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COMMISSION COUNSEL
PUBLIC SERVICE COMMISSION

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri-American Water Company)
for authority to file tariffs reflecting increased)
rates for water service in the Missouri service)
area of the Company.)

CASE NO. WR-89-265

REPORT AND ORDER

Date Issued: May 11, 1990

Date Effective: May 26, 1990

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Inc., Monfort, Inc. and Swift Adhesives Division of Reichhold
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Jefferson City, Missouri 65102, for the Office of the Public Counsel
and the Public.

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Assistant General Counsel, P. O. Box 360, Jefferson City,
Missouri 65102, for the Staff of the Missouri Public Service
Commission.

HEARING

EXAMINER: Michael F. Pfaff

Procedural History

On June 29, 1989, the Missouri-American Water Company ("Applicant or "Company") filed for Commission approval proposed tariffs reflecting an annual increase of \$1,824,700 in gross revenue exclusive of gross receipts and franchises taxes for water sales in the Company's Joplin and St. Joseph districts. On July 21, 1989, the Commission suspended the tariffs to May 26, 1990, and established a procedural schedule for consideration of the suspended tariffs.

On September 18, 1989, Staff recommended a test year ending September 30, 1989, adjusted for known and measurable charges through December 31, 1989. No one opposed Staff's proposed test year. Following a motion by the Office of Public Counsel, the Commission, on December 13, 1989, ordered local public hearings in Joplin, Missouri, on January 24, 1990, and in the City of St. Joseph, Missouri, on January 25, 1990. No members of the public offered testimony at Joplin; eight witnesses were sworn and offered testimony in St. Joseph.

On Staff's motion, the Commission ordered a true-up hearing to consider the inclusion of certain capital projects in rate base which were not yet in service at the end of the test year. Following the prehearing in early February, all parties executed and filed a Hearing Memorandum. On February 21, 1990, Applicant and Staff submitted a nonunanimous Stipulation and Agreement (Stipulation), which is further referenced in the Findings of Fact, *infra*.

On February 28, 1990, and March 1, 1990, the Commission conducted hearings and considered evidence on all issues identified as contested by the Hearing Memorandum except those connected only to true-up issues. After granting Staff's motion for true-up, the Commission conducted a true-up hearing on March 20, 1990, after which the evidentiary record was closed. Initial and reply briefs having been duly filed, this case is now formally at issue.

Findings of Fact

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

I. Introduction

The Missouri-American Water Company is a public utility providing water service to customers in two Missouri districts, Joplin and St. Joseph. As shown by Exhibit 3, classes and number of customers in each district is:

<u>Joplin</u>	<u>Customer Classes</u>	<u>St. Joseph</u>
15,909-----	Residential-----	24,013
2,363-----	Commercial-----	3,134
52-----	Industrial-----	115
84-----	Public Authority-----	148
7-----	Sales for Resale-----	12
199-----	Private Fire Service-----	256

The Company proposes to spread its originally sought revenue increase of \$1,824,700 in an across-the-board application. All classifications of Joplin customers were to receive a 15.8 percent increase (rounded); St. Joseph customers were to receive rate increases of 19.9 percent (rounded). As discussed below, Applicant and Staff entered into a nonunanimous Stipulation which proposed that Applicant's revenue requirement be increased by \$824,374, subject to a proposed true-up which, per the Stipulation and subject to Commission approval, could increase the Company's revenue requirement an additional \$473,144, or to \$1,297,518, total Company.

The test year in this case ended September 30, 1989, with an allowance made for known and measurable changes to December 31, 1989. In its order of February 23, 1990, the Commission granted Staff's motion for a true-up hearing

regarding four capital projects identified in the Company's initial filing as pro forma rate base additions. By the same order, the Commission stated its intention to limit its consideration to only those projects which were "in service" by 12:01 a.m., March 1, 1990. To determine which such projects were, or were not, in service, and to match investment, revenues and expenses associated with each, the Commission Staff was ordered to submit a complete audit to all parties by March 12, 1990. At the true-up hearing on March 28, 1990, Staff's true-up audit was received in evidence as Exhibits 33, 34, 35, 36 and 37.

The Stipulation between Applicant and Staff states that it is nonunanimous "due to the existence of certain unresolved revenue requirement and rate design issues with other parties." The other parties were Office of Public Counsel, three Public Water Supply Districts (PWSDs), and Ag Processing, Inc. (AGP). The Stipulation provides that if the Commission rejects the true-up, that both the Company and Staff are bound by the revenue requirement of \$824,374 and that the Company will not oppose Staff's proposed rate design.

On March 27, 1990, Intervenor PWSDs and AGP objected to the nonunanimous Stipulation and, pursuant to 4 CSR 240-2.115, requested a hearing "on all issues." Intervenor AGP states that the nonunanimous Stipulation is nothing more than a joint recommendation, and that it enjoys no evidentiary support in the record. AGP cites *Fischer v. Public Service Commission*, 645 S.W.2d 39 (Mo. App. 1983) for the proposition that due process requires evidentiary support for, and a fair hearing regarding, rate design reached or agreed to by nonunanimous Stipulation. The Commission finds that the requirements of *Fischer* have been fully met in this case. Unlike *Fischer*, Intervenor herein were granted a full hearing in the first instance on all contested issues, specifically including rate design. Instead of being "...precluded from approving anything but the stipulated rate design..." (*Fischer*, p. 43), the Commission has before it in this case rate design evidence

from Staff and from Intervenor AGP and PSWDs, and has conducted a full and contested hearing on the rate design issue. Nor does the Commission find merit in Intervenor AGP's broad assertion that everything stipulated to by Staff and Applicant requires an evidentiary presentation and findings in support thereof. Only contested issues require an evidentiary hearing and findings, and the Commission finds that the contested issues are as contained in Exhibit 1, the Hearing Memorandum, a document executed by all parties to this proceeding. In pertinent part, the Hearing Memorandum provides, at page 3, that "the parties agree to Company's and Staff's agreed upon revenue requirement of \$824,374 as the starting point from which adjustments for the contested issues will be made." Inasmuch as the Hearing Memorandum identifies only the following contested issues, and because the hearing and cross-examination were properly confined to the agreed upon issues, the Commission will consider this case as presented, on agreement of the parties and after having heard each of the contested issues. Before so doing, the Commission finds that Company Exhibits 3, 4, 5, 6, 7, and Staff Exhibits 12, 13, 14, 15, 16, 17 and 18 are prima facie evidence of the stipulated revenue requirement of \$824,374, based on the Company's rate base, expenses and revenues as of December 31, 1989. The Commission also approves that portion of the nonunanimous Stipulation which provides that the starting point for revenue requirement is \$824,374, and approves all other portions of the Stipulation which address noncontested issues.

II. True-up

The Hearing Memorandum reserves only three true-up issues for the Commission's consideration. The first is the propriety of conducting a true-up proceeding. The second issue is whether the Commission should permit a true-up of specific capital projects, and the third poses the question, "should rate design be addressed at the true-up hearing?" Inasmuch as rate design was fully litigated at

the hearings on February 28, 1990, and March 1, 1990 (prior to the true-up hearing on March 28, 1990), the Commission finds it unnecessary to litigate rate design more than once.

Two additional true-up issues, apparently unforeseen when the Hearing Memorandum was signed, arose prior to the true-up hearing on March 28, 1990. The first issue regards the Company's St. Joseph River improvement project. This project is one of the four proposed late additions to plant and was not, at least completely, in "service" by 12:01 a.m., March 1, 1990, as required by the Commission's order of February 23, 1990. The other unforeseen issue involves the question of a true-up of Applicant's rate case expenses.

(A) Propriety of True-Up

The Hearing Memorandum identifies the following capital construction projects as subject to true-up, if they are "in service" by February 28, 1990.

- Joplin Groundwater Development Project - three wells, with associated equipment, to produce water for the Joplin district.
- St. Joseph, Missouri, River Intake Project - three conduits, each with pumps and associated equipment to extend into the Missouri River during periods of low water.
- St. Joseph Office Building - for Company's general administrative offices.
- AS-400 Computer - an IBM AS-400 Computer, with program, employees, and associated hardware.

All parties agreed that a true-up proceeding should also include and address the following Company accounts: Depreciation reserve, capitalized deferred maintenance, contributions in aid of construction, customer advances, deferred income taxes, revenues and associated electrical and chemical expenses for changes in customer levels. Staff also examined property taxes, depreciation and contractual maintenance expenses associated with the four capital projects and rate case expense to February 28, 1990. Staff's true-up testimony and exhibits

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make adjustments in these accounts to achieve a balance of revenue, expense and rate base items to the end of the true-up period.

The projected costs of these four projects were included as rate base and expense items in the Company's original filing. Both the Commission Staff and the Office of Public Counsel knew of the projects, and made data requests concerning them. Although planned for completion prior to the end of the known and measurable period ending December 31, 1990, the record discloses that not all of the projects were in service on that date. Pursuant to the Commission's Order Granting True-Up Hearing of February 23, 1990, engineers from the Commission's water and sewer department made an on-site investigation of the projects on February 26 and 27, 1990. Testimony at the true-up hearing established, and the Commission finds, that (a) the Joplin Groundwater Project was complete, in service, and tied to the Company's water system as of March 1, 1990; (b) Applicant's St. Joseph office building was complete and in service as of March 1, 1990; (c) the Company's new AS-400 computer was on line and in use as of March 1, 1990; and (d) on March 1, 1990, the Missouri River Intake Project was not completed, although a portion of the project was providing service.

A true-up is simply an adjustment to the test year. The purpose of a test year, as stated in *Re Kansas City Power & Light*, 26 Mo. P.S.C. (N.S.) 104, 109 (1983), is to "...create or construct a reasonable expected level of earnings, expenses, and investments during the future period in which the rates...will be in effect." (Emphasis supplied.) In the same case, the Commission stated "the Commission has generally attempted to establish those levels at a time "as close as possible to the period when the rate in question will be in effect (*Id.* p. 109). Although apparently needed, a true-up was not employed in the *KCP&L* case, leading the Commission to observe:

The true-up procedure has received broad acceptance as a proper ratemaking tool. A true-up permits adjustments outside of the test year without improperly disturbing the revenue-expense relationship. The Staff has not proposed a true-up in this proceeding, although it believes true-ups are a desirable regulatory procedure.

Staff's failure to recommend a true-up is based on its lack of resources to conduct a true-up prior to the anticipated date for an order, while maintaining its auditing obligation in the current press of other similar major rate cases. Absent a true-up, the Commission is faced with the choices of using a completely historical test year, or utilizing an interim procedure. (*Ibid.*, p. 109.)

Public Counsel opposes the true-up, stating that capital improvements should not be added to rate base by true-up. Public Counsel cites no authority for this proposition. Given the stated purpose of a test year, and the rationale for adjustments beyond the test year by true-up, the Commission finds that adding capital improvements to Applicant's rate base by true-up is a proper ratemaking procedure, provided that other aspects of the revenue-expense relationship are also taken into account.

Public Counsel and AGP also oppose the true-up for the reasons that Staff, not the Company, requested same; that Staff's request for a true-up came too late; that the prescribed procedure for requesting a true-up was not followed; that the Company filed its rate case too early; and that granting a true-up of such relatively large rate base items would create a bad precedent. The Commission finds little merit in these arguments. The Commission's Suspension Order of July 21, 1989, while requiring the Company to advise by August 21, 1989, whether a true-up was required, did not foreclose any other party from making such a request. The Commission also finds that the Company anticipated that at least three of the four projects would be in service by December 31, 1989. Thus, by the time Applicant knew a true-up would be necessary, the date by which Applicant was to

request a true-up had passed. No authority has been cited for the proposition that rate filings made "too early" cannot be trued-up, whatever the relative size of the plant; nor does the record disclose prejudice to any party arising from Staff's request of January 22, 1990, for a true-up. A complete audit of the trued-up accounts was performed, given to all parties prior to the true-up hearing, and both Staff and Company witnesses were cross-examined on true-up issues.

The Commission has employed true-up audits when necessary and will continue to do so. The procedure was used to adjust the test year in *Re Kansas City Power & Light*, 24 Mo. P.S.C. (N.S.) 386 (1981). In *Re Joplin Water Works Company*, Case No. WR-81-282 (1981), the Commission permitted an addition to rate base which was not "in service" until after the Commission's Report and Order. This circumstance does not obtain here; the Commission has found that three of the four projects subject to true-up were complete and in service as of March 1, 1990. The fourth, the St. Joseph, Missouri, River Intake Project (discussed *infra*) was partially in service.

The Commission finds that it is lawful, proper and necessary to consider the inclusion of the four projects above-described by a true-up hearing.

(B) Joplin Groundwater Development Project, St. Joseph Office Building,
AS-400 Computer

As stated in (A) above, the Commission finds that each of these capital construction projects were in service on or before March 1, 1990. The Commission also finds that as of March 1, 1990, the Company's gross revenue requirement associated with all three projects, less the Staff's true-up adjustments for other operating revenues and expenses is \$234,179.

In addition to opposing the true-up of all Company projects, Public Counsel also opposes--on different grounds--inclusion of the AS-400 computer in rate base. The Commission will address this separate issue in Section IV, *infra*, but pending that consideration, the Commission finds that the three projects listed

above should be included in Company's rate base and that each project was in service sufficiently close to the operation of law day to merit inclusion.

(C) St. Joseph, Missouri, River Intake Project

The Company's St. Joseph Division obtains its water solely from the Missouri River. After experiencing profound supply difficulties owing to low river levels, during which portions of St. Joseph had no water, the Company initiated its Missouri River Intake Project to extend and improve its access to the river at low river levels. Company witnesses testified at the true-up hearing regarding the nature of the project, its necessity, and sponsored exhibits consisting, in part, of a diagram showing the facility (Exhibit 39) and, attached to Exhibit 38, a copy of the construction contract for the project. No one contested the need for the River Intake Project, only its stage of completion and the timeliness of its inclusion in rate base.

The Stipulation between Staff and Applicant, apparently in anticipation of the completion of all four true-up projects by March 1, 1990, provided for an increase in Applicant's gross revenue requirement from \$824,374 up to \$1,297,518. The net true-up increase in the Company's total revenue requirement thus anticipated was \$473,144, a large portion of which, \$150,392, would have been attributable to the Missouri River project.

Staff's investigation, report, and testimony at the true-up hearing disclose that the Company's Missouri River project, while largely in service, was not complete by March 1, 1990.

The River Intake Project consists of one 24-inch intake pipe, two 36-inch intake pipes and various pumps, hydraulic controls, intake screens, pipe supports, footings and other equipment for each intake. At the true-up hearing, Staff's witness testified that as of March 1, 1990, the northern most 36-inch intake pipe was not in service; this caused Staff to eliminate the entire project from the

Company's rate base, an adjustment Staff felt was mandated by the Commission's order authorizing the true-up hearing.

The revenue effect of removing the River Intake Project from St. Joseph's rate base was \$150,392.

The Company states that all three intakes will be in service by May 26, 1990, and that the Commission should include all the investment in rate base. Failing that, the Company maintains that since each of the three intakes operates independently of the other, and that two of the three were in service, the Commission should admit at least a portion of the River Intake Project in rate base. Public Counsel and AGP oppose the true-up of all accounts, including the River Intake Project.

Having considered the facts and positions of all the parties, the Commission finds that the Company's River Intake Project is essential for the delivery of a year-round water supply to the customers in the St. Joseph district. The Commission also finds that each of the three intakes can, and does, operate independently of the other and that two such intakes, a 24-inch and a 36-inch intake, were in service on March 1, 1990. Given the sole purpose of the Intake Project, and the fact that each intake and its associated pumps, controls, screens, footings and other equipment can offer service to the public on a "stand alone" basis, the Commission finds that the River Intake Project was, on March 1, 1990, at least two-thirds complete and in service to the same extent.

The Commission therefore finds that two-thirds of the Company's investment in said plant up to March 31, 1990, should be included in rate base and that the revenue effect of said addition, in the St. Joseph district, is \$100,261.

(D) True-up of Rate Case Expense

The Hearing Memorandum provides that if the Commission finds that a true-up is appropriate, another item for consideration is whether Applicant's rate

case expense to February 28, 1990, should be trued up. The Company claims an actual rate case expense (up to February 28, 1990) of \$141,000 and the record discloses that Staff made no adjustment to true up the Company's rate case expense. Staff recommends that only \$96,800 be expensed and amortized over two years. Staff maintains that billings to Applicant by its parent service company for services rendered in the true-up period were not specific to rate case expense, but were instead allocations of a general nature. Public Counsel agrees with Staff, noting that truing up rate case expense would be tantamount to paying five months of salary to employees of the parent (service) corporation. The Commission finds that truing up Applicant's legal expenses to February 28, 1990, is not appropriate when, as shown, Applicant is claiming expenses on an annualized basis from a parent service company. The Commission also finds that the sum of \$96,800 represents a reasonable allowance for rate case expense.

III. Tank Painting/Deferred Maintenance

Staff and Company propose to include \$680,917¹ of unamortized (deferred) tank painting maintenance expenses in rate base. If permitted, the revenue effect would be to increase Joplin's revenue requirement by \$33,474 and St. Joseph's by \$62,001. Public Counsel opposes capitalizing the Company's unamortized tank painting expense; instead, Public Counsel suggests that a ten-year period be examined¹ to derive the Company's average annual tank painting expense figure which, each year, could be properly expensed as part of the Company's cost of service. By so doing, Public Counsel states that Applicant will recover its deferred maintenance expense as a cost of service, not as a capital investment. Intervenor PWSDs and AGP take no position on this issue.

¹Shown to be an average interval for Applicant's tank painting.

Staff and Company liken the deferred and unamortized painting expenses to prepaid insurance, the unamortized deferred cost of which has traditionally been included in rate base, where the "investment" earns a rate of return. Taking issue with this comparison, Public Counsel notes that unlike insurance, the Company does not prepay tank painting and that painting expense is intermittent, varying considerably from year to year.

Both Staff and Company cite Commission cases for the proposition that capitalizing deferred maintenance expense has been approved in past cases. Staff and Company also cite a 1980 NARUC Committee on Accounts' "interpretation" which favors their position. Public Counsel distinguishes the Commission cases cited by Staff and Company and points out that the NARUC "interpretation" was meant to apply to smaller water companies than Applicant and then only during inflationary periods.

Public Counsel also avers that the 1976 Uniform System of Accounts, adopted by this Commission, permits only the first painting of tanks as a rate base item; painting to maintain tanks, as here, is treated only as an item of expense.

The Commission finds that storage tank painting is a maintenance function which, while doubtlessly preserving the tank as a capital asset, does not itself rise to the level of an addition to rate base. The Commission finds that Applicant's unamortized and deferred tank painting maintenance expense, accrued over time, is not part of Applicant's rate base, but simply an element of Applicant's cost of service. To find otherwise would invite similar treatment of other deferred expenses, thereby increasing the difficulty of arriving at a logical and fair separation, for ratemaking, between rate base and cost of service. As a result, the Commission does not accept that portion of Staff and Company's Stipulation which proposes to add \$680,917 to Applicant's rate base to reflect this

item. The net effect on Applicant's total Company revenue requirement, without considering other adjustments, is \$95,475.

IV. The AS-400 Computer

Company and Staff propose to include in rate base and expense all costs associated with Applicant's new IBM AS-400 computer. The issue has a rate base impact of \$459,047, with \$72,417 allocated to Joplin and \$386,630 to St. Joseph. Including it in rate base would increase the Company's overall revenue requirement by \$122,872, with \$29,266 attributable to Joplin, and \$93,606 to St. Joseph.

Initially, Public Counsel and Intervenor AGP oppose including any of the computer's cost in rate base; failing total exclusion, each suggests that the Commission should exclude one-half of the cost. Central to Public Counsel's and AGP's opposition is their assertion that the AS-400 is not "...fully used and useful."

Company witnesses testified that the computer runs an Electronic Data Inquiry System (EDIS) for the following functions: Customer billings and inquiries, meter changes and readings, installations, address changes and data requests. The evidence discloses that prior to obtaining the AS-400, Applicant's employees performed these functions manually, although customer bills are still mailed from the offices of Applicant's parent in Richmond, Virginia.

The evidence also shows that other IBM AS-400 computers are in use by other subsidiaries of the American Waterworks Association; as a result, the software to run Applicant's system was already available, and had been used with success by other water companies. The AS-400 enables Applicant to process an average of 6,700 customer contacts each month, and the undisputed evidence shows that doing so requires 97 percent of the presently available capacity of the AS-400. However, both Public Counsel and AGP maintain that the AS-400 has far greater capacity than is being used, that such excess capacity is not required to

run the EDIS function, and that as a result all, or at least one-half, of the Company's investment should be disallowed.

The evidence on this point unquestionably indicates that in 1992 Applicant intends to use the AS-400 to process a Financial Accounting System (FAS), a fully computerized accounting system. But to do so the Company must purchase more hardware and storage capacity for the AS-400 which, in its present configuration, cannot implement a FAS system. It is the expandable nature of the AS-400 which seems to have aroused Public Counsel and AGP.

The Commission, however, finds nothing amiss with Company's election to purchase a proven, expandable system to enter the computer age, especially one working at 97 percent present capacity. The Commission therefore finds that the Company's IBM AS-400 computer, and the costs associated therewith, is used and useful and should be included in Applicant's rate base.

V. Rate Design

Having found that the Company's overall revenue requirement is \$963,078 with \$362,605 attributable to Joplin and \$600,473 to St. Joseph, the Commission must now determine how Applicant is to recover this amount, per district, through its rates. In its initial filing, Applicant proposed an across-the-board increase of 15.8 percent in its Joplin district and 19.9 percent in St. Joseph. Applicant has since agreed to forego its across-the-board request and not to oppose Staff's rate design. Intervenor PWSDs and AGP strenuously oppose Staff's design and urge the Commission to instead approve an across-the-board increase and to order Applicant to perform a class cost of service study which takes peak use and demand into consideration.

Applicant's present tariff, shown in Exhibit 3, contains private fire and general water service rates for Joplin and St. Joseph. By way of example, the general service tariff for St. Joseph authorizes a fixed charge for all water

customers based on meter size. The fixed charge for a 5/8-inch meter, the smallest shown, is \$4.47 a month, or \$8.02 a quarter. An 8-inch meter, the largest, costs \$145.09 a month, or \$429.89 a quarter. All customers pay the fixed meter charge, regardless of their water usage. The Company's usage rates, often referred to in the testimony as the commodity or "step" rates, are also shown on Company's Exhibit 3. There are only two "steps" in the usage rate.

In the first "step" for St. Joseph, the current rate per 100 cubic feet of water (748 gallons) is \$.9922. If more than 100,000 cubic feet (748,000 gallons) of water is used in one month, the second "step" is reached, where the rate drops to \$.4576 per 100 cubic feet (748 gallons). In Company's proposed tariff for St. Joseph, the rate in the first step is \$1.1904 per 100 cubic feet. Using more than 748,000 gallons, a customer reaches step 2, where the Company proposed a rate of \$.5490 per 100 cubic feet.

Staff proposes to use the same method for developing rates as was approved by the Commission in the Company's last rate case. Staff's design develops rates by making allocations of the Company's total revenue requirement, by plant and expense accounts, into the following four components.

1. Billing component - this component consists of costs associated with the rendering of bills and other customer accounting related costs.
2. Meter component - this component consists of costs associated with meter reading and maintenance expense and the related plant accounts.
3. Commodity rate component No. 1 - this component consists of costs related to the total production and transmission of all water sold.
4. Commodity rate component No. 2 - this component consists of those expenses and plant costs associated with the distribution system and storage.

Neither Staff, the Company, nor any intervenor performed a cost-of-service study by class, one in which peak use or load factors were given consideration.

Intervenors PWSOs and AGP take particular issue with that part of Staff's rate design which produces a higher percentage of increase on "step 2" use of water than on "step 1" use. Intervenors also protest that under the Company's original filing, which sought only an across-the-board increase, step 2 usage rates would have increased 19.9 percent in St. Joseph while under Staff's proposal, step 2 rates could (if 8,000 ccf is consumed) be as much as 23.8 percent higher.

Staff's design requires that the commodity (step) costs associated with the St. Joseph district are to be recouped by a commodity charge (step 1) of \$1.0424 cents for each hundred cubic feet (748 gallons) of water up to 100,000 cubic feet. Thereafter, Staff's design requires a commodity charge (step 2) of \$.5379 for each additional 100 cubic feet (748 gallons). Intervenors apparently prefer the Company's original across-the-board request not because it reduces the actual cost of step 2 water (Company originally priced step 2 water at \$.5490 per 748 gallons), but because in the Company's original filing more of the requested 19.8 percent increase would have been absorbed by step 1 users than step 2 users. For comparison purposes, the St. Joseph monthly commodity rates (steps 1 and 2) under discussion are:

Company's Present Tariff Rate	Company's Proposed Tariff Rate	Staff and Company's Proposed Rate
STEP RATE 1 (For the first 748,000 gallons)		
\$.9922 (per 748 gal.)	\$1.1904 (per 748 gal.)	\$1.0424 (per 748 gal.)
STEP RATE 2 (For usage in excess of 748,000 gallons)		
\$.4576 (per 748 gal.)	\$.5490 (per 748 gal.)	\$.5379 (per 748 gal.)

To support their position that only an across-the-board increase be considered, Intervenor's have pointed out anomalies in Staff's rate design study. In one such instance, Staff made a reallocation in Joplin with the result that residential customers would experience a smaller percentage increase than under Staff's initial allocation. Intervenor's also question whether certain Company investments should be properly assignable to water production, rather than distribution or another area. Although Intervenor's state that Staff's study is flawed and "result" driven, the Commission finds that Intervenor's appear to be at least equally, if not more, concerned with the "results" of Staff's rate design instead of the methodology. Intervenor's point out that Staff's method requires too much judgment, especially in the allocations, but the Commission finds that all rate design requires the exercise of judgment. On this point, the Commission finds that even in those circumstances where a class cost-of-service study has been performed (as Intervenor's urge for Applicant's "next" case), it may not be good ratemaking to follow it. See *In Re Arkansas Power and Light Co.*, Case No. ER-81-364, Report and Order, p. 32 (Mo.P.S.C. April 20, 1982).

The Commission finds little merit in Intervenor's suggested across-the-board, equal percentage, rate increase. Applicant's costs can be recovered only through its rates and, as nearly as possible, the rates should reflect costs. An across-the-board rate increase can produce a good design only if there has been an even across-the-board increase in all areas of Applicant's costs since Applicant's last rate case. The Commission finds that Applicant's plant and costs show no such uniformity. There are, for example, significant differences between Company investment and cost of service in its Joplin and St. Joseph districts. Staff's rate design witness explained that the higher percentage increase in step 2 of the St. Joseph commodity water rate is attributable to increased costs associated with the St. Joseph district's production of water. As

both the findings regarding the true-up and Staff's rate design study show, there has been a substantial increment in both plant and cost of service in the St. Joseph district. This investment and cost should be borne by those who put bigger demands on the system and require more water. Inasmuch as large water users contribute a proportional share to both system cost and demand in step 1, and--in essence--pay only for the transmission and production costs of water in step 2 (at approximately half price), the Commission finds that the rates prescribed by Staff's design are reasonable.

The Commission therefore accepts Staff's proposed rate design as contained in Staff's true-up Exhibit 37.

Conclusions of Law

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

Applicant is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 393, RSMo 1986,' as amended.

Company's tariffs were suspended pursuant to Section 393.150, RSMo 1986, as amended, which puts the burden of proof on Applicant to show the proposed increase in rates is just and reasonable.

The Commission, pursuant to Section 393.270(4), RSMo 1986, as amended, may consider all facts which in its judgment have any bearing upon a proper determination of the price to be charged for water service with due regard, among other things, to an average return on capital actually expended. The Commission may also consider all agreements by the parties to this proceeding, including the nonunanimous Stipulation and Agreement and the Hearing Memorandum, in order to determine which issues are contested.

The Commission concludes that the Hearing Memorandum, Exhibit 1, executed by all parties, identifies the contested issues and further provides that

Applicant's revenue requirement, exclusive of the contested issues, is \$824,374 and, for the purpose of hearing, "is the starting point from which adjustments for the contested issues will be made" (p. 3, Exhibit 1).

The Commission also concludes, subject to the above-stated Findings of Fact, that it is in the public interest to accept the nonunanimous Stipulation and Agreement between Applicant and Staff.

The Commission concludes that the requirements of *Fischer v. Public Service Commission*, 645 S.W.2d 39 (Mo. App. 1983) have been fully met in this proceeding. Intervenor AGP and PWSDs received a full and contested hearing on rate design and the Commission, instead of only adopting Company and Staff's Stipulation on rate design, has instead conducted a contested hearing on the issue and made findings of fact in support thereof.

The Commission also concludes that the case of *Smith v. Public Service Commission*, 351 S.W.2d 768, cited by Intervenor PWSDs for the proposition that a proper rate design must derive from a reasonable classification of services, is also authority for the proposition that industrial or large users of utility services can properly be charged a higher percentage increase than residential users. In *Smith*, by Commission order, residential electric rates increased 15.4 percent, commercial rates 27.0 percent and industrial rates 26.2 percent. In setting these rates, the Commission said: "The Commission is conscious of the fact that on the percentage basis the commercial and industrial rates are increased a greater amount than the residential service, however, a percentagewise increase straight across the board, if followed in fixing new rates, does not in most instances bring about an equitable distribution of the increased costs" (*Smith*, p. 770). On appeal by the commercial and industrial users, the court sustained the Commission's rate design, noting, at p. 771: "It may well have been that the old rate...(for large users) was much too low...", adding, "...the reasonableness of

the basis of the classification must appear, and whether a discrimination is unlawful...is usually a question of fact" (*Ibid.*, *Smith*, p. 771).

The Commission concludes that a higher percentage increase to users of large quantities of water than to users of smaller quantities does not, if supported by cost of service differences, constitute unjust discrimination.

The Commission therefore concludes that the rate design sponsored in evidence by Staff, and contested by Intervenor's cross-examination, evidence and briefs, is not, as a matter of law, an unjustly discriminatory rate design.

Based on the revenue requirement found reasonable herein, the Commission concludes that Applicant Missouri-American Water Company shall be allowed to file revised tariffs designed to increase revenues exclusive of gross receipts and franchise taxes in its Joplin, Missouri, district by \$362,605 on an annual basis and in its St. Joseph, Missouri, district by \$700,734 on an annual basis, for a total of \$1,063,339.

Based on the evidence regarding Applicant's investment and cost of service in each district, and on the rate design evidence and study above cited, the Commission concludes that the revenue requirement per district as above set out shall be recovered by using the rating system and methodology prescribed by, and in, Staff Exhibit 37 with rate adjustments necessitated by the Commission's findings regarding the revenue requirement of each district.

It is, therefore,

ORDERED: 1. That pursuant to the findings and conclusions in this Report and Order, the proposed tariffs filed by the Missouri-American Water Company, St. Joseph, Missouri, are hereby disapproved and the Missouri-American Water Company is authorized to file in lieu thereof, for this Commission's approval, tariffs designed to increase annual gross revenues exclusive of gross

receipts and franchise taxes by the amount of \$362,605 in the Company's Joplin district and by the amount of \$700,734 in the Company's St. Joseph district.

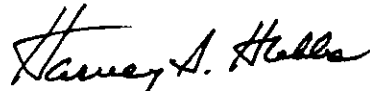
ORDERED: 2. That the tariffs for each district authorized herein shall reflect the rate design specified by this order.

ORDERED: 3. That the Commission approves those parts of the nonunanimous Stipulation and Agreement between Staff and Missouri-American Water Company as provided by this order.

ORDERED: 4. That any objections or motions not heretofore ruled on are hereby overruled or denied.

ORDERED: 5. That this order shall become effective on the 26th day of May, 1990.

BY THE COMMISSION


Harvey G. Hubbs
Secretary

(S E A L)

Steinmeier, Chm., Mueller, Rauch, McClure
and Letsch-Roderique, CC., Concur and certify
compliance with the provisions of Section
536.080, RSMo 1986.

Dated at Jefferson City, Missouri, on the
11th day of May, 1990.