BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of Missouri Cities Water Company's tariffs to increase rates for water service in the company's service area.	)	Case No. WR-92-207
In the matter of Missouri Cities Water Company's tariffs to increase rates for sewer service in the company's service area.	)	Case No. SR-92-208

APPEARANCES

Byron E. Francis, Armstrong, Teasdale, Schlafly & Davis, One Metropolitan Square, St. Louis, Missouri 63102-2740, for Missouri Cities Water Company.

Jeremiah D. Finnegan, Attorney at Law, 1209 Penntower Building, 3100 Broadway, Kansas City, Missouri 64111, for cities of Houston Lake, Lake Waukomis, Parkville, Platte Woods and Riverside, Missouri, and Platte County Public Water Supply District No. 6.

Carl J. Lumley, Curtis, Oetting, Heinz, Garrett & Soule, P.C., 130 South Bemiston, Suite 200, Clayton, Missouri 63105, for city of Warrensburg, Missouri.

John B. Coffman and Douglas E. Micheel, Assistants Public Counsel, Office of Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of Public Counsel and the public.

Michaelene A. Knudsen and Lee C. Tieman, Assistants General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

HEARING EXAMINER: **Edward C. Graham.**

REPORT AND ORDER

Procedural History

On February 21, 1992, Missouri Cities Water Company (MCWC or Company) filed with the Missouri Public Service Commission (Commission) proposed tariffs bearing an effective date of March 23, 1992. These proposed tariffs were designed to produce an overall Company rate increase of $853,000 in charges for water and sewer service ($846,500 water rate increase and $6,500 Platte County Division sewer service increase), exclusive of gross receipts and sales tax.

On March 18, 1992 the Commission issued its Suspension Order And Notice Of Proceedings which suspended the Company's proposed tariffs until January 21, 1993. On April 3, 1992 the Commission granted the Company's Motion To Amend Suspension Order which remedied incorrect language in Company's proposed tariffs and altered the procedural schedule. Company filed direct testimony on April 23, 1992. On May 19, 1992 the Commission granted intervention to the City of Warrensburg, Missouri, the City of Mexico, Missouri, and the cities of Riverside, Parkville, Platte Woods, Lake Waukomis and Houston Lake, Missouri, and Platte County Public Water Supply District (collectively called Platte County Intervenors). On June 2, 1992 the Commission adopted a test year of the twelve (12) months ending December 31, 1991, as updated through June 30, 1992. On August 14, 1992 the Commission's Staff (Staff), Platte County Intervenors, and the Office of Public Counsel (Public Counsel) filed their direct testimony. On August 21, 1992 additional direct testimony was filed by Staff and Platte County Intervenors.

On August 31, 1992 a prehearing conference began and continued through September 3, 1992 with all the parties present and participating except the City of Mexico, Missouri. A hearing memorandum setting forth the contested issues was filed by all parties on September 11, 1992. Rebuttal testimony was filed by the parties on September 18, 1992. On September 23, 1992 the Staff issued a Notice of Subpoena Duces Tecum directed to Company. On September 30, 1992 the Commission issued its Order denying the motion to quash subpoena duces tecum. On October 7, 1992 the parties filed surrebuttal testimony.

The hearing convened on October 13, 1992 and continued through October 16, 1992. All parties appeared except the City of Mexico, Missouri. During the hearing the Commission issued a Protective Order for the Company as to the testimony that was the subject matter of the subpoena duces tecum and granted Staff's motion to accept late-filed testimony. Pursuant to the briefing schedule, simultaneous briefs were filed on November 30, 1992 and simultaneous reply briefs were filed on December 7, 1992.

Background

Missouri Cities Water Company (MCWC) is a utility company engaged in providing water service in and around the cities of Brunswick, Mexico, Parkville, and Warrensburg, Missouri and St. Charles County, Missouri, and providing sewer service in Parkville, Missouri. As of December 31, 1991, MCWC provided service to 32,388 water customers and 101 sewer customers in the five operating divisions. Of these 32,388 water customers, 507 customers were served in the Brunswick Division, 4,547 customers were served in the Mexico Division, 3,754 customers were served in the Platte County Division, 5,126 customers were served in the Warrensburg Division, and 18,454 customers were served in the St. Charles Division. MCWC's principal office is located at 3877 Highway 70, St. Peters, Missouri. In this office is located the administrative, engineering and other general office personnel for all of the MCWC operations. MCWC is a wholly-owned subsidiary of Consolidated Water Company, a holding company with other operating subsidiaries in Florida, Indiana, Ohio and Michigan. Consolidated Water Company offices are in Coral Gables, Florida. The accounting for MCWC is maintained at a regional center in Greenwood, Indiana. MCWC has 55 employees spread among the general office and separate divisions. In October 1991, MCWC was granted $767,619 in rate relief in Case Numbers WR-91-172 and SR-91-174. In October 1989, MCWC was granted $900,000 in rate relief in Case Numbers WR-89-178 and SR-89-179. On October 23, 1990 MCWC was granted a change in its rate design in Case Number WR-90-236 that created no revenue impact to the Company or its customers.

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.

I. Test Year

Company proposed a test year ending December 31, 1991 as adjusted for changes which are fixed, known and measurable up to January 21, 1993. Staff proposed a test year ending December 31, 1991 consisting of 12 months actual data, updated through June 30, 1992. On June 2, 1992, the Commission established the test year to be the 12 months ending December 31, 1991, as updated through June 30, 1992.

II. Revenue Requirement

A. Areas of Agreement

(1) Security Deposits

Company agrees to refund, within three months following the effective date of the Commission's final order in this case, all security deposits now held by Company, along with six percent interest compounded annually, to those customers for whom security deposits are no longer required to be held pursuant to Company's currently tariffed Rule 9.2(c).

Company agrees to provide the Public Counsel, at the end of the three month deadline, a list showing name and customer number of each customer for which a security deposit is still held and has been held by Company for over a 12-month period. The Company will also provide to Public Counsel the month and year that each security deposit on the list was paid to Company and Company's justification for not refunding each security deposit on that list.

The agreement between Company and Public Counsel herein as to security deposits is hereby approved and adopted by the Commission.

(2) Other Issues

All items not specifically decided herein were settled at the prehearing conference by the parties and are approved herein by the Commission as a Stipulation And Agreement and hereby adopted by the Commission.

(3) Reconciliation

The Reconciliation marked as Exhibit 2 indicates that, based upon the issues remaining to be decided herein, the revenue requirement of the Company, with Company winning all issues, would be $413,421 for water operations and $3,583 for sewer operations. The Company's revenue requirement request is based on a tier coverage calculation and not on adjusted revenue and expense amounts. These numbers cannot be used as the starting point for reconciliation due to the findings herein regarding return on equity. Scenario II and the attached footnotes of Staff's response, being part of late-filed Exhibit 53 herein, set out the appropriate methodology and starting point for revenue requirement.

B. Operating Expenses

(1) Leased Vehicles and Equipment

MCWC currently leases from Wheels, Inc. approximately twenty-two (22) vehicles used by its employees. The Staff contends that MCWC is paying an excessive lease cost compared to costs which MCWC would incur if it purchased company vehicles. MCWC contends that Staff has failed to consider additional costs it would incur by owning company vehicles as opposed to leasing them. Some of these factors are additional labor resources, maintenance, higher purchase price and lower resale price, and sales tax. MCWC also states that Staff failed to include credit adjustments in the amount of $7,260 relating to the fleet incentive program and the resale of vehicles. The Staff requested an adjustment of $22,762 for water and $146 for sewer on this issue.

Both parties agree that the decision whether to lease or own company vehicles is a management decision of the Company. Therefore, the Commission must determine whether the evidence supports the leasing, rather than the purchasing, of company vehicles. The Commission is of the opinion that the evidence supports MCWC's decision to lease company vehicles rather than to own them. First of all, Staff's adjustment did not consider the proper treatment of sales tax in calculating the total estimated cost if MCWC owned its vehicles; and, it failed to include adjustments relating to the fleet incentive program and the resale of vehicles. Those two mistakes alone would reduce Staff's adjustment by $13,516 ($6,256 sales tax + $7,260 credit adjustment). MCWC has a lengthy history of leasing its company vehicles. By leasing its vehicles, MCWC does not require the labor resource or internal expertise to manage and maintain the vehicles as would be required if it purchased the vehicles. The significant operational benefits MCWC receives by leasing include new vehicle acquisitions, fleet administration, used vehicle resale, and fleet management regarding warranties. Also, in regards to financing, the leasing company charges favorable interest rates to MCWC, whereas if it would be required to purchase its fleet, it would be required to utilize short term credit from banks to fund the purchase and, as a result, take money away from capital projects and customer service. Staff failed to show that these benefits were not of substantial value to MCWC in its management decision to lease vehicles rather than purchase them.

The Commission, therefore, determines that Staff's adjustment for leased vehicles and equipment should be disallowed.

(2) St. Charles County Water Purchase Agreement

MCWC purchases all of the water it sells in its St. Charles Division from the St. Charles County Water Department (SCCWD). MCWC pays ten cents into a "renovation and replacement fund" (fund) for every 1,000 gallons of purchased water. MCWC paid $246,196 into the fund during the test year. The average annual expenditure of the fund for the period from 1987 through 1992 was $170,752. The cumulative balance of the fund from prior years as of December 31, 1991 was $295,705. Staff has requested a revenue adjustment of $94,251 and a rate base adjustment of $295,705.

Staff's revenue adjustment reflects the amount MCWC paid into the fund for the test year in excess of the previous five-year average annual expenditures of the fund. Staff further reduced the five-year average by 11.23 percent because the expenditures of the fund for the test year, 1991, in its opinion, did not meet the specific terms of the contract between MCWC and SCCWD. Staff's proposed reduction to rate base reflects the cumulative balance of the fund from prior years as of December 31, 1992. Staff believes that the adjustment gives ratepayers credit for the fund "prepayments" they have made. Staff states that it has made these adjustments because MCWC is requiring current ratepayers to fund construction activities that may not be performed for several years. Staff believes the "prefunding" mechanism is analogous to putting construction work in progress (CWIP) in rate base.

MCWC contends that Staff's adjustment suffers from several defects. First, MCWC says that Staff has misread the contract between MCWC and SCCWD in that it has employed a "snapshot" in time premise which subjects MCWC to the adjustment when the payments to the fund exceed expenditures and provides no offsetting benefit to MCWC if the expenditures exceed the payments to the fund. Second, MCWC says that Staff's adjustment amounts to retroactive ratemaking. Third, MCWC says that Staff's adjustment disregards an agreement made at arm's length between MCWC and a third-party vendor. Fourth, MCWC says that Staff's attempt to "match" revenues and expenses is distorted because it matches revenues and expenditures of SCCWD and not MCWC. Finally, that Staff in its 11.23 disallowance has included items which, if owned by MCWC, would be rate base items and properly characterized as "capital assets". The fund itself is for "capital assets of the facilities."

The Commission is of the opinion that the expenditures to the SCCWD maintenance, renovation and replacement fund are proper and necessary. Although MCWC purchases approximately 73 percent of the SCCWD water production, with Public Water District No. 2 purchasing the other 27 percent, SCCWD is still a separate entity from MCWC and the expenditures at the rate of ten cents per 1,000 gallons of water purchases were actually made. It is the segregated fund quality that probably makes this an issue in the first place. Staff witness, Larry Cox, in response to the question, "Would it surprise you if the amount being paid to Kansas City is more than that being paid to St. Charles County, even with the 10-cent fund?" said: "I wouldn't be surprised." MCWC purchases water from the City of Kansas City for its Platte County Division. Staff wishes to make SCCWD, in effect, a subsidiary of MCWC. This is not the case. Obviously there is a close relationship between the two entities out of necessity, but they are still separate entities with no co-ownership. The contract could just as easily have not included a segregated fund; but, in the alternative, just incorporated those expenses of SCCWD into one commodity charge. In providing for the fund in its contract with SCCWD, MCWC is exercising a good management policy. MCWC, through the existence of the fund, has some control over the actual expenditures by SCCWD for maintenance, renovation and replacement of facilities.

The significant question is whether MCWC is paying too much into the fund. Staff advocates a lower fund rate for MCWC. Staff believes that MCWC can renegotiate the contract which was executed between MCWC and SCCWD on

September 11, 1984. An addendum on April 18, 1985 revised the fund rate from three cents per 1,000 gallons to ten cents per 1,000 gallons. Expenditures from the fund by SCWWD have varied dramatically from $57,516 in 1987 to $276,966 in 1989. Staff advocates a normalization for the expenditures of the fund which, for a five-year average, is $170,724. Normalization can be used to even out drastically uneven or irregular expenses of a company over a period of time. This allows for the company to not experience windfalls or oppressive costs from the use of a test year with unusual results. This instance is different in that MCWC is not retaining any of these expenditures. The fund rates are contractually set and are actually paid out regardless of the actual expenditures of SCCWD from the fund. The fund is unlike the situation wherein MCWC would own SCCWD or lease its water facilities and retain earnings from ratepayers to pay for the same expenditures for which the fund provides. In that case normalization might be useful to smooth out the earnings results for MCWC. In this case, neither MCWC nor its stockholders are benefiting from any excessive overpayments by the ratepayers. The ratepayers are benefiting, however, in that MCWC is eliminating as much as is reasonable, costly "surprises". The fund affects the reliability of SCCWD's water facilities and the ratepayers directly benefit. All parties agree that the water facilities of SCCWD are quite old, having been constructed during World War II. Following the war, the water facilities were idled and in an abandoned condition until 1974. SCCWD receives no other revenue from any other source to maintain the facilities. The fund balance must be able to fund literally every cost associated with maintenance, renovation and replacement of plant. The commodity charge that MCWC pays SCCWD specifically does not include depreciation. Staff advocates employing the "additional funds" provision of the contract as an "assessment" mechanism for funding any "surprise" or unusual costs. This means, essentially, paying for any construction activities as they are performed. This method would allow for little planning by SCCWD. It is apparent from Staff's own request for the use of normalization that expenditures are such that attributing costs to any particular year is questionable and not a good predictor of future expenses. The Commission is of the opinion that the fund is, in fact, a mechanism itself to allow for normalization. The "assessment" provision could work to the detriment of the ratepayer by encouraging excessive rate cases and possibly creating rate shock, not to mention the adverse effect on effective management and planning. The Commission is aware that if the fund built up an excessive balance, much of Staff's primary argument would prove to be true (i.e., that the fund constitutes an excessive "prepayment" by the ratepayers). The Commission, for that reason, believes that there should be a maximum placed on the cumulative balance of the fund. The Commission determines that $300,000 would be a reasonable maximum for the fund's cumulative balance, and that any excess be credited to the ratepayers by reducing rate base. This reduction would give ratepayers reasonable and appropriate credit for excessive fund prepayments that they would have made.

The Commission is of the further opinion that Staff's 11.23 percent adjustment to the five-year average expenditure figure should not be allowed either. Staff's witness Larry Cox indicated that all the items included in the 11.23 percent adjustment, if owned by MCWC, would be rate base items and properly characterized as capital assets. Basically, Staff deemed certain items such as pickup trucks, parking lots, air compressors and file cabinets as not being "capital assets". The fund is for expenditures for "capital assets of the facilities." The Commission does not agree with Staff's narrow reading of the term "facilities".

The Commission is not setting any precedent in this case and would look at each case separately to determine whether commodity charges or fund maintenance charges are prudently incurred by the Company so that the ratepayer is only paying rates that are just and reasonable. The Commission does not characterize the fund payments by MCWC as being analogous to CWIP and would only constitute a "prepayment" at all if found to be excessive. Again, it is important to say that these fund expenses of MCWC are actually paid to a third party and not retained by MCWC in any way. The Commission determines that the fund costs are prudently incurred by MCWC and attempt to address a potentially volatile expense situation for MCWC and its ratepayers.

The Commission, therefore, determines that Staff's adjustment to revenue requirement and rate base for the St. Charles County Water Purchase Agreement issues should be disallowed.

The Commission further adopts the position that any cumulative balance of the fund in excess of $300,000 for any future test year will reduce the rate base of MCWC dollar for dollar, unless MCWC can prove to the Commission's satisfaction the necessity for the additional accumulation in excess of $300,000.

(3) <u>Bad Debt Expense</u>

MCWC experienced unusually high bad debt expense during the test year. In 1990, the year prior to the test year, the bad debt expense was $21,545; while in the test year the bad debt expense was $34,209. The Staff proposes an adjustment of $8,468 on this issue.

The Staff has proposed a normalization technique to compensate for what it sees as an irregular pattern. The Staff analyzed MCWC's actual net write-offs of uncollectible accounts for the period of January 1988 through June 1992. The Staff then computed an average of the 54-month period and included an annual level of that average in its case as the appropriate level of bad debt expense.

MCWC has based its position on this issue on the premise that bad debt expense amounts change proportionately with customer levels and revenues. MCWC has traditionally calculated an average of net write-offs to revenues over a period of years and has then multiplied that average by the current year revenues to determine the allowance for doubtful account balances. Utilizing this method the normalized net write-off was only $1,866 less than the actual test year write-offs. MCWC determined this to be immaterial and used actual test year write-offs.

The Commission is of the opinion that Staff's method is the more appropriate one to utilize in normalizing bad debt expense. First, the relationship between customer levels and bad debts since 1988 shows that although the level of customers grew at a steady annual pace, the amount of net write-offs actually decreased from 1989 to 1990 and also decreased in the 1992 update period. Also, while the amount of net write-offs did increase from 1990 to 1991, the increase was grossly disproportionate to the customer growth rate of that same period. Likewise, there is no evidence of a positive pattern to the relationship between revenues and bad debt. From 1988 to 1989, revenues decreased by 2.91 percent, while net write-offs increased by 1.03 percent. From 1989 to 1990, revenues increased by 10.84 percent, while net write-offs decreased by 17.91 percent. Normalizing bad debt expense according to Staff's method is appropriate and the better method in that it levels out the irregular pattern of bad debt expense. Staff estimates a net write-off for 1992, based on its updates, of $28,000. This indicates that Staff's method compensates for the unusual test year.

The Commission, therefore, determines that Staff's adjustment for bad debt expense in the amount of $8,468 for water operations should be allowed.

(4) <u>Rate Case Expense</u>

MCWC and Staff agreed upon a rate case expense level of $132,235 to be amortized over two years for an annual rate case expense level of $66,117. Public Counsel has proposed an adjustment of $70,275 to reduce MCWC's rate case expense, also to be amortized over two years. Public Counsel contends that rate case expenses are not extraordinary expenses which should be amortized, but are ordinary expenses controlled by management and should be included in a company's cost of service at a reasonable level calculated upon historical data. Public Counsel's recommendation is based upon a normalization of MCWC's actual rate case expenditures for five of seven of its most recent general rate cases. Platte County Intervenors contend that if the Commission finds that no increase or a minimal increase is allowed, which would be an amount little more than the rate case expense allowed, then no rate case expense should be allowed at all or, alternatively, that a moratorium be placed on rate cases for a period of years.

The Commission is of the opinion that MCWC should be allowed the actual rate case expense as agreed to between it and Staff. It is true that the rate case expense in this case is considerably above the average of the previous general rate cases on any determination. In fact, MCWC's agreed-upon actual rate case expense is almost double Public Counsel's normalized average of $67,449. A very significant flaw in Public Counsel's proposal is that it did not utilize <u>any</u> expenses from the current case to come up with this normalized level. Also, problems exist in considering past rate cases to determine what is a reasonable rate case expense amount. Some cases are litigated and some are stipulated. Also, cases vary in what issues are addressed and as to the number of data requests. Also, expert witnesses and managerial studies utilized by a company in litigation can significantly add to the cost of a general rate case. In addition, all rate case expenses are subject to potential inflationary factors. The Commission is in agreement with Public Counsel that the function of rate-setting is to establish a level of expense that will most likely represent <u>future</u> expenses. Public Counsel and Platte County Intervenors want to categorize this case as "a case that should not have been filed". The Commission does not want to put itself in the position of discouraging necessary rate cases by denying rate case expense. This is a particularly treacherous area for the Commission to be addressing in that the Commission cannot be viewed as having a dampening effect upon a regulated company's statutory procedural rights to seek out a rate increase when it believes the facts so justify it. Disallowing prudently incurred rate case expense can be viewed as violating the company's procedural rights. At the same time, if it was determined by clear and convincing evidence that a rate case was frivolously filed, then the Commission would be under a duty to protect ratepayers from imprudently incurred costs. The Commission cannot find in this case clear and convincing evidence that this current case is frivolous and imprudently filed by MCWC. The Commission must, however, determine that the rate case expense incurred is reasonable. Normalizing rate case expense, while it may appear to be appropriate to level out fluctuations over a historical period, also is tainted with the possibility of dampening a company's full right to litigate to the extent it deems necessary. If a company in litigating a rate case knew that it was limited to a normalized rate case expense, it may possibly be adversely affected in its approach to the case. In other words, after the normalized rate case expense is incurred, a company may be pressured to settle when it really does not believe it should. Normalization of rate case expense may not be inappropriate if a company were to agree to it. There is a certain ongoing nature to rate case expenses that could make it advantageous to a company to adopt. MCWC has not applied for normalization of rate case expense. In the previous rate case, the same methodology that MCWC and Staff employ in this current case was accepted by the Commission. MCWC would have been justified in this current case in believing that the same methodology as to rate case expense that was allowed by the Commission in the previous case would likewise be approved. It would not be fair to MCWC now, in effect, to penalize it by switching to a normalization methodology that it neither wants nor could have reasonably anticipated in litigating the current case. Public Counsel's witness even pointed out that it may not be pursuing normalization of rate case expense if, in fact, actual rate case expense in the current case was significantly below its normalized average expense. This is not the critical factor by any means. Public Counsel believes that MCWC may receive some windfall if it is allowed the agreed-upon rate case expense. First of all, since the previous rate case's expense was significantly below the current rate case's expense, it can be argued that the previous case was not a good predictor of future costs and that MCWC in fact lost unrecovered dollars on rate case expense in the current case. Also, MCWC's actual rate case expenditures in the current case will apparently be more than the agreed-upon figure. These are not dollars that MCWC gets to keep, but are dollars actually paid out. The Commission determines that there are many good reasons not to normalize rate case expense for MCWC and to do so would, at this point, arbitrarily punish the Company for pursuing the current case to its fullest legal right. Also, to normalize rate case expense according to Public Counsel's method would totally eliminate any consideration of rate case expense for the test year that is the main time frame on which MCWC's revenue requirement is based.

The Commission would offer a caveat for future cases that rate case expense must be prudently incurred by a company to be useful in determining a reasonable level of rate case expense. To provide for the recovery of past rate case expense could constitute retroactive ratemaking, which is prohibited. The Commission's basic task is to determine what expense levels will most likely reflect future costs. The Commission is of the opinion that normalization of rate case expense is usually inappropriate. However, if rate case expense grossly exceeds normalized levels while at the same time achieving relatively insignificant rate case increases for a company, the Commission could determine that those rate case expenses were imprudently incurred and order the shareholders to share in the expenses.

The Commission, therefore, determines that Public Counsel's and Platte County Intervenors' adjustment for rate case expense should be disallowed.

(5) <u>Public Affairs and Retainers</u>

The general rule is that advertising or promotional expenses of a company should not be charged to ratepayers. As MCWC states, these expenses are essentially corporate activities that are "image enhancing" and are expenses that should be borne by the shareholders. Staff has made four separate adjustments in this area. Staff categorizes these adjustments as essentially promotional and advertising expenses. Staff's adjustments fall under two general subcategories: public affairs expense and Corporate EVENTS. Under the subcategory of public affairs expense, the Staff made adjustments to MCWC's public affairs, dues and subscriptions expense accounts in the amount of $13,886. The Staff also made an adjustment to public affairs related accounts under the general heading of "miscellaneous/other" account in the amount of $3,582. Under the subcategory of Corporate EVENTS, the Staff proposed a disallowance of the outside public relations consultant, Corporate EVENTS, retainer in the sum of $15,000 and a disallowance of the direct expenses charged by Corporate EVENTS to MCWC in the amount of $1,288. The total of Staff's adjustments on these public affairs issues is $33,756. MCWC believes that it has supported its expenditures in this area as "educational" and not "image-building" corporate activities. MCWC also believes these expenses should be allowed because they were not contested by Staff in its last rate case. Public Counsel believes there should be a total $16,652 adjustment in this area for the same reasons Staff proposes. Public Counsel's disallowance consists of $8,671 for promotional/institutional advertising and $7,981, which is a disallowance of 29.12 percent of the retainer fees charged by Corporate EVENTS which it found to be for promotional purposes.

The Commission is of the opinion that Staff's adjustments to MCWC'S public affairs, dues and subscriptions expense accounts should be allowed. The Commission has previously set out five categories of advertisement: (1) general; (2) safety; (3) promotional; (4) institutional; and (5) political. In regards to those categories, the Commission found it would never include the cost of institutional or political ads, include the cost of promotional ads only to the extent the utility can provide cost justification for the ads, and always include the cost of general and safety ads. A review of the items listed on Schedule 2 of the direct testimony of Staff's witness, Susette Cassidy, clearly shows MCWC's expenditures fall under the category of institutional or promotional advertising. A sampling of Staff's disallowed entries include holiday greeting ads, pencils, T-shirts, fun cups, key holders, gift certificates, items purchased for parades and political events, such as sweatshirts, candy, dunk tank, and booth rental. Staff also excludes a large number of entries entitled dues, donations and subscriptions. These types of expenditures are not necessary in the provision of safe and adequate service and do not fall under the characterization of "educational". Public Counsel is more generous with MCWC in this area than Staff, but the Commission determines that Staff's analysis of these items is the more exacting and will adopt its adjustment over Public Counsel's. Public Counsel's adjustments are largely included in Staff's adjustments. Also, Staff's adjustments as to "miscellaneous/other" should be allowed in that these items, including flowers, cookbooks, Christmas cards, and charges for congressional dinners are also clearly under the categories of promotional/institutional advertising.

The Commission is of the opinion that Public Counsel's adjustment as to the Corporate EVENTS retainer should be allowed. Corporate EVENTS serves as a local public relations consultant for MCWC. In addition to Corporate EVENTS, MCWC also receives services from the Director of Public Affairs employed by Avatar Utilities, Inc. (AUI). AUI is the parent company of MCWC and the salary and related expenses of AUI's Public Affairs Department are allocated to each subsidiary, including MCWC. Staff has objected to the entire Corporate EVENTS retainer for several reasons. Staff believes that the divisional manager's job description provides that the manager is responsible for instituting and carrying out public relations in maintaining a positive image for MCWC. Therefore, Staff believes it is not necessary to hire an outside consultant such as Corporate EVENTS. Also, Staff believes that the Director of Public Affairs, with the assistance of MCWC's managers, should be performing the work now charged MCWC by Corporate EVENTS. Staff considers this to be an unnecessary redundancy. MCWC says that just because the work product of Corporate EVENTS and the Public Affairs Director of AUI are similar does not mean it is redundant. MCWC views the work product as necessary and complementary. Staff's witness, Ms. Cassidy, testified that approximately 68 percent of the work performed by Corporate EVENTS was spent on preparing brochures, news releases, employee newsletters, the continuing education program, seminars and National Water Week events. Staff classifies the remaining 32 percent of Corporate EVENTS' work product as 12 percent institutional/promotional activities and 20 percent dealing with the City of Mexico Division customer relations problems related to the last rate case, which Staff classifies as a nonrecurring cost and not an ongoing expense. Staff's witness, Ms. Cassidy, also testified that approximately three-fourths of the time, the monthly nonbilled time as reported on the log did not reach the level of hours proposed to be provided under the retainer.

The Commission believes that Public Counsel's approach reaches the best result. Public Counsel's witness, John Tuck, determined from Corporate EVENTS' client billing worksheets that 29.12 percent of its work product was promotional or institutional in nature. This approach is largely substantiated by Staff's independent audit. The Commission finds it difficult to totally disallow the entire retainer paid to Corporate EVENTS. Even though a division manager may have the duty of public relations within the job description, it would not necessarily be his or her area of expertise and would only be there to eliminate the need for another salaried person. Also, public relations and employee education could benefit possibly more from local assistance than a far-removed public affairs director in the state of Florida, as would be the case with AUI. The complementary concept of MCWC seems appropriate. Obviously, the specific activities of a public relations consultant such as Corporate EVENTS are of critical concern in determining the appropriateness of a retainer. A specific event or purpose charge on an hourly basis would seem more appropriate than a retainer. The Commission, in this line of reasoning, would support Staff's disallowance of direct expenses of Corporate EVENTS charge to MCWC as being in the nature of institutional/promotional activities.

The Commission, therefore, determines that Staff's adjustment for public affairs, dues and subscription expense in the amount of $13,843 for water operations and $43 for sewer operations should be allowed.

The Commission further determines that Staff's adjustment for miscellaneous/other accounts under public affairs in the amount of $3,578 for water operations and $4 for sewer operations should be allowed.

The Commission further determines that Public Counsel's adjustment to the Corporate EVENTS retainer in the amount of $7,981 for water operations should be allowed.

The Commission further determines that Staff's adjustment to the Corporate EVENTS retainer above Public Counsel's adjustment should be disallowed.

The Commission, finally, determines that Staff's adjustment to the Corporate EVENTS direct expenses in the amount of $1,288 for water operations should be allowed.

(6) <u>Pension Expense</u>

Pursuant to the Employee Retirement Income Security Act (ERISA), MCWC is required to make a minimum contribution annually. The minimum is computed by MCWC's parent company, AUI's actuary using Aetna Benefits Consulting Actuarial

Valuation Report to ensure contributions are sufficient to meet the obligations as defined by the provisions of ERISA. Under ERISA, also, a maximum contribution level is set so that employers are not allowed a tax deduction for excessive contributions to the pension plan. MCWC is proposing to include a level of pension expense using the Financial Accounting Standards Board FAS 87 net periodic cost as recorded on MCWC's books. MCWC contends that under FAS 87, MCWC is required to record the net periodic pension cost as an expense in accordance with Generally Accepted Accounting Principles (GAAP). MCWC then recorded the minimum ERISA contribution as a liability and the difference between the minimum ERISA contribution and FAS 87 was recorded as a deferred credit. Staff's adjustment represents the difference between the minimum ERISA contribution and FAS 87 recording, which is $7,028 for water operations and $18 for sewer operations. Public Counsel has also recognized the minimum ERISA contribution as being the preferable cost of service but has used a different time period than Staff. Staff recommends $57,345 in pension expense attributable to MCWC's 1992 minimum contribution. Public Counsel recommends $50,718 in pension expense attributable to the minimum amount MCWC is required to contribute to its pension trust for plan year 1991 multiplied by its Operations and Maintenance rates.

The Commission determines that Staff's adjustment to pension expense should be adopted. MCWC contends that the net periodic pension cost represents the most appropriate level of expense to include in MCWC's cost of service because it matches the incurrence of the liability with the period incurred. The Commission's decision in MCWC's last rate case, Case Nos. WR-91-172 and SR-91-174, did not find in MCWC's favor on the same issue. In that case the Commission found in favor of Staff's position to use a three-year average ERISA minimum contribution as the appropriate expense level. The Commission determines that the minimum ERISA contribution is still the appropriate basis for pension expense if that is the minimum contribution by the Company. FAS 71 alleviates the inequities for the Company by allowing for the difference between the minimum ERISA contribution and the FAS 87 recorded amount to be treated as a "regulatory asset" if the Company has probable assurance from the Commission that the difference can be recovered in a future period. The proper vehicle for such an assurance is an accounting authority order. The Commission fully intends to allow prudently incurred pension costs to be recovered in the future on a pay-as-you-go basis. Pension costs are legitimate, historically approved costs of providing service, and, absent any evidence that they are excessive or imprudently incurred, they may be recovered by MCWC on a pay-as-you-go basis. The Commission believes it is probable that these pension costs booked under FAS 87 above the minimum ERISA contribution, capitalized as a regulatory asset, will be recovered in rates. To find for MCWC on this issue would allow it more pension expense in rates than MCWC would actually place in its external pension fund. As Public Counsel points out, there would have been no adverse tax consequences if MCWC had contributed the full FAS 87 amount in 1991, because full tax deductibility would still have been maintained. Any inclusion of costs at a higher level than MCWC's actual contribution would result in a distortion of the cost of service, because MCWC would be recovering from ratepayers costs that it chose not to incur.

The Commission is of the opinion that Staff's allowance for the 1992 minimum ERISA contribution is preferable to Public Counsel's choice of the 1991 test year minimum ERISA contribution. Allowances are made for updates to expenses through June 30, 1992 that can be determined by the Commission to be known and measurable. The Commission determines that minimum contributions for 1992 became known and measurable and that MCWC should be allowed the updated expense.

The Commission, therefore, determines that Staff's adjustment to pension expense in the amount of $7,028 for water operations and $18 for sewer operations should be allowed.

The Commission further determines that Public Counsel's adjustment beyond Staff's adjustment should be disallowed.

The Commission, finally, determines that MCWC can book the difference between the ERISA contribution and the FAS 87 amount to Uniform System of Accounts No. 186, Miscellaneous Deferred Debits, as a regulatory asset.

(7) Cash Working Capital

The Staff has proposed an adjustment to MCWC's cash working capital (CWC) in the amount of $30,885 and a reduction of $238,880 from rate base for Company's treatment of major maintenance items as "unamortized deferred maintenance" and a negative CWC requirement. MCWC is attempting to give these major maintenance expenses equivalent rate base treatment by including them in the CWC calculation with a lengthy expense lag, according to Staff. Cash working capital, or CWC, represents the amount of cash necessary for a company to fund the payment of day-to-day expenses incurred to provide service to the ratepayers. CWC is either provided by the shareholders or the ratepayers. The investor supplies CWC in those situations where the company spends cash for an expense before the cash is provided by the ratepayer. Investors are compensated for the CWC they provide by including those funds the company's rate base. By earning a return on their investment, the shareholders are thereby compensated for the CWC they provide. The ratepayers supply CWC in those situations where they pay for services received from the company before the company pays for the costs incurred to provide those services. Ratepayers are compensated for the CWC they provide through a reduction to rate base by the amount of CWC they provide. A lead/lag study is used to determine the amount of cash a utility must provide in order to provide service to the ratepayer. A lead/lag study also determines who supplies the cash. A negative CWC requirement indicates that the ratepayer has provided the CWC in the aggregate during the test period. A positive CWC requirement indicates that the investor has provided the CWC in the aggregate during the test period. Good cash management practices consist of taking measures to collect amounts due the company as quickly as possible, while deferring payment of amounts owed by the company to the due date or statutory date of payment. The Staff performed a lead/lag study focusing on the cash management of MCWC. The Staff's study found a "billing lag" of 7.3 calendar days. A "billing lag" is the time period between the end of the last day of a service period and the day the bill is placed in the mail by the company. This resulted in Staff's adjustment of $30,885 to CWC. The Staff's study also found certain "expense lags". An "expense lag" describes the amount of time between the receipt of goods or services by the company and the subsequent payment for those goods and services. Staff made individual calculations of all expenses and when totaled resulted in total net ratepayer-supplied funds, or a negative CWC requirement. This meant that there was excess CWC supplied by the ratepayer over the amount supplied by the shareholder. This CWC component was subtracted from rate base to compensate the ratepayers for the use of their funds. This result coupled with Staff's treatment of the major maintenance expenses resulted in the proposed reduction to rate base of $238,880.

MCWC believes that its billing lag of 7.3 calendar days is satisfactory. MCWC says the meter processing and billing schedule utilized by it has been developed in cooperation with all employees involved and takes into account inclement weather, employee work load, equipment problems, processing time and review procedures. MCWC says the schedule allows the double-checking of unusual usages through rereading of the meter and eliminates the number of incorrect bills, which are costly to the Company and aggravating to the customer. Staff has proposed a 2.8 calendar day billing lag as being in line with other utility companies. Staff, alternatively, proposes a 5.0 calendar day billing lag. MCWC believes that the entire process employed by Staff in computing a negative cash working capital requirement adjustment is inconsistent and discriminatory because it does not recognize the timing of expense recognition of certain costs such as rate case expense and major maintenance which are deferred, while at the same time adjusting CWC for costs such as property taxes and interest costs. MCWC also questions Staff's calculation for the expense lag for cash vouchers, claiming that the sample taken was improper because it included only vouchers over $500. MCWC also questions Staff's calculations of expense lag for vacations because they do not match the accounting treatment. MCWC says that Staff's lag would be correct if MCWC accrued the liability and recorded expenses in the year the vacation was earned. MCWC says that because it does not accrue the expense, but rather records it when the vacation is taken and paid, the lag for vacations should be identical with the regular payroll.

The Commission is of the opinion that Staff's alternative recommendation as to the billing lag of 5.0 calendar days should be adopted. Utilities of various sizes were listed by Staff with a billing lag of 2.8 calendar days or less. MCWC's present billing lag is 7.3 calendar days or five business days. Staff's 2.8 calendar day recommendation would equal two business days. In the previous rate case for MCWC, Staff calculated the billing lag to be 10.0398 days (presumed to be calendar days). Staff has stated that the 5.0 calendar day billing lag approximates the maximum billing lag used recently for major utilities, as well as the Staff's recommendation for MCWC in its previous two rate cases. MCWC has stated many reasons why it believes it is exercising good management with its present billing lag. However, the facts are that it is at the high end of all utility companies for billing lag levels. MCWC should be required to maintain billing lags in line with other utilities absent a showing of an inability to do so. The Commission finds that MCWC has offered no major reason why it cannot reach the average billing lag levels of other utilities. Setting the billing lag at Staff's alternative recommendation rate of 5.0 calendar days compensates MCWC for the progress it has made and gives some recognition to its arguments. The Commission, however, does believe that MCWC can approach the Staff's recommendation of 2.8 calendar days for billing lag in the future.

The Commission is of the opinion that Staff's adjustment as to the so-called "unamortized deferred maintenance" which relates to major maintenance expenses should be adopted. The Staff in recommending this treatment is being consistent with the Commission's precedents on this issue, which includes major maintenance as part of allowable expense rather than giving it rate base treatment. Major maintenance items, such as tank painting, are ongoing operation expenses that must be paid when incurred. The Staff's treatment is neither a deferral nor an amortization. Through the rate case normalization process, the Company is provided a normal, ongoing level of this expense in rates. By including those expenses in the CWC calculation with a lengthy expense, the Company essentially "back doors" these expenses into rate base. The Staff proposes a -0- day revenue lag and expense lag for CWC treatment for major maintenance. This would give such an item no CWC effect and the Commission determines that to be the proper treatment.

The Commission also is of the opinion that Staff's recommendation for rate base reduction due to the negative CWC requirement should be adopted. The Commission believes that Staff's expense/lag study showed accurate results and that the examination of all vouchers exceeding $500 was proper. Sampling is a proper technique, but by reviewing all large dollar invoices a greater portion of the total dollar value of all invoices would normally be reviewed. The Commission also gives no effect to MCWC's argument that rate case expense was not given CWC treatment. Rate case expense is not a rate base item, and only should be reflected in CWC insofar as there was a lag between the Company's incurring the expenses and its payment to vendors (e.g., consultants and legal assistance). The Commission also gives no effect to MCWC's argument that vacation expense was improperly treated by Staff. MCWC is on a cash basis instead of an accrual basis for accounting for vacation, and only records expense when vacation is taken and paid. Whether or not MCWC records an accrued liability for vacation, it has incurred the obligation to pay vacation expense as soon as it is earned by the employees. The purpose of the lag is to show that while the Company does owe the vacation pay to employees when it is earned (evenly throughout the year), the Company does not actually pay the employees until the following year. Therefore, the Company has the use of those funds for other purposes. Overall, the Commission has fully considered Staff's expense/lag study and finds that the calculations are correct and that the adjustments resulting to rate base are appropriate.

The Commission, therefore, determines that Staff's alternative proposal for a "billing lag" of 5.0 calendar days should be approved with the resulting adjustment to revenue requirement as to water operations and as to sewer operations.

The Commission also determines that Staff's position as to the treatment of major maintenance expenses and its expense lag study findings should be approved and result in a rate base reduction of $238,880 for water operations and $609 for sewer operations.

(8) <u>Allocation of Parent Company Costs</u>

The Staff has made an adjustment to the management expenses paid to the parent company by MCWC in the amount of $98,643 and to rate base on the same issue in the amount of $97. In the previous water rate case, Case No. WR-91-172, the Commission, in accepting Staff's adjustments for these expenses, put MCWC on notice that it would have to prove the benefit of its present corporate structure and allocations of affiliated costs to the Company's ratepayers. As a direct result of that case, MCWC through its parent company, Avatar Utilities, Inc.

(AUI), engaged Metzler and Associates (Metzler) to conduct a cost-effectiveness and efficiency of services study of AUI and MCWC. The results of this study are contained in a report titled "Affiliate Relationship and Organization Study" (Metzler Study). Metzler found that the services provided by the various affiliated companies to all of the various operating utilities of AUI were reasonable and necessary, not redundant, and provided in a cost-effective manner. The Staff contends that the Metzler Study should be discounted by the Commission because of its lack of timeliness, authentication and critical review. Staff also believes that the Metzler Study fails to meet its own objectives. The Staff concludes that because of the failure of the Metzler Study, nothing has changed since the last rate case and MCWC has failed to meet its burden of proof. The Staff sought supporting documentation for the Metzler Study, but Metzler refused to provide all of the work papers to the Staff on the grounds of confidentiality. These work papers were the subject of the subpoena duces tecum requested by the Staff and issued by the Commission over MCWC's motion to quash, and that ultimately was decided by the Missouri Supreme Court in favor of the Commission's decision. Staff states, "After the court system alleviated the Company's impediments, the Staff determined the real reason for the Company's tactics. The subpoenaed workpapers provided minimal, if any, additional documentation for the Metzler Study." The ultimate concern of Staff is that MCWC's customers are subsidizing the costs of its parent company, AUI. The Staff has allowed MCWC to recover in rates $132,270 in expenses from the parent company. As to the proposed adjusted expenses, the Staff claims that there is a proliferation of management which results in a redundancy of services with no proof of the reasonableness of the price for the affiliate services.

MCWC is part of a multiple holding company structure with Avatar Holdings, Inc (AHI) at the top. Although AHI does not have any employees of its own, services are provided to the subsidiaries under its control through an assignment of its management services agreement rights and obligations to Avatar Properties, Inc. (API). API is a property development subsidiary of AHI located in Florida. API allocates expenses to Avatar Utilities, Inc. (AUI), which is a utility holding company. The AHI services included the expenses of the following API departments: Executive, Legal, Internal Audit, Corporate Tax, Accounting, Financial Operations, and Other. These costs are allocated to AUI based on the percentages contained in the Management Services Agreement. The expenses of AHI are then added to the management expenses from AUI. Services provided to MCWC by AUI include management accounting, legal, risk management, engineering, human resources, and public affairs. After deducting engineering and safety expenses from the total since they are charged directly to the entity requesting service, AUI subtracts a 10 percent retention. The combined expenses are then allocated to AUI's subsidiaries which include two utility companies, a data processing services company -- Avatar Utility Services, Inc. (AUSI), and Consolidated Water Company (CWC), which is a holding company which includes five utility companies, including MCWC, and an accounting regulatory service company, Consolidated Water Services, Inc. (CWSI). Accounting and rate case, data processing, and special project engineering services are provided by CWSI, AUSI, and AUI, respectively, and charged directly to MCWC.

The Commission is of the opinion that neither Staff nor MCWC has fully proved their position. Simply put, each party's position blows gaping holes in the other party's position. The positions are not reconcilable. Also, Staff is somewhat vague as far as a dollar amount in that it arbitrarily chose percentages of expenses to exclude. MCWC's position is equally vague in that there are little, if any, time studies to support the Metzler Study findings that these parent company expenses were justifiably charged to MCWC. Because of the vagueness of the testimony the Commission must decide between two arguably arbitrary positions.

The Metzler Study supported the theory that certain specialized services can be provided more effectively and efficiently on a consolidated basis rather than on an individual subsidiary company basis. One Metzler Study analysis indicated that a total additional cost to Company, on a stand-alone basis, would be $540,600 to $781,300 per year. Lee F. Burgess was the Metzler partner who testified as to the Metzler Study. As stated in his testimony in Exhibit 25: "As a result, the Avatar structure combines to deliver cost-effective, nonduplicative services at three levels: the local water utility level, the AUI service company level, and the AHI level. ... For MCWC to be a stand-alone utility and provide the same level of service it now provides would require that it increase its staffing levels and use of outside contractors and consulting at a cost far greater that [sic] what it currently pays."

Also, the Metzler Report indicated that the operation and maintenance costs of AUI on a per-customer basis are lower than those of industry comparisons, Consumer Utilities (Consumers) and American Water Works (American) and the industry average as compiled from the National Association of Water Companies (NAWC) financial and operating data for the year 1990. Also, the "customers per employee" for MCWC were significantly higher than Consumers, American and the industry average. Also, the Metzler Report further revealed that MCWC's water utility operating and maintenance costs per customer and parent company's charges per customer have increased at rates below the rate of inflation since 1981. Industry averages do not create an industry standard of prudence, but can be used for broad comparison. Industry comparisons are not controlling evidence due to the varying characteristics of individual companies. However, in the context used here they would seem to add to the credibility of the Metzler Study.

Approximately 60 percent of Staff's adjustment was related to the removal of 100 percent of AHI management fees. Staff's witness, Shirley Norman, indicated that no clearly defined benefit to MCWC was observed. She said that

MCWC did not provide tangible proof that MCWC needed the management oversight. It was her opinion that the chief operating officer of MCWC could make the necessary operating decisions without outside help. A further reason was that AUI provided administrative oversight to MCWC; and, therefore, the management expenses of AHI provided yet another layer of unnecessary management. Staff believed that the only service provided by AHI which did not seem to be duplicated elsewhere was the internal audit function, which was allowed by Staff as an expense. Staff also disallowed legal fees and other professional fees allocated to MCWC from AUI. Staff noted that MCWC also hired legal consultants directly related to its own operations and that any direct benefit to MCWC was not observed. Also, Staff believed that other consulting services could be provided in-house since they involved human resources and risk management, which are services directly offered by AUI. Another expense adjustment item involved employee pension and mirrored Staff's position on this issue, which the Commission has upheld herein. The other major adjustment item involved a 10 percent retention factor used by AUI. AUI recognizes that certain management time and resources are spent on nonutility business, but AUI has not done a comprehensive study to prove what percentages should be allocated to the nonutility operations. Staff also believes that there is a potential for some cross-subsidization of costs because income tax, human resources, legal, public affairs, and engineering and safety concerns in the utility industry are also relevant to AHI's property development business. As a result of these concerns, Staff increased AUI's retention factor from MCWC's recommended 10 percent to 20 percent to compensate the utility companies for advice and coordination performed on behalf of the development companies. Staff strongly recommends that MCWC's parent company and other subsidiaries that charge expenses to MCWC be required to provide an auditable time-keeping mechanism in the future. The result of this would allow AUI and AHI to charge more of the costs directly to MCWC and also ensure that time spent on nonregulated entities would be charged to those entities rather than to the regulated utilities.

As previously stated, the Commission is left, arguably, with substantial and competent evidence supporting both MCWC's and Staff's positions on the allocation of parent company cost issues. The Commission is of the opinion that MCWC has met at least some of the burden imposed upon it in the previous rate case to provide the Commission with a study supporting its parent company expenses. However, the Commission determines that the Metzler Study is basically a management-oriented study that is based largely upon professional opinion. There does seem to be considerable duplication of management as Staff contends. A more definitive time study could prove MCWC's position on these expenses. Thus, the Commission is left with the dilemma of choosing one position over the other or providing a separate compromise position. The Commission determines that the most reasonable compromise is to allow 50 percent of Staff's adjustment on the parent company costs allocated to MCWC. The Commission is of the opinion that this approach gives the proper weighting to each party's position and appropriately provides for reasonable expenses properly chargeable to MCWC by its parent company and its affiliates.

The Commission, therefore, determines that 50 percent of Staff's adjustment for parent company costs allocated to MCWC in the amount of $49,322 to water operations and $49 to water operations rate base should be allowed.

(9) <u>Excess Profit From Affiliated Transactions</u>

The only affiliated company which charges a profit margin to MCWC along with actual expenses is AUSI. AUSI provides data processing and customer billing services to MCWC. These costs are charged according to a contract price agreed to by MCWC. The test year charges from AUSI to MCWC were $259,317. Although AUSI does perform work for nonaffiliated entities, over 82 percent of its business is with the regulated subsidiaries of AUI. AUSI manages the business for profit and, according to consolidated financial statements furnished by MCWC, its return on equity was 86.46 percent for 1991. Staff believed the return on equity earned by AUSI in the test year was entirely too high, and, therefore, limited it to the high end of the return on equity range recommended for MCWC by the Staff, 12.76 percent, which resulted in an adjustment of $53,915 to water operations.

MCWC says that the efficacy of AUSI's pricing to affiliates is directly and irrefutably shown by AUSI's contract with Orange Osceola Utility Corporation (OOU), an independent corporation which paid the same price for these computer services as did MCWC. Also, MCWC says that the use of return on equity of a utility company as a measure of profitability for what is essentially a service company, is inappropriate.

The Commission is once again confronted with a dilemma where the evidence on both sides of the issue is compelling but not totally convincing. The Commission determines that to be consistent it will adopt the same methodology as it used in the previous allocation of parent company expenses and allow 50 percent of Staff's adjustment. Staff's contention that the AUSI-MCWC arrangement is not an arm's length transaction is properly noted. Staff's adjustment mirrors the profit which would have been reflected in rates if the data processing service had been provided by MCWC rather than AUSI. Staff's contention regarding the Public Utility Holding Company Act (PUHCA) is compelling. Gross abuse of parent company structure and costs allocated to subsidiaries was a main reason for PUHCA reforms passed by Congress. MCWC is not subject to PUHCA but the same theory applies. No affiliate should be allowed to charge excessive returns to another, regulated entity with the expectation that those excessive costs will be passed on to its customers. The problem is that Staff has not offered definitive proof that these profits are as excessive as they appear to be. This is the only parent affiliate of MCWC that charges a profit margin to MCWC along with actual expenses. Supporting MCWC's position that the profits of AUSI are not excessive is the problem of AUSI's contract with OOU. The Metzler Report states:

> AUSI's contract with OOU is direct and irrefutable proof of what a similar entity -- a water utility -- is reasonably willing to pay for a commodity service. OOU is not an affiliate of AUI and is charged the same rates as affiliated companies such as MCWC. Further, this market validation is strengthened by OOU's reported six-year search for an alternative source for data processing services as well as its higher-cost alternative to continue to provide these services internally.

The Commission, therefore, determines that, since it cannot determine whether these profits of AUSI are excessive, it must again compromise the seemingly irreconcilable positions by disallowing half of the Staff's adjustment. This may not be the most accurate result that additional evidence could lead to, but it reconciles positions that are compelling but appear to be mutually exclusive.

The Commission, therefore, determines that 50 percent of Staff's adjustment for excess profits from affiliated transactions with MCWC in the amount of $26,958 to water operations should be allowed.

10. <u>Depreciation</u>

All parties agreed to the depreciation schedules at the prehearing conference and there are no contested issues.

The Commission, therefore, determines that the depreciation schedules agreed to should be implemented.

11. **Return on Equity**

The overall rate of return for a company is established by estimating its cost of common equity and combining it with its costs for debt and preferred stock. Staff and Public Counsel used the discounted cash flow (DCF) method for estimating the cost of common equity. The purpose of the DCF analysis is to estimate the return on equity necessary to attract investors to a company given the future value of the stock based upon its projected price and expected dividend per share. The DCF model is a market-oriented approach that uses three variables to determine a cost of equity of a company. These variables are the expected dividend and the current stock price and growth factor. Under the formula for the DCF, the return on equity is obtained by dividing the expected dividend by the current stock price and adding a growth factor. MCWC is not a publicly traded company and information is difficult to obtain to apply the DCF model. There are only a handful of publicly traded water companies in the country, and they are significantly larger than MCWC.

Staff and Public Counsel are in virtual agreement on the capital structure, proper cost of long term debt and preferred stock, the amount of short term debt in the MCWC capital structure, and the dividend yield. The only conflict between Staff and Public Counsel is the sustainable growth rate that should be adopted for use in the DCF formula. Staff uses a growth rate of 5.79 percent based upon historical dividends per share. Utilizing the results of the growth rate and dividend yield analysis, the Staff then determined the DCF cost of equity for seven comparable water companies. The Staff determined that the summarized DCF cost of equity range for the seven comparable water companies utilized to determine a fair and reasonable return on equity for MCWC lies in a range from 11.63 percent to 12.62 percent with a midrange of 12.09 percent. Staff also recommends this same range be applied to the common equity of MCWC. Public Counsel uses a growth rate range of 3.16 to 3.81 percent in its analysis.

The low end of Public Counsel's sustainable growth rate range was calculated by determining the retention growth rate with an added component which reflects external financing. This is the so-called "plowback method". The high end of Public Counsel's sustainable growth rate was calculated as the average of: (1) Value Line's projected growth estimates in Earnings Per Share, Dividends Per Share and Book Value Per Share; and (2) the projected sustainable growth rate of (3.16 percent). The resulting DCF return on equity for MCWC recommended by Public Counsel falls within a range of 10.03 percent to 10.69 percent. The essential difference between Staff and Public Counsel lies in the type of information used to determine the sustainable growth rate. Staff used both historical and projected data in its analysis while Public Counsel used only projected growth rate data in calculating its growth rate estimate.

MCWC has indicated that its position is that rate of return on common equity will be a "fallout number". Essentially, MCWC is requesting that the Commission look solely at interest coverage ratios in determining return on equity. MCWC expresses an intent to access the bond market for $5 million of First Mortgage Bonds in September 1993. MCWC's witness, Peter H. Kind, indicates that a pretax 2.25 times coverage is the threshold minimum which a prospective investor would require for an "A Rated" utility. MCWC, therefore, is requesting the Commission to allow a rate of return sufficient to allow MCWC to achieve a revenue requirement of $413,421 regardless of any findings on the contested issues to ensure its financial position in September 1993, in order to finance the additional bonds necessary to construct the improvements it deems essential for the system. The rate of return on equity then "falls out" from the other issues as the final determinant of the revenue requirement of MCWC.

The Platte County Intervenors essentially support the position of Public Counsel and strongly urge the Commission to "make a statement to the

Company about the filing of unsubstantiated rate cases" and allow the lowest return on equity of 10.03 percent.

The Commission determines that Staff's analysis is the most appropriate method for deciding the proper rate of return on equity for MCWC. In expressly ruling against MCWC, the Commission believes that interest coverage ratios should be used only as a test of the reasonableness of a proposed return on equity, and should not be used as the sole mechanism for determining a cost of equity figure. Adopting an interest coverage ratio methodology would effectively allow the Company to increase its revenue requirement each time it issued debt (via the increased interest expense), incurred a reasonable expense, or incurred an unreasonable expense. In essence, the regulatory process would be inconsequential, as each time the Commission deemed an expense to be unreasonable in providing safe and adequate service, the offset would be an increase to the return on equity in order to maintain a constant pretax interest coverage. This position is also consistent with the Commission's determination in MCWC's last rate proceeding, Case Nos. WR-91-172 and SR-91-174. The Commission does not believe that a company's borrowing needs should dictate the revenue requirement. Currently, the difference between "A" and "BBB" rated securities is 10-25 basis points. These basis points represent the interest rate premium, under current market conditions, that MCWC ratepayers could be required to pay if MCWC's pretax interest coverage ratio is below 2.0 times. Based upon MCWC's proposed $5 million bond issue under market conditions, MCWC would pay an extra $5,000 to $12,500 in interest expense annually. This is hardly a difference that justifies all abandonment of traditional methods for determining rate of return on equity. The Commission, however, is not attempting to lower MCWC's bond rating. In setting revenue requirements the Commission also considers interest coverage ratios as a standard portion of cost of capital analyses. The Staff considered interest coverage calculations in its analysis of a fair rate of return. Staff's calculations show a synopsis of pretax interest coverage being a range of 2.33x - 2.81x. Utilizing Staff's analysis the Commission determines that MCWC would retain its "A" bond rating and demonstrate ample financial strength to attract capital going forward.

The Commission also determines that Staff's methodology for the DCF formula is more appropriate than Public Counsel's. The Commission finds that Public Counsel's use of the "plowback" growth rate estimate is not appropriate given the current water industry environment. Seventy-five percent of Public Counsel's growth rate estimate is derived from a five company 1995-1997 projected "plowback" growth estimate. This analysis does not embody historic growth rates at all and fails to recognize the increased risks in the water industry. Public Counsel's analysis picks a point in the future and assumes that conditions related to that specific date will continue forever. Staff's analysis revolves around a long term perspective that underlies the cyclical nature of the economy, the industry, and MCWC. In particular, Staff's approach includes economic conditions before and after the enactment of the 1986 amendment to the Safe Drinking Water Act. By including long term historical growth rates as Staff has done, as opposed to Public Counsel's projected growth rates, <u>actual</u> financial information that has resulted from <u>actual</u> related business operations is included in the analysis. By including this <u>actual</u> financial information which is derived during different business and economic cycles, a proper risk-return relationship can be established. Since the water industry is not widely followed by the investment community, any projected information is bound to be less reliable than the same information provided by widely followed industries. Using historical dividends per share growth rates provides a better estimate of future growth in that they are more statistically consistent than historical earnings per share data. Also as far as investor expectations are concerned, without a proper and sustainable growth rate estimate, the stock price used within the DCF formula framework is incorrect. If the stock price is incorrect, then the risks that investors perceive are not captured.

The Commission for these reasons determines that Staff's rate of return on equity range is the appropriate one to base its decision upon. In that context the Commission further determines that the midrange of the 11.63 percent to 12.62 percent should be adopted as the most just and reasonable rate of return on equity.

The Commission, therefore, determines that Staff's position on rate of return on equity should be adopted and that the most appropriate and just and reasonable rate of return on equity for MCWC is 12.09 percent.

12. <u>Rate Base</u>

All parties agreed to the rate base at the prehearing conference except for those issues herein discussed.

The Commission, therefore, determines that the MCWC's rate base for water operations of $22,175,725 and $58,506 for sewer operations should be adopted except for any adjustments herein explicitly made by the Commission

13. <u>Overall Weighted Cost of Capital</u>

The Commission adopts the capital structure used by Staff for MCWC as follows with weighted costs:

Capital Component	Percentage of Capital	Rate	Weighted Cost
Common Stock Equity	42.53%	12.09%	5.142%
Preferred Stock	1.44%	5.88%	0.085%
Long Term Debt	43.18%	9.18%	3.964%
Short Term Debt	12.85%	6.00%	0.771%
TOTAL	100.00%		9.961%

Thus, the total overall weighted average cost of capital as determined by the Commission to be applied to the rate base as established in this case is 9.96 percent.

III. Rate Design

Two years ago in *Re: Missouri Cities Water Company*, 30 Mo. P.S.C. (N.S.) 363 (1990), the Commission approved the current uniform rate design structure, including two components for each rate element in each of MCWC's five service districts. The first component of this structure is the so-called "uniform rate", which is the same in all districts for a given rate element (e.g., the monthly fixed service charge and the rate for the first block of water consumption). The second component, the so-called "equalization rate", varies by district. The equalization rate was set equal to the difference between an individual district rate and the uniform rate for each rate element. Customers pay the sum of the uniform and equalization rates. In that case the Commission stated:

> The Commission has reviewed the evidence in this matter and finds that the proposal to establish a system-wide rate for water service is reasonable. These tariffs would not make everyone's water bill the same. This proposal would only make any future rate increases the same. That is, current differences in rates among the districts would remain the same but the increases would be spread equally among all customers. The Commission finds also that the proposal to

establish equalization rates to maintain the current differentials between Company districts is also reasonable. The Commission agrees with Public Counsel that the proposal will allow Company to spread future increases in rates on a system-wide basis while maintaining the current rate differential which will reduce rate shock in future cases and limit cross-subsidization. Spreading the costs to all Company customers will also allow Company greater flexibility in timing plant additions.

The Commission agrees with Public Counsel that the equalization rates should stay in effect until some future date. Even though an equalization rate might change because of changed billing determinants the Commission finds that the current rate differential should be maintained. This matter can be reviewed in some future rate case.

In the first rate case after the uniform rate decision, Case No. WR-91-172, certain parties urged the Commission to alter the rate design. In rejecting the argument the Commission stated:

"The Commission also finds that the proposal by Platte County Intervenors to go immediately to system-wide average rates, as depicted in figure 3, is premature. Over time, the rate structure herein approved will conduce to a leveling of rates throughout the Company's five divisions."

In this second rate case, filed within two years after the Commission's decision in ***Missouri Cities Water Company***, the same parties again seek to relitigate the rate design issue decided in that case.

MCWC has made no specific recommendation with respect to the rate design previously approved by the Commission. The Staff's position is that if there is a change in the Company's overall revenue requirement, the change should be used to design rates according to the functional cost allocation method as explained in its testimony. Also, Staff recommends that if there is a change in Company's revenue requirement, the current commodity equalization rates should be eliminated. However, if there is no change in the Company's overall revenue requirement, Staff recommends that the rates stay at the level they are currently set. Staff further recommends, and MCWC and Public Counsel concur, that the mathematical error in the Brunswick tariffs be recalculated using the method ordered in *Missouri Cities Water Company*. MCWC in its filing adjusted the equalization revenues for a transposition of usage between the first and second block for the Brunswick Division and Staff agrees with the calculation. Public Counsel opposes any elimination or phase-out of the equalization rates as being premature. Intervenor, City of Warrensburg, opposes any phase-out or elimination of the equalization rates. It is Warrensburg's position that phasing out or eliminating the equalization rates would result in additional rate increases for customers in Warrensburg for no reason other than to reduce rates in other districts. It states that the current use of uniform rates and equalization rates results in each division bearing a share of expenditures as the Company goes through a rotation of major improvements in the divisions. Each division avoids an isolated larger increase and, instead, experiences periodic smaller increases. Platte County Intervenors believe that the current rate design discriminates unfairly between divisions which have had substantial capital investments since the date of the cost of service utilized to justify the equalization rate portion of the billing rate and those divisions which have not had substantial capital investments. It believes that the current methodology, in addition to discrimination, sets rates without regard to current costs and, ultimately, will lead to inappropriate patterns of consumption. Platte County Intervenors recommend that there be immediate adoption of full uniform rates and the elimination of the equalization rates.

The Commission determines that it should maintain the course it set upon in the "uniform rate design case", *Missouri Cities Water Company*. Maintaining the current level of equalization revenues mitigates interdivision cross-subsidies. A complete movement to company-wide uniform rates would cause severe cross-subsidization between divisions, since the rates varied considerably from division to division prior to *Missouri Cities Water Company*. The current rate design is, above all, a delicate balance between the desire to allow the implementation of rate increases uniformly and the desire to limit cross-subsidization. The uniform rate component allows all future rate increases to be implemented uniformly, thus relieving rate shock to any particular division experiencing large capital improvements. The equalization rate components preserve the rate differentials between divisions. Any reduction in the differentials between divisions will result in corresponding cross-subsidization. The equalization rate components should not be phased out at least until MCWC completes a full cycle of capital improvements. Platte County Intervenors perceive inequities because the capital improvements recognized in the last rate case were predominantly in the Warrensburg and St. Charles divisions. "Inequities" perceived in this fashion are temporary. MCWC made it clear at the hearing in this case that the other divisions will receive similar large investments in the near future. Any "inequity" reduced through the elimination of equalization rates would be countered by unjustifiable rate increases to other customers. All customers deserve to benefit equally from the carefully designed balance of the current rate design before it is modified. Platte County Intervenors might argue that they are being unfairly treated at this time, but, as they say, "the worm will turn" when planned additions are made in their division and other divisions help pay for them through the uniform rates. If the Commission alters the starting point set in ***Missouri Cities Water Company*** in an effort to adjust for what appears to be cross-subsidization in the eyes of one party at this instant, it will result in an unraveling of all equitable and impartial aspects of the intended uniform rate design system. Substantial rate changes would occur in addition to revenue requirement changes if equalization rates are eliminated. Public Counsel's calculations indicate the resulting effect would be as follows:

Division	"Percentage Change"
Brunswick	-46.8%
Mexico	-18.0%
Platte County	- 6.5%
Warrensburg	+20.9%
St. Charles	+ 4.0%

The ultimate effect would clearly be "rate shock" for the Warrensburg Division. The Commission is basically of the opinion that it is far too early to contemplate reducing equalization revenues since MCWC has not completed its first "building cycle" since the implementation of uniform rates barely a year ago in Case No. WR-91-172. The Commission is also of the opinion that the mathematical transpositional error in the calculation relating to the current rates for the Brunswick Division should be corrected.

The Commission, therefore, determines that the position of Public Counsel and the City of Warrensburg should be adopted and that the equalization rates for each division of MCWC should be maintained as set out in ***Missouri Cities Water Company*** with MCWC being allowed to file its proposed rate increases at the uniform rate only.

The Commission, therefore, determines that MCWC's, Staff's and Platte County Intervenors' position, that the equalization be either "phased out" or eliminated or altered in any way, is disallowed.

The Commission further determines that the position of MCWC and Staff and concurred in by Public Counsel, to allow for a rate design which corrects the transpositional error between the first and second blocks of the Brunswick Division, should be allowed.

IV. Accounting Recommendations

A. Lease Cost/Benefit Analysis

In conjunction with the Staff's proposed adjustment regarding MCWC's leased vehicles, the Staff is requesting that the Commission order the Company to develop and perform a lease cost/benefit analysis. The Staff believes MCWC should perform such an analysis as a normal internal requirement before renewing or entering into any new lease agreements. The Staff further proposes that the Commission order MCWC to follow established Generally Accepted Accounting Principles (GAAP) provisions contained in Financial Accounting Standard No. 13, "Accounting for Leases". The Staff estimates that there would be a reduction in future costs incurred as a direct result of following these recommendations. MCWC does not believe that the proposal is appropriate. It states that there is no way to value the benefits of the numerous services and operational benefits derived from the present leasing company, the ability to buy and sell vehicles at a price comparable to such a large leasing company, and the additional labor costs for administration that need to be considered. MCWC states that due to the number of vehicles and equipment involved, all with different age lives, different values and different uses, a simple mathematical calculation does not show whether a leasing or purchase decision is beneficial.

The Commission is of the opinion that the Staff's proposed accounting recommendation that a lease cost/benefit analysis be concluded before MCWC enters into any leasing arrangement should not be required. This issue has previously been decided in favor of MCWC. the Commission therein has determined that MCWC is acting prudently in leasing vehicles as opposed to purchasing the vehicles. The Commission is of the opinion that such an analysis would require a significant investment in labor just to perform the necessary comparison shopping to determine the "purchase price" and the analysis of the publications available to determine the original cost and depreciated cost. In effect, the Commission finds no obvious abuse in MCWC leasing its vehicles as opposed to purchasing them. To require an expensive analysis by MCWC of its leasing practices would not be consistent with the Commission's findings on the issue herein. The Commission, however, reserves the right to examine the Company's future leasing expenses to determine that those expenses are in fact prudently incurred. Also, the Commission is of the opinion that MCWC should comply with GAAP requirements as to provisions accounting for leasing.

The Commission, therefore, determines that the Staff's accounting recommendation as to a lease cost/benefit analysis should be disapproved.

The Commission further determines that the Staff's accounting recommendation that MCWC follow GAAP provisions contained in Financial Accounting Standard No. 13, "Accounting for Leases", should be approved.

B. Preparation of Maintenance Work Orders

The Staff recommends that the Commission order MCWC to develop and utilize a maintenance work order system for individual projects that have a probable cost in excess of $1,000. Staff believes that maintenance work orders are appropriate for documenting work performed on Company facilities. Staff believes that such records will provide reasonable documentation of material Operations and Maintenance (O&M) expenses. Staff recommends a maintenance work order form which would identify particular Company facilities on which physical work was performed. The Staff envisions that the form would set out a description of the problem, the location of the work, and a summary of the maintenance costs, including indirect charges as are necessary. Staff believes that such a program would allow MCWC to better evaluate Company operations and provide information to Staff in determining proper ratemaking treatment for these types of items. MCWC is opposed to the Staff recommendations as being unnecessary, inappropriate for its system and too costly to implement. MCWC believes that such a program would require a substantial increase in labor, supervision, and the creation of expensive accounting records in the form of software. MCWC believes that a maintenance work order system is more justified on a large stand-alone system and that it already currently tracks on a monthly basis projects that have abnormal costs.

The Commission is of the opinion that Staff's recommendation as to maintenance work orders should be approved. Staff has determined that O&M expense had increased several hundred thousand dollars in the test year over the previous year. The Commission is of the opinion that Staff's requirements would not be significantly costly to MCWC. Any additional bookkeeping costs will be outweighed by the benefits derived from the program. The Commission suggests that MCWC implement a system using a format similar to the form provided in Schedule 4 of William Meyer's direct testimony. Also, as suggested by Staff, the program should be implemented only for projects with a probable cost in excess of $1,000. The Commission is of the opinion that Staff's suggested program is reasonable and should be implemented along the lines suggested by Staff and not according to the expensive software system project suggested by MCWC.

C. Recording Plant Additions and Retirements

Staff and MCWC have agreed that the Company will keep the Accounting Staff advised by semiannual written information of the Company's progress in computerizing the plant accounting system. Computerization of these records will allow MCWC to more easily close plant additions on a quarterly basis.

Conclusions of Law

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

Company is a public utility subject to the jurisdiction of the Commission pursuant to Chapters 386 and 393, R.S.Mo. 1986, as amended. Company's tariffs herein were suspended pursuant to authority vested in the Commission by Section 393.150, R.S.Mo. 1986, which places upon Company the burden of proof to show that the proposed increase in rates is just and reasonable.

Pursuant to Section 536.060, R.S.Mo. 1986, the Commission may approve a stipulation and agreement concluded between parties to any issues in a contested case. The Commission has determined that the agreements among the parties as to the issues of security deposits, recording plant additions and retirements accounting recommendations, and all items not specifically mentioned in the Hearing Memorandum which were settled at the prehearing conference, are reasonable and, therefore, should be approved.

The Commission's ruling in favor of Staff on the Company's Motion To quash upon the Staff's request for a subpoena duces tecum was affirmed by the Missouri Supreme Court on October 9, 1992, ***State ex rel. Missouri Cities Water Co. v. Missouri Public Service Commission***, No. 75301.

The Commission set out the five categories of advertisement: (1) general, (2) safety, (3) promotional, (4) institutional, and (5) political, for determining proper expenditures in considering revenue requirement in ***In Re: Kansas City Power & Light Company (KCPL)***, 28 Mo. P.S.C. (N.S.) 228, 75 P.U.R. 4th 1 (1986). The Commission in that case determined that a utility's revenue requirement should: (1) always include the cost of general and safety ads; (2) never include the cost of institutional or political ads; and (3) include the cost of promotional ads only to the extent that the utility can provide cost justification for the ads.

The Commission has previously ruled that dues, donations and subscriptions should not be included in a company's cost of service, ***State ex rel. Laclede Gas Company v. PSC***, 600 S.W.2d 222, 229 (Mo. App. 1980).

The Commission has previously ruled that charitable contributions should not be included in a company's cost of service, ***Re: St. Louis County Water Company***. 29 Mo. P.S.C. (N.S.) 425, 94 P.U.R.4th 96, 107 (1988).

The Commission has previously used an average of uncollectibles to establish a level of expense when there appears to be little or no pattern to the fluctuation, ***Re: Union Electric***, 25 Mo. P.S.C. (N.S.) 194.

The Commission has previously determined that industry averages do not create an industry standard of prudence. ***Re: Union Electric Company***, 27 Mo. P.S.C. (N.S.) 183; ***Re: Kansas City Power and Light***, 28 Mo. P.S.C. (N.S.) 228.

The Commission has previously found in ***Missouri Cities Water Company***, Case Nos. WR-91-172 and SR-91-174, that for ratemaking purposes, the Company's pension expense should be based upon the minimum ERISA contributions.

FAS 71 provides that a company can place the difference between the minimum ERISA contribution and the FAS 87 amount in a "regulatory asset" or "regulatory liability" account if the company has a probable assurance from its commission that the difference can be recovered in a future period.

The Commission must also determine what is a just and reasonable return on equity for the Company. In so doing, the Commission ultimately relies on ***Federal Power Commission v. Hope Natural Gas Co.***, 320 U.S. 591, 602, 64 S. Ct. 281, 287, 88 L. Ed. 333 (1945), wherein the U.S. Supreme Court said: "It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry ... is at an end. The fact that the method employed to reach that result may contain infirmities is not then important." The Commission has also stated in the Company's last rate case, ***In Re: Missouri Cities Water Company***, Case Nos. WR-91-172 and SR-91-174: "This Commission cannot, as suggested by the Company, use interest coverages to arrive at Company's revenue requirement."

The Commission has previously approved and found fair and reasonable the current uniform rate design structure, including two components for each rate element in each of Company's five service districts in ***Re: Missouri Cities Water Company***, 30 Mo. P.S.C. (N.S.) 363.

Based upon the Commission's findings in this case, the Commission concludes that just and reasonable revised tariffs should be filed by MCWC designed to increase its total revenues exclusive of gross receipts and sales tax by $93,741 or 1.02 percent on an annual basis as to water operations and $1,797 or 5.0 percent on an annual basis as to sewer operations.

IT IS THEREFORE ORDERED:

1. That pursuant to the findings and conclusions of law in this Report And Order, the proposed tariffs filed by Missouri Cities Water Company in this case are hereby disapproved; and that Missouri Cities Water Company be authorized hereby to file in lieu thereof, for the approval of the Commission, tariffs designed to increase gross revenues, exclusive of gross receipts and sales tax, by the amount of $93,741 as to water operations and $1,797 as to sewer operations on an annual basis over the current revenues.

2. That the tariffs to be filed pursuant to this Report And Order shall become effective for service on and after January 21, 1993.

3. That the stipulations and agreements concluded among the parties as to the issues of security deposits, recording plant additions and retirements accounting recommendations, and all items not specifically mentioned in the Hearing Memorandum, being Exhibit 1, which were settled at the prehearing conference, are hereby approved.

4. That late-filed Exhibit 53, dated December 31, 1992, which was a request by Examiner Graham for completion of hypothetical revenue requirement

scenarios and the responses thereto by the parties, be hereby received into evidence.

5. That any cumulative balance of the St. Charles County Water Department Renovation and Replacement Fund in excess of Three Hundred Thousand Dollars ($300,000) for any future test year shall reduce the rate base of Missouri Cities Water Company dollar for dollar, unless Missouri Cities Water Company can prove to the Commission's satisfaction the necessity for the additional accumulation in excess of $300,000.

6. That Missouri Cities Water Company shall be hereby authorized to book the difference between the Employee Retirement Income Security Act contribution and the Financial Accounting Standard No. 87 amount to Uniform System of Accounts No. 186, entitled "Miscellaneous Deferred Debits", as a regulatory asset.

7. That the rate design correction of the transpositional error between the first and second blocks of the Brunswick Division is hereby authorized.

8. That Missouri Cities Water Company shall follow Generally Accepted Accounting Principles provisions as contained Financial Accounting Standard No. 13, "Accounting for Leases".

9. That Missouri Cities Water Company shall implement a system as herein specified as to maintenance work orders for projects with a probable cost in excess of One Thousand Dollars ($1,000).

10. That any objections not heretofore ruled upon be overruled hereby, and any outstanding motions be hereby denied.

11. That this Report And Order shall become effective on the 21st day of January, 1993.

BY THE COMMISSION

Brent Stewart

Brent Stewart
Executive Secretary

(S E A L)

McClure, Chm., Rauch, Perkins and Kincheloe, CC., concur and certify compliance with the provisions of Section 536.080, R.S.Mo. 1986.
Mueller C., absent.

Dated at Jefferson City, Missouri, on this 8th day of January, 1993.