of the Cities argue that the termination of the subsidies would expose them to the risk of violating the Hancock Amendment. Such an argument is not persuasive and, if accepted, would preclude the Commission from raising any rates that affected municipal service. None of the arguments advanced justify the Company's continued extension of service and rates which do not recover costs.

The City of Canton also contends that its fixed rate contract should be continued because it is inextricably tied to the contract for the sale of its former municipal electric system to Missouri Power & Light Company in 1976. The contract for the sale was approved by the voters of the City of Canton, at an election for that purpose. Canton's Mayor, Roy Thirtyacre, testified that the proposal was approved by the voters but that the City's poll showed that it would not have passed were it not for the guaranteed electrical service rate for the 20-year period. The attorney for the City of Canton was given permission to file an exhibit to demonstrate that fact, in response to an objection to Mr. Thirtyacre's testimony. The exhibit furnished is a newspaper notice to the voters of the City of Canton explaining the desirability of accepting the proposal of sale to Missouri Power & Light at the election to be held on Tuesday, November 4, 1975. That advertisement states, in addition to others, the following reasons for recommending approval of the sale:

> 1. The cost of operating under our present system last year produced a $64,410.15 deficit.
>
> 2. The efficiency of our system over the past years of spiraling costs has gone down.
>
> 3. We cannot continue to operate under the present system without a substantial increase in our electric rates.
>
> 4. The City's financial position will be appreciably improved.
>
> 5. Missouri Power & Light Company will reduce the cost of most residential users of electricity in Canton.
>
> 6. Missouri Power & Light Company is regulated by the Missouri Public Service Commission which assures the citizens of Canton that no changes in rates, schedules or rules and regulations can be made without the permission of the Public Service Commission.

In the Commission's opinion the information furnished does not bear out the contention that the sale of the municipal system of Canton to MPL was contingent upon the maintenance of a favorable municipal service rate. To the contrary, such a municipal service rate is mentioned at no place in the information furnished and the objection to Witness Thirtyacre's testimony in that regard should be sustained.

To the contrary, Canton's Ordinance No. 84-C concerning the franchise to MPL states in part as follows:

> Section Three: The rates to be charged by the said power company under this Ordinance shall be in accordance with those now or hereafter filed with and approved by the Missouri Public Service Commission or its legally qualified successor.

In the Commission's opinion all municipal service should be rendered under the filed tariff rate, which supersedes the municipal flat rate contracts.

Some of the Cities suggested methods to temper the effect of the termination should it be ordered. One of the suggestions was a phase out over a period of two or three years. Another suggestion concerned the possibility of increasing the rates under contract by only the amount of the general increase.

The Commission is mindful of the difficulties that an immediate termination might create. To allow the Cities some time to prepare for that contingency, the

Commission is of the opinion that service under the fixed rate contracts for municipal services and street lighting should be eliminated in two phases. Six months after the effective date of the new rates to be established by this order, the Company shall commence to bill all municipalities with fixed rate service contracts remaining in effect by an additional amount which is one-half of the net difference between the Company's filed municipal tariff schedules and the rates provided for in the individual contracts. With the effective date of the tariffs filed pursuant to the Commission's order in the Company's next general rate proceeding, all service to the affected Cities shall be rendered at the rate prescribed in the Company's municipal tariff schedule.

The Commission has taken into consideration the fact that the involved municipalities have received substantial advance notice of the Staff's advocacy of the termination of the flat rate contracts. In preparation for the Company's prior rate case the Commission Staff became aware of the inequities represented by the involved contracts. By that time the intervention date had been past and it was near the Staff's filing date. Staff felt it would be unfair to propose a change at that late date, and decided to wait until the Company's next rate case to give early notice. On February 18, 1982, the Commission Staff filed its Motion Requesting an Order to Direct Company to Notify Contract Customers. By an Order issued on March 1, 1982, the Commission granted the motion and directed the Company to tender express notice of these proceedings to the municipalities receiving service under contract. Of the 29 Cities having substantial time remaining under the fixed rate contracts, several have participated fully in these proceedings.

Capital Structure and Return on Equity. Company and the Staff agreed that the capital structure to be used in this proceeding is the actual structure as of March 31, 1982. The parties contemplate that the Company will issue common stock prior to the true-up audit and hearing. It was agreed by Company and Staff that the capital structure should be trued up as a part of that proceeding. As a result of the information presented by the parties at the true-up hearing the Commission finds that the appropriate capital structure for the purpose of this case is as follows:

	Actual Amount at 9/30/82	Adjustment	Pro Forma	Percent
Company Equity	$ 42,867	2,400(1)	45,267	39.95
Perferred stock	6,000	-	6,000	5.30
Long-term debt	62,040	-	62,040	54.75
	$110,907	2,4000	113,307	100.00

(1) Common stock issued October 1

The Company contended in testimony, but did not elaborate in its brief, that a proper return on common equity is 17.25 percent. The Commission Staff proposed the appropriate return on common equity in the range of 15.2 to 16.1 percent. As a result of the true up of the Company's capital structure the Staff's range has become 14.97 to 15.77 percent. The Public Counsel supports an adoption of the low point of the Staff's range.

The Company witness developed a range of risk measures as reported by Value Line Investment Service. The purpose was to calculate a sample that possessed risks very similar to the Company's parent, Union Electric. Of 1,700 stocks used by Value Line a sample of 72 industrials and 79 utilities was selected. The Company then used a Discounted Cash Flow analysis (DCF) to portray what an investor would require in order to purchase the Company's stock. The DCF employed the following formula:

$$\text{Return on equity} = \frac{\text{dividend per share}}{\text{market price per share}} + \text{growth in earnings per share.}$$

The Company's analysis employed the high stock price for 1981, expected dividends for 1982 and the expected future growth rate as estimated by Value Line. A frequency distribution was developed to determine how many stocks had returns between the highest and the lowest percentages of the sample. The extremes of the 0.50 percent and 27.21 percent were discarded as not being appropriate for MPL. The calculation resulted in an average of 16.40 percent and the median of the distribution was 16.50. Since those numbers were similar 16.50 was adopted. The industry analysis showed a range from 12.97 percent to 19.49 percent.

The 16.50 percent DCF was adjusted assuming a 5 percent flotation cost and a 5-year average pay out ratio of 76.6 percent. Flotation costs are the costs associated with the issuance of stock and include legal and accounting fees, printing and avertising costs. Five percent was the level experience by UE in 1981. The resultant 17.17 percent was rounded to the nearest quarter of a percent to reach the 17.25 percent proposed by the Company.

The Staff employed a continuous DCF model to calculate a proper cost of equity for MPL within the consolidated return for UE. The Staff's proposed range for UE consolidated is between 15.6 percent 16.5 percent.

The Staff then applied the consolidated return to develop a return for MPL by allocating the subsidiary a proportional share of the return which reflects a portion of the subsidiary's equity supplied by the parent's debt and preferred stock. The calculation also considered the difference in financial risks between the subsidiaries. The resulting original recommendation of 15.2 percent to 16.1 percent was rounded to the nearest tenth. It has been necessary to commence with a determination of a return for UE consolidated since MPL's stock is held by UE. Since it is not publicly traded it is not possible to directly apply a DCF to MPL's equity.

The Staff's method of applying a continuous form of the DCF formula has been consistently approved by the Commission in the past. In the recent rate case involving MPL's parent, Union Electric, ER-82-52, the Commission rejected Value Line estimates in favor of the Staff's method. Generally the Staff's approach is sound and should be adopted for this case.

The Company has pointed out that the Staff's DCF formula applied a dividend rate of $1.56 per share annually, whereas, the UE Board of Directors, prior to the hearing, had increased the dividend to $1.58 per share. That increase would change the growth rate in the Staff's formula to 3 percent and raise the Staff's range for UE consolidated to be from 15.9 percent to 16.7 percent. Although the

Staff witness testified that information alone would not necessarily change the growth rate or the range of returns recommended, the Commission deems it appropriate to apply the dividend actually being paid. The Staff's formula or equation for arriving at a proper rate of return employed an estimated dividend payment. If it is logical to employ an estimated amount in the equation, it appears equally logical to employ the correct amount, once known.

Company also asserts that the rate of return should be calculated by omitting a Leverage Adjustment employed by the Staff. Leverage Adjustments are employed to recognize the variations in equity ratios between affiliated companies. A subsidiary should not necessarily have the same rate of return as a consolidated return if the equity ratio is not the same. The Company contends it is improper to reduce MPL's rate of return by the use of a leverage adjustment if a corresponding increase is not applied to the rate of return of UE. The Company points out that such an adjustment has not been applied in the last five UE rate cases.

Company appears to be arguing that it should be allowed to earn a liberal rate of return to compensate for a contended under-recovery by its parent. In the Commission's opinion it is improper to modify MPL's rate of return to compensate for what the Company perceives to be an omission in a proceeding involving its parent.

As a result of the trued-up capital structure the Staff's recommended range of proper returns on equity has shifted to a low of 14.97 percent and a high of 15.77 percent. The trued-up mid point of the Staff's recommendation is 15.37 percent. Adjusting the Staff's recommendation for the actual UE dividend results in a change in the growth rate which leads to an adjusted range of 15.09 percent to 15.97 percent, the mid-point of which is 15.54 percent. The Commission finds that 15.54 percent should be applied to the capital structure as adjusted at the time of the true-up hearing.

The Staff has constructed a range of returns on equity which may be characterized as a zone of reasonableness for the Company's rates. Since it is difficult, and nearly impossible, to establish a single scientifically correct rate, judgment must be exercised within the zone of reasonableness. The instant record provides no persuasion for either the upper or the lower end of the proposed range. In the absence of evidence in favor of either end of the scale, the Commission is of the opinion that it is fair and reasonable to select a return which is equally remote of those which are unreasonably excessive and those which are unreasonably inadequate.

The overall rate of return which the Company will earn on its adjusted rate lase is 10.56 percent which the Commission finds to be fair and reasonable.

Rate of Return Adjustment. While the Commission may raise or lower a company's rate of return to account for management efficiency, or a lack thereof, there is not sufficient evidence in this record upon which to base such an adjustment. However, the parties should be made aware of the possibility of such an adjustment in the future and should, in future cases, present testimony, when appropriate, upon which the Commission could base such an upward or downward adjustment.

Attrition. In its prefiled testimony the Company contends it must receive \$11,540,000 in additional rates to achieve a return of 17.25 percent on common equity. As an attrition adjustment the prefiled case included an amount of \$408,000 in electric rates and \$106,000 in gas rates. The Company witness defined attrition as the difference between the revenue deficiency projected by the Company for the first year the rates will be in effect and the revenue deficiency determined by the Commission in this case. According to the Company witness the following five kinds of attrition exists:

1. Revenue attrition which is caused by changes in sales.
2. Operational attrition which stems from increases in operating and maintenance expenses.
3. Rate base attrition which results from increases in expenses directly associated with plant. These expenses consists primarily of property taxes, depreciation, and capital costs.
4. Financial attrition caused by increases in the costs associated with senior securities, debt, perferred stock and common equity plus changes

in the amount outstanding.

5. Regulation attrition which results when methods utilized in arriving at earnings on common equity for regulatory purposes do not coincide with methods utilized in arriving at earnings on common equity for financial statement reporting purposes such as stockholders' reports.

The Hearing Memorandum on this issue states: "Company proposes that the Commission include $______ in addition to the revenue requirement determined in the test year used by the Commission in this proceeding to enable Company to earn the authorized level of return during the first year the rates established by this case will be in effect." The Company's counsel stated that the amounts mentioned in the prefiled testimony had become invalid and the proper attrition allowance could not be quantified. A part of the difficulty stems from the Staff's later test year and a consent to true-up certain items. The basis for any adjustment will not be known until the true-up, and under the Company's definition, probably not until an order is issued in this matter. The Company's counsel described the issue as "result oriented". In effect, the Company's attrition adjustment is unknown until it ascertains what portion of its request will not be granted.

At the time of the hearing the Staff objected to the Company's Exhibit 41 entitled: "Rebuttal Testimony of Joseph L. Loethen, Attrition Issue". The Staff objected to the exhibit because it had not filed any testimony on the attrition issue and the alleged "rebuttal" testimony does not fall within the definition contained in the Suspension Order and Notice of Hearing in this matter as being "testimony and exhibits which explain why a party rejects or disagrees with adjustments to book figures proposed by another party". The Staff has not proposed any adjustments to book figures proposed by any other party on this issue. The objection to Exhibit 41 should be sustained and Exhibit 41 and the examination and cross-examination thereon has not been considered as a part of this record.

The Company objected to the introduction of Exhibits 43 and 44 which contained the rebuttal testimony of two Staff witnesses on this matter. Since Exhibits 43 and 44 explain why the Staff rejects or disagree with adjustments to book figures proposed by the Company, the exhibits are proper rebuttal testimony and the objection to Exhibits 43 and 44 should be overruled.

The Company concedes in its brief that talking about attrition is a lot easier than arriving at a specific amount that can be linked to the problem. The Company's brief describes the problem as the inability to substract an unknown number from another unknown number. The principle could not be practically applied since the test year data was being updated at the time the Company's brief was being written.

The Commission and its Staff have conceded the existence of attrition in the past, and as recently as the Report and Order issued in Re: Missouri Public Service Company, ER-82-39 and WR-82-50 (June 21, 1982). To alleviate the difficulties created by attrition the Commission has adopted forecasted fuel expense, true-ups and other mechanisms to employ data from a period as close to, or during the period when the rates to be set will be in effect. Even the Company in its brief concedes the Commission's recognition of the problem and attempts to partially offset it by the means enumerated and other attempts to accelerate the rate case process.

Although recognized, a problem cannot be corrected if it cannot be measured. The instant record does not permit such a measurement since it would be available only after the "operation of law date" of the tariffs herein involved.

The Staff, in other cases, has studied the concept of attrition and has attempted to formulate a method of quantifying it. In the Company's next rate proceeding the Commission will expect the Staff's presentation to reflect, at least, a consideration, of specific proposals in this regard. Although not presently measurable, it may be possible to establish a reasonable attrition factor at some time in the future.

A portion of the attrition problem might be eliminated by an attempt to include in cost of service items of certainty that will materialize early in the period during which the new rates will be in effect. As an example, several witnesses have referred to known wage and salary increases which the Company faces in the near future. The first will be effective January 1, 1983, however, no attempt was made by the Company to secure recognition of those costs.

Miscellaneous and Settled Issues. The Hearing Memorandum in this matter contains several proposed areas of agreement between the parties. Although the Hearing Memorandum was only signed by the Company, the Commission Staff, and the State of Missouri, none of the other parties raised any objection to the proposed areas of agreement. Those agreements, which remain of some effect, are as follows:

1. Company agrees to continue with its pole maintenance program and to enter into a contract covering such for calendar year 1983 and Staff agreed to allow the annualized amount from the current contracts for the program in its test year expenses.

2. The Company agreed to file tariffs effective December 8, 1982, which rebase the Purchased Gas Adjustment for the appropriate wholesale rate from Panhandle Eastern Pipeline Company in effect on October 31, 1982.

3. The increase in gross annual gas revenues granted by the Commission in this proceeding shall be spread on a cents per unit basis. The gas customer charge shall not be changed as a result of this proceeding.

4. The parties agreed that the Company should be authorized to file tariffs identical in text to those set forth in Appendix A, attached to the Hearing Memorandum, regarding charges for reconnection and trip charges.

5. Any increased gross annual electric revenues granted by the Commission in this proceeding shall be spread on the following basis: amounts which relate to fuel costs shall be spread on a uniform cents per kwh basis and all remaining amounts shall be applied on a uniform percentage increase basis to each of the steps in the tariffs.

6. The parties have agreed that the increased gross annual steam revenues granted by the Commission in this proceeding shall be divided by 12 and added to the steam heat monthly charge.

7. The actual ratio as of June 30, 1982, shall be utilized to determine the proper operating ratio for this proceeding.

8. The parties agreed that a true-up hearing should be held on or after November 12, 1982, and before the Commission issues its Report and Order in this proceeding. To be addressed at that hearing were electric and gas plant and related depreciation reserves at actual levels in service as of October 31, 1982, and deferred taxes applicable to such rate base; annualized payroll and related taxes with respect to pay increases for noncontract employees between July, 1982, and October 31, 1982; and capital structure at October 31, 1982. The Company reserved the right to have a witness testify at the true-up hearing with regard to any major projects which have been placed into service between October 31, 1982 and the date of the true-up hearing. The determination, during the hearing, to hold the true-up hearing on October 15, 1982, modified the agreement by substituting the date of September 30, 1982, for that of October 31, 1982.

9. To determine gas sales, the parties agreed that the normalized level as determined by Staff in its direct testimony for the period ending March 31, 1982, shall be utilized, updated for known and measurable items such as the loss of sales to major customers through October 31, 1982.

Because of the change in the date of the true-up hearing the parties have modified the agreement by the adoption of September 30, 1982, as the end of the period on which to base results presented at the true-up hearing. In all other regards the Commission is of the opinion that the proposed agreements are reasonable and proper dispositions of those issues and should be accepted and incorporated in this Report and Order.

The Staff's case includes an allowance for forecasted fuel costs, subject to refund in the event of overcollection by the Company. At the true-up hearing the Company and the Staff offered proposed language, received as Exhibit 46, for the purpose of ordering the proper determination and disposition of any potential refund. In the Commission's opinion the proposal is reasonable and proper and has been adopted in the ordered section, infra.

The Company and Staff also jointly sponsored Exhibit 47 as a proposal for the disposition of the overcollection of budgeted fuel costs allowed in the Company's most recent rate proceeding ER-81-304. That proposal appears to be a reasonable treatment of those costs and has been adopted in the ordered section infra.

Revenue Deficiency. When applying the overall rate of return of 10.56 percent, herein found to be reasonable, to the net original cost electric rate base, as adjusted, in the amount of $98,089,555, the Company's net operating income requirement is $10,358,257. The net operating income under existing rates is $7,422,893. Applying the proper factor for income taxes, the additional electric revenue requirement for the purpose of this case is $5,594,613 on an annual basis, exclusive of applicable gross receipts and franchise taxes.

The corresponding revenue deficiency for gas operations, based on a net original cost rate base of $17,461,822 and net operating income of $1,340,044 under existing rates is $962,350.

The present net operating income for steam operations of $16,638 depicts a revenue deficiency of $58,273 when applied to the steam rate base of $437,159.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law:

The Company is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 393, RSMo 1978. The Company's tariffs which are the subject matter of this proceeding were suspended pursuant to the authority vested in this Commission by Section 393.150, RSMo 1978.

The burden of proof to show that the proposed increased rates are just and reasonable is upon the Company.

Orders of this Commission must be based upon competent and substantial evidence upon the whole record.

The Commission after notice and hearing, may order a change in the rate, charge, or rental, in any regulation or practice affecting the rate, charge or rental, and it may determine and prescribe the lawful rate, charge or rental and the lawful regulation or practice affecting said rate, charge or rental thereafter to be observed.

The Commission may consider all facts, which in its judgment, have any bearing upon a proper determination of the price to be charged with due regard, among other things, to a reasonable average return upon the capital actually expended, and to the necessity of making reservations out of income for surplus and contingencies.

Any evidence recieved without objection which has probative value shall be considered along with other evidence in the case. Evidence which is not of such quantity to be persuasive of the fact to be established may be rejected even if not objected to or controverted.

When the Company's existing rates and charges are insufficient to yield reasonable compensation for service rendered by it in this State, and accordingly, revisions in the Company's applicable tariff charges, as herein authorized, are proper and appropriate and will yield the Company a fair return on the net original cost rate base or the fair value rate base found proper herein new rates resulting from the authorized revisions that will be fair, just, reasonable and sufficient and not unduly discriminatory or unduly preferential should be authorized.

Although there is no requirement that a test year, or any other specific procedure, be used, a test year is commonly utilized in an attempt to measure a period of normal operations, to which reasonable adjustments may be made to permit the establishment of a reasonable estimate of conditions during the period of time in which the new rates will be in effect.

Under ordinary circumstances, adjustments to a test year are confined to those permitting a matching of revenues and expenses. When known increases in expenses will occur, the inequity in disallowances for a lack of precise measurement may outweigh the potential for unfairness in the allowance of the expense for which the precise corresponding revenues cannot be established.

No individual allowance is improper if it has not contributed to an ultimate rate level that is in excess of that which is fair and reasonable.

Any motion not previously ruled on should be considered denied, and any objection not previously ruled on should be considered overruled.

For ratemaking purposes, the Commission may accept a stipulation in settlement of any contested matters submitted by the parties. If the matters of agreement between the parties are reasonable and proper the agreement should be accepted.

It is, therefore,

ORDERED: 1. That the proposed revised electric tariffs filed by Missouri Power & Light Company in Case No. ER-82-180 are hereby disapproved, and the Company is authorized to file in lieu thereof, for approval by this Commission, permanent tariffs designed to increase gross revenues by approximately $5,594,613, on an annual basis, exclusive of gross receipts and franchise taxes.

ORDERED: 2. That the proposed revised steam tariffs filed by Missouri Power & Light Company in Case No. HR-82-179 are hereby disapproved and the Company is authorized to file in lieu thereof, for approval by this Commission, permanent tariffs designed to increase gross revenues by approximately $58,273, on an annual basis, exclusive of gross receipts and franchise taxes.

ORDERED: 3. That the proposed revised gas tariffs filed by Missouri Power & Light Company in Case No. GR-82-181 are hereby disapproved, and the Company is authorized to file in lieu thereof, for approval by this Commission, permanent tariffs designed to increase gross revenues by approximately $962,350, on an annual basis, exclusive of gross receipts and franchise taxes.

ORDERED: 4. That the tariffs authorized herein shall embody the rate design approved herein and may be effective for service rendered on and after the effective date of this Report and Order.

ORDERED: 5. That within thirty (30) days from the effective date of this

Report and Order, the Company shall file with the Commission a proposed plan for the development of an accurate customer count. The plan shall include a schedule designed to permit an accurate customer count within one (1) year from the date of this Report and Order.

ORDERED: 6. That six (6) months after the effective date of the new rates to be established by this Report and Order, the Company shall commence to bill all municipalities with fixed rate service contracts remaining in effect by an additional amount which is one-half (1/2) of the net difference between the Company's filed municipal tariff schedules and the rates provided for in the individual contracts. Commencing with the effective date of the tariffs filed pursuant to the Commission's Order in the Company's next general rate proceeding, all service to the affected Cities shall be rendered at the rate prescribed in the Company's municipal tariff schedule.

ORDERED: 7. That the proposed agreements between the parties, described herein under Miscellaneous and Settled Issues are hereby approved and adopted for purposes of disposition of this case.

ORDERED: 8. Company in filing compliance tariffs to the order of the Commission in this case shall deduct from the electric increase granted on a kwh basis the overcollection of forecasted fuel costs in Case No. ER-81-304 which relate to the period December 10, 1981 through September 30, 1982. The amount of such overcollection is $447,924. Any overcollection of forecasted fuel costs relating to the period October 1, 1982 to the date of the new rates become effective shall be considered by the Commission in Company's next retail electric rate case. In addition, Company has unrefunded fuel costs from Case No. ER-80-286 amounting to $26,765, including interest of $3,729 which shall be deducted from the kwh basis from the electric increase granted in this case.

ORDERED: 9. The Commission places into effect subject to refund an amount of .143 cents per kilowatthour sold ($0.00143/kwh) in order to recognize that forecasted fuel costs are being included in electric retail rates, pending an audit of the actual versus forecasted fuel costs incurred by Company from Union Electric Company and Kansas City Power & Light Company for the period November 1, 1982 through October 31, 1983. A weighted average fuel cost of 1.478 cents per kwh ($0.01478/kwh) is included in the case and is not subject to refund. Total weighted annual average fuel costs of 1.609 cents per kwh ($0.01609/kwh) were utilized for purposes of calculating annualized purchased power fuel costs which results in a difference of .131 cents per kwh ($0.00131/kwh) being subject to refund. To determine if a refund is to be made, Company shall multiply the applicable retail electric kilowatthours sold by .143 cents. From this amount, Company shall deduct the weighted annual average fuel costs in excess of 1.478 cents per kwh times the applicable kwh deliveries. Should Company's weighted annual average fuel costs exceed 1.609 cents per kwh for the November 1, 1982 through October 31, 1983 period, no refund shall be made. Any refund would be made on a uniform cents per kwh basis by means of a credit on the customer's bill. Any applicable interest on such amounts shall be calculated from November 1, 1982 to the date such credits are made on the bills, utilizing for an interest rate the provisions in Section 35.19a of the Rules of the Federal Energy Regulatory Commission for the period from November 1, 1983 to the date such credits are made. The actual period during which these fuel costs subject to refund are collected may be shorter than twelve (12) months in the event of an order of the Commission in a succeeding rate proceeding involving Company, in which case the length of the period may be modified.

ORDERED: 10. Late-filed Exhibit 51 jointly sponored by the Company and the Commission Staff, for the purpose of establishing the Company's capital structure at September 30, 1982, is hereby received into evidence.

ORDERED: 11. That this Report and Order shall become effective on the 8th day of November, 1982.

BY THE COMMISSION

Harvey G. Hubbs

Harvey G. Hubbs
Secretary

(S E A L)

Fraas, Chm., McCartney, Dority,
Shapleigh and Musgrave, CC., Concur
and certify compliance with the
provisions of Section 536.080, RSMo 1978.

Dated at Jefferson City, Missouri,
this 29th day of October, 1982.