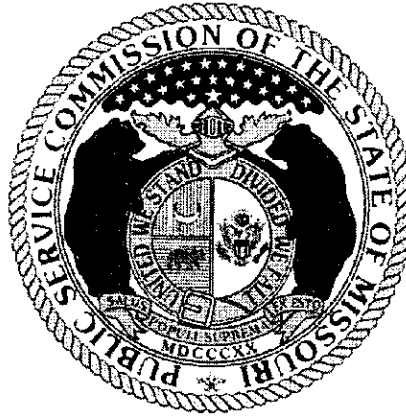


**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**



In the Matter of Missouri-American Water	)	
Company's Tariff Sheets Designed to Implement	)	<b><u>Case No. WR-2000-281</u></b>
General Rate Increase for Water and Sewer	)	Tariff No. 200000366
Service Provided to Customers in the Missouri	)	Tariff No. 200000367
Service Area of the Company.	)	

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**REPORT AND ORDER**

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**Issue Date:** August 31, 2000

**Effective Date:** September 14, 2000

253



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**TABLE OF CONTENTS**

<b>Appearances</b> .....	<b>2</b>
<b>Procedural History</b> .....	<b>3</b>
MAWC's Motion to Strike and Motion for Summary Judgment .....	14
<b>Discussion</b> .....	<b>19</b>
<b>Findings of Fact</b> .....	<b>21</b>
The Parties .....	21
The Company .....	23
Number of Customers in Each Class in Each District .....	23
Assets, Income and Expenses by District .....	24
Capital Structure and Return on Equity .....	25
Deferred Income Taxes .....	27
The New St. Joseph Water Treatment Plant and Related Facilities .....	27
Other New Construction .....	33
<b>Conclusions of Law</b> .....	<b>34</b>
Jurisdiction .....	34
Burden of Proof .....	35
Applicable Statutes and Legal Standards .....	35
Uncontested Issues .....	38
The New St. Joseph Plant-Valuation .....	39
The New St. Joseph Plant-Capacity .....	46
Capitalization Rate for AFUDC .....	47
Accounting Authority Order (AAO) .....	48
Premature Retirement .....	50
Property Taxes .....	52
Other New Construction .....	53
Deferred Income Taxes .....	53
Capital Structure, Return on Equity and Rate of Return .....	54
Rate Design .....	57
<b>Ordered Paragraphs</b> .....	<b>61</b>

## APPEARANCES

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Keith R. Krueger, Deputy General Counsel, Cliff E. Snodgrass, Senior Counsel, and Robert Franson, Assistant General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102-0360, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Kevin A. Thompson, Deputy Chief.

## **REPORT AND ORDER**

### **Procedural History**

On October 15, 1999, Missouri-American Water Company (MAWC or Company) submitted to the Commission its proposed tariff sheets intended to implement a general rate increase for water and sewer service provided to customers in the Missouri service areas of the Company.<sup>1</sup> The proposed tariffs bore a requested effective date of November 15, 1999. The proposed water service tariffs were designed to produce an annual increase of approximately 53.97 percent (\$16,446,277) in the Company's revenues. The proposed sewer service tariffs were designed to produce an annual increase of approximately 5.0 percent (\$2,363) in the Company's revenues.

On October 28, 1999, the Commission issued its Suspension Order and Notice and Order Consolidating Cases by which the Commission consolidated Case No. SR-2000-282 into Case No. WR-2000-281 for all purposes and suspended the proposed tariffs for a period of 120 days, plus an additional six months beyond the requested effective date, in order to allow sufficient time to study the effect of the proposed tariffs and to determine if they are just, reasonable and in the public interest. By this order, the Commission also directed MAWC to file its prefiled direct testimony by November 29, 1999, including its proposed test year and any request for a true-up audit and hearing. The Commission also directed that

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<sup>1</sup> St. Joseph, Joplin, St. Charles, Warrensburg, Mexico, Parkville, and Brunswick; not including Jefferson City or St. Louis County.

MAWC provide individual notice by mail to all of its customers, and directed that notice be sent as well to county commissions, state legislators, and the media serving MAWC's Missouri service areas, and set an intervention period of 20 days. The Commission by this order also set an early prehearing conference for December 14, 1999, and directed that the parties file a joint proposed procedural schedule by December 21, 1999. Finally, the Commission set an evidentiary hearing for May 9, 2000, through May 15, 2000.

On November 2, 1999, the Company moved for a protective order. Thereafter, on November 4, 1999, the Commission adopted by order its standard protective order herein to protect proprietary and highly confidential information.

On November 9, 1999, the Staff of the Missouri Public Service Commission (Staff) and the Office of the Public Counsel (Public Counsel) filed their Joint Motion to Modify the Suspension Order, stating that the Suspension Order did not allow a sufficient interval between the date on which Company must file its direct testimony, November 29, 1999, and the first day of the evidentiary hearing, May 9, 2000. The movants averred that, according to the "generic" rate case timeline employed by Staff, the hearing should start on June 5, 2000. Thereafter, on November 18, 1999, the Commission reset the evidentiary hearing to June 5 through June 9, 2000. The Commission also required that MAWC file its direct testimony, test year recommendation and true-up request by November 24, 1999.

Meanwhile, on November 16, 1999, the Missouri municipalities of Joplin, Warrensburg, O'Fallon, and Weldon Spring filed their application to intervene, followed by the municipality of Mexico, Missouri, the following day (collectively, the Municipal Intervenor). Also on November 17, 2000, Public Water Supply Districts (PWSD) Nos. 1 and 2 of Andrew County, Missouri, PWSD No. 1 of DeKalb County, Missouri, and PWSD No. 1 of Buchanan

County, Missouri (collectively the St. Joseph Area PWSD Intervenor) filed their applications to intervene. On the same day, AG Processing, Inc., a cooperative (AGP), Friskies Petcare, a division of Nestle USA (Friskies), and Wire Rope Corporation of America, Inc. (Wire Rope), filed their application to intervene (collectively, the St. Joseph Industrial Intervenor or SJ Industrials). The Commission granted these uncontested interventions by order issued on December 1, 1999.

The cities of Warrensburg, O'Fallon and Weldon Spring filed a motion, on November 16, 1999, to extend the intervention period herein to December 7, 1999. AGP, Friskies and Wire Rope joined in this motion on November 17, 1999. As no party made any objection to this motion, the Commission extended the intervention deadline, by its order of December 1, 1999, to December 7, 1999.

On November 23, 1999, the City of St. Peters, Missouri (St. Peters), filed its application to intervene out-of-time, as did St. Charles County, Missouri (St. Charles), on November 29.<sup>2</sup> Also on November 29, 1999, the City of St. Joseph, Missouri (St. Joseph), filed an application to participate without intervention; on December 6, 1999, St. Joseph filed an application to intervene. On December 7, 1999, a group of six entities located in Warrensburg, Missouri, filed a joint application to intervene: Hawker Energy Products, Inc., Harmon Industries, Inc., Stahl Specialty Company, Swisher Mower and Machine Company, Inc., and Central Missouri State University (collectively, the Johnson County Intervenor). Finally, also on December 7, 1999, an association of three entities in St. Louis County filed a joint application to intervene under the name Missouri Industrial Energy Consumers (MIEC): The Boeing Company, Ford

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<sup>2</sup> In fact, these applications were timely.

Motor Company and Hussmann Refrigeration.<sup>3</sup> The Commission granted these unopposed applications on December 23, 1999.

There were also applications to intervene which MAWC contested. Public Water Supply District No. 2 of St. Charles County, Missouri (St. Charles PWSD), timely filed its Application to Intervene on November 16, 1999. On November 29, 1999, MAWC filed its opposition to St. Charles PWSD's application to intervene; St. Charles PWSD responded on November 30, 1999. The Commission granted St. Charles PWSD's application to intervene on December 6, 1999.

On November 17, 1999, the St. Joseph Building and Construction Trades Council (Council) filed its application to intervene. The Council was composed of various St. Joseph area trade unions, including Iron Workers Local Union No. 10, Operating Engineers Local 101, International Brotherhood of Electrical Workers Local Union No. 545, Laborers Local Union No. 579, Sheet Metal Workers Local No. 2, Carpenters District Council of Kansas City and Vicinity, Plumbers and Steamfitters Local No. 45, Roofers Local Union No. 20, Plasterers and Cement Masons Local Union No. 518, Teamsters Local No. 460, Asbestos Workers Local Union No. 27, Painters District Council No. 3, Boilermakers Local Union No. 83, Carpenters Local No. 110, and Elevator Constructors Local No. 12. MAWC responded in opposition on November 29, 1999; the Commission granted the Council's application by order on December 23, 1999.

One final application to intervene was received on June 8, 2000, on the fourth day of the evidentiary hearing from the City of Riverside, Missouri. This application was taken up at the opening of the hearing on June 9. The application was unopposed and, consequently, was granted by

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<sup>3</sup> MAWC responded to MIEC's application on December 14, 1999, but did not oppose it.



the presiding officer on condition that the City of Riverside take the case as it found it.

On November 16, 1999, the Public Counsel moved the Commission to hold Local Public Hearings (LPHs) in seven locations in MAWC's Missouri service areas in order to receive public testimony regarding the proposed general rate increase. MAWC responded on December 8, 1999. On January 7, 2000, the City of St. Joseph moved for an LPH in that municipality.

On November 19, 1999, MAWC filed Direct Testimony supporting its proposed tariffs, as well as its recommendation as to the test year and a motion for a true-up audit and hearing and a motion for an accounting authority order (AAO). On November 29, 1999, MAWC filed Direct Testimony concerning the issue of rate design. Public Counsel responded in opposition to MAWC's request for an AAO on November 29. On the same date, the SJ Industrials responded in opposition to MAWC's test year recommendation, its AAO motion, and its true-up motion. Staff and the Public Counsel responded in opposition to MAWC concerning the test year and true-up on December 7. MAWC replied to the SJ Industrials on December 9 concerning the AAO, test year and true-up, and to Public Counsel on December 9 concerning the AAO and again, on December 20, concerning the test year and true-up. The SJ Industrials responded to MAWC regarding the test year on December 9. Staff filed out-of-time in opposition to MAWC's motion for an AAO on December 14; MAWC responded on December 22.

On February 1, 2000, the Commission issued its Order Concerning Test Year, True-up, Accounting Authority Order, and Local Public Hearings. Noting the general agreement of the parties, the Commission determined that the proper test year was the 12-month period ending September 30, 1999, updated for known and measurable changes through December 31, 1999, for plant, revenues, property and income taxes, operations expenses, including labor wage increases, rate case expenditures, and conversion from quarterly

to monthly meter reading in the St. Joseph district. The Commission further directed MAWC to update its accounting information consistent with the test year. As to the true-up, the Commission adopted MAWC's position and set a true-up audit for certain specified items<sup>4</sup> as of April 30, 2000, with a true-up hearing to be held in late June. As to the AAO, MAWC sought authority from the Commission to amortize Allowance for Funds Used During Construction (AFUDC) between the in-service date of the new St. Joseph water treatment plant for about four and one-half months between its in-service date and the suspension date of September 14, 2000; MAWC also proposed to defer depreciation expense over the same period. This motion was vigorously contested by the SJ Industrials, Staff and the Public Counsel. The Commission decided to take the issue with the case. Finally, as to the Public Counsel's pending requests for LPHs, the Commission determined that it would schedule LPHs in Joplin, St. Joseph, Warrensburg, and Mexico, with the specific dates and locations to be specified in a later order.

Meanwhile, a discovery dispute had developed. On December 27, 1999, the SJ Industrials filed their First Motion to Compel, to which MAWC timely responded on January 6, 2000, with an appendix filed on January 7. The SJ Industrials filed their reply and supplemental reply on January 11 and MAWC responded to those replies on January 13. On January 10, 2000, the SJ Industrials filed their Second Motion to Compel. MAWC responded on January 20, 2000. The issues presented in the Second Motion to Compel were closely related to those raised by the SJ Industrials' First Motion to Compel and the Commission determined both motions in its Order Concerning

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<sup>4</sup> Residential and commercial customers and revenues, Commission's annual assessment for 2001, chemicals, waste disposal, fuel, and power expenses related to new facilities, capital structure, rate base, rate case expenses, employee levels, wage rates and benefits, depreciation expense, amortization of premature retirement, post-in-service allowance for funds used during construction, and deferred depreciation expense, income and property taxes, utility operating income, and purchased water expense.

Motions to Compel, issued on February 2, 2000. In the meantime, Staff filed a motion to compel on January 21, 2000, to which MAWC responded on January 31.

On December 14, 1999, a prehearing conference was held. Thereafter, on December 23, 1999, Staff filed its proposed procedural schedule and motion for additional hearing dates. On December 27, the Commission by order adopted the proposed procedural schedule and granted Staff's motion for additional hearing dates.

On February 10, 2000, the SJ Industrials filed their Application for Rehearing as to the Test Year, the True-up and the AAO, as well as their Application for Rehearing as to the Motions to Compel. Also on February 10, MAWC filed its Motion for Reconsideration as to the AAO. On February 18, 2000, the SJ Industrials responded in opposition to MAWC's motion; MAWC replied on February 28, 2000. Public Counsel responded in opposition to MAWC's motion on March 15; MAWC replied on March 23. On March 3, 2000, the Commission issued its Order Denying Rehearing and Concerning Accounting Authority Order. This order denied the two applications for rehearing filed by the SJ Industrials and stated that the Commission would hold a hearing on MAWC's motion for reconsideration.

In the meantime, on February 23, 2000, MAWC, together with Staff and the Public Counsel, filed a Non-unanimous Stipulation and Agreement (NUSA). This document was an attempt by MAWC to achieve by agreement what it had thus far failed to secure through an AAO, namely, capitalization of post-in-service AFUDC and deferral of depreciation expense on the new

St. Joseph water treatment plant.<sup>5</sup> On February 23, the City of St. Joseph filed a letter stating that it was not opposed to the NUSA, as did the St. Joseph Area PWSD Intervenors.

On February 24, the stipulating parties (MAWC, Staff and Public Counsel) filed a Motion to Modify the Procedural Schedule in order to permit the case to be quickly disposed of pursuant to the NUSA. The Commission issued its Notice and Order Regarding the Filing of the Non-unanimous Stipulation and Agreement on February 25. On the 28<sup>th</sup>, the Public Counsel moved to compel discovery and requested an extension of time to file testimony and expedited consideration. On March 1, 2000, a group of fourteen intervenors<sup>6</sup> jointly filed an objection to the NUSA and a request for hearing on "all issues in the case." On the same day, the stipulating parties filed testimony in support of the NUSA. On March 3, MAWC filed its Response to Public Counsel's Motion to Compel, Request for Extension of Time to File Testimony, and Request for Expedited Consideration. As previously noted, the Commission on this date issued its order denying the SJ Industrials' applications for rehearing and stating that a hearing would be held on MAWC's motion for reconsideration with respect to the AAO. This hearing, the order stated, would be held in conjunction with the hearing on the NUSA mandated by Rule 4 CSR 240-2.115.

On March 7, the SJ Industrials applied for rehearing of the March 3 order and responded in partial opposition to the stipulating

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<sup>5</sup> The precise mechanism contained in the NUSA, as well as its other details, are unimportant in view of its eventual fate. The NUSA provided in part for a mechanism of "deferred revenues" during the lag period between the in-service date of MAWC's new St. Joseph plant and the effective date of MAWC's new rates, which may include the new plant in rate base, presumably September 14, 2000. MAWC also agreed to withdraw its proposed tariffs, the filing of which initiated this case; to merge with its subsidiary, St. Louis County Water Company; and to initiate a new rate case no later than May 31, 2000.

<sup>6</sup> AG Processing, Inc., a Cooperative, Friskies Petcare, a Division of Nestle USA, Wire Rope Corporation of America, Inc., St. Charles County, the cities of St. Peters, Warrensburg, O'Fallon, Weldon Spring, and Joplin, Hawker Energy Products, Inc., Harmon Industries, Inc., Stahl Specialty Company, Swisher Mower and Machine Company, and Central Missouri State University.

parties' motion to modify the procedural schedule. The stipulating parties, in turn, replied in opposition to the SJ Industrials on March 13.

On March 15, the Commission extended the due date for direct testimony by all parties except MAWC, which had already filed its direct testimony in November. Also on March 15, Public Counsel filed suggestions in opposition to MAWC's motion for reconsideration as to the AAO. On March 22, Public Counsel moved to suspend the procedural schedule and for expedited treatment.

On March 23, 2000, the Commission issued its Order Concerning Non-unanimous Stipulation & Agreement, Denying Motion to Modify Procedural Schedule, Granting Reconsideration as to AAO, and Denying Motion to Compel. By its Order of March 23, the Commission determined that the case could not be disposed on the basis of the NUSA: "[t]his procedure is completely contrary to law, and cannot form the basis for a valid order by the Commission." State ex rel. Fischer v. Public Service Commission, 645 S.W.2d 39, 43 (Mo. App., W.D. 1982), cert. den., 464 U.S. 819, 104 S.Ct. 81, 78 L.Ed.2d 91 (1983). As the NUSA was a dead issue, so was the joint motion to modify the procedural schedule. The Commission revisited the AAO issue, and pointed out that MAWC did not need Commission authorization under the Uniform System of Accounts (USOA), adopted by Commission rule and mandatory for regulated utilities, to defer depreciation and to capitalize post-in-service AFUDC on the new St. Joseph plant. Finally, the Commission denied Public Counsel's motion to compel as moot.

On March 31, 2000, Public Counsel filed its Second Motion to Compel and Request for Expedited Consideration. On the same day, a Joint Motion to Modify the Procedural Schedule was filed; the Commission granted this motion on April 4, 2000. A week-long prehearing conference began on April 3, 2000. Also on April 3, the parties other than MAWC filed direct

testimony on all issues except rate design; additional testimony was filed on April 6, 7 and 14. On April 4, Public Counsel moved for an order scheduling LPHs and for expedited consideration. Also on April 4, the Commission shortened the time to respond to Public Counsel's second motion to compel; MAWC responded on April 6 and the Commission dismissed Public Counsel's motion as abandoned on April 11, 2000.

On April 7 and again on April 10, several intervenors filed suggestions in support of Public Counsel's motion for an order scheduling LPHs, as well as a motion to add an additional LPH in the St. Charles District. Public Counsel filed suggestions supporting the motion for an additional LPH on April 10. MAWC responded on April 12 and, on April 17, the Commission issued its order scheduling LPHs, including an additional LPH in the St. Charles District. Staff moved on April 11 to amend the procedural schedule; the Commission granted the motion on April 12. On April 13, Staff moved to establish a procedural schedule for the true-up hearing. The Commission adopted a procedural schedule for the true-up hearing on May 1, 2000.

On May 4, 2000, MAWC formally notified the Commission of its withdrawal from the NUSA. Also on May 4, all parties filed rebuttal testimony. LPHs were held at Mexico on May 10, at St. Charles on May 11, at Joplin on May 18, and at Warrensburg and St. Joseph on May 31. The LPHs were all well-attended. On May 25, the parties submitted a list of issues, a list of witnesses, and the agreed order of cross-examination. Also on May 25, the parties filed surrebuttal testimony. On May 30, the parties filed position statements as required by the procedural schedule.

On June 2, 2000, MAWC filed its Motion to Strike Testimony and for Summary Judgment. Public Counsel and the SJ Industrials responded in opposition on June 5. The motion was necessarily taken with the case. True-up testimony, and Staff's true-up accounting schedules, were filed on

June 15. Conformed replacement pages were late-filed as Exhibit 109 on July 5.

The Commission held an evidentiary hearing on June 5 through 9, June 15 and 16, and on June 26 through 29. The true-up hearing was held on June 26. All parties were represented at the evidentiary hearing and the true-up hearing.

MAWC filed a Joint Recommendation regarding undisputed issues on July 3. Late-filed Exhibit 120 was filed on July 3. After an extension granted on July 21, briefs were filed on July 24. Reply briefs were filed on August 2. By an order directing filing issued on July 31, the Commission permitted proposed findings of fact and conclusions of law to be filed on or before August 11. Staff filed its proposed findings of fact and conclusions of law on August 11; the SJ Industrials late-filed their proposed findings of fact and conclusions of law on August 14, with a correction on August 16. Also, on August 16, the Municipal Intervenors adopted the proposed findings of fact and conclusions of law filed by the St. Joseph Industrials.

On August 8, the Commission requested as a late-filed exhibit from each party or group of parties, an annotated summary of the financial impact of its position, including revenue requirement, rate design, and impact on an average ratepayer of each customer class. The requested exhibits were filed by Staff, MAWC and the St. Joseph Area PWSD Intervenors on August 15, by Joplin on August 16, and by Public Counsel on August 21. As Staff's late-filed exhibit was deficient, the Commission requested corrections by order issued on August 17; Staff filed its corrected exhibit on August 22. Also on August 22, the City of St. Joseph concurred in the late-filed exhibit submitted by the St. Joseph Area PWSD Intervenors.

On August 17, 2000, the St. Joseph Industrials filed objections to the Commission's receipt of the annotated late-filed exhibits requested on

August 8. The same day, the Staff filed an objection to MAWC's annotated late-filed exhibit. MAWC responded to Staff's objection on August 23.

On August 22, 2000, the Commission issued its Order Directing Scenarios. Staff filed its response on August 24. Also on that day, the Commission issued its Second Order Directing Scenarios. On August 24, the SJ Industrials and Joplin filed objections to the Public Counsel's late-filed exhibit and, on August 25, to Staff's corrected late-filed exhibit.<sup>7</sup>

Also on August 25, 2000, the SJ Industrials and the Cities of Joplin and Riverside filed their Applications for Rehearing with respect to both the Commission's Order Directing Filing of August 17, which directed Staff to revise its late-filed exhibit, and the Commission's Order Directing Scenarios of August 23. On the same day, the St. Joseph Area PWSD Intervenor filed their "Response and/or Objections" to Staff's revised late-filed exhibit. Finally, on August 28, 2000, the Cities of Joplin and Riverside and the SJ Industrials filed their Application for Rehearing with respect to the Commission's Second Order Directing Scenarios, issued on August 24.

The Commission sustained the objections of the SJ Industrials and the Cities of Joplin and Riverside to the late-filed exhibits and responses to scenarios, and denied their requests for rehearing as moot, by its order issued on August 31.

### **MAWC's Motion to Strike and Motion for Summary Judgment:**

MAWC moved, on June 2, 2000, to strike portions of the testimony of Public Counsel's expert witnesses, Ted L. Biddy<sup>8</sup> and

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<sup>7</sup> Presumably because Public Counsel's late-filed exhibit was submitted after the objecting parties had filed their first objections.

<sup>8</sup> Direct, p. 4, line 15, through p. 26, line 12; Surrebuttal, p. 1, line 11, through p. 25, line 21.



Russell Trippensee,<sup>9</sup> and portions of the testimony of the SJ Industrials' expert witnesses, Ernest Harwig<sup>10</sup> and Charles D. Morris.<sup>11</sup> The testimony in question relates either to the issue of the prudence of MAWC's decision to build the new St. Joseph Water Treatment Plant and related facilities or to the issue of whether the plant was overbuilt. Unsurprisingly, the testimony in question is adverse to MAWC.

MAWC offers four theories to support its motion to strike. First, that the Commission has already determined these issues in Case No. WA-97-46. Second, that the parties sponsoring the testimony in question are equitably estopped from taking positions contrary to those they espoused in Case No. WA-97-46. Third, that the Commission is equitably estopped from redetermining these issues. Fourth, that consideration of the prudence of MAWC's decision to build a new treatment plant and other facilities in St. Joseph is impermissible as a collateral attack on the Commission's decision in Case No. WA-97-46. MAWC's motion must fail on each of these theories.

Three of MAWC's theories turn on the scope of the Commission's decision in Case No. WA-97-46. In its Report and Order in that case, the Commission determined that building a new water treatment plant and related facilities in St. Joseph was a reasonable alternative. Therefore, Commission granted MAWC a certificate of public convenience and necessity, permitting it to go forward with the project. However, the Commission expressly reserved consideration of the prudence of MAWC's decision to go forward with a new plant for a later rate case:

That nothing in this Report and Order shall be considered a finding by the Commission of the prudence of either the proposed construction project or financial

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<sup>9</sup> Direct, p. 15, line 1, through p. 19, line 10.

<sup>10</sup> Direct, p. 2, line 1, through p. 4, line 18.

<sup>11</sup> Direct, p. 5, line 17, through p. 24, line 13; Surrebuttal, p. 2, line 1, through p. 12, line 9.

transaction, or the value of this transaction for ratemaking purposes, and the Commission reserves the right to consider the ratemaking treatment to be afforded the proposed construction project and financial transaction and their results in cost of capital in any future proceeding.

In the Matter of the Application of Missouri-American Water Company, Case Nos. WA-97-46 and WF-97-241 (Report & Order, issued October 9, 1997), Ordered Paragraph No. 5. The present case is that later rate case.

More importantly, the Commission expressly refused in Case No. WA-97-46 to pre-approve the new St. Joseph plant as MAWC had requested. Consequently, the testimony in question is not subject to being stricken as going to an already-decided issue: the issue has never been decided. Likewise, since those issues were not determined in Case No. WA-97-46, determination of them in this case is not prohibited by Section 386.550, RSMo 1994, as a collateral attack. Finally, for the same reason, the Commission is not equitably estopped from weighing the prudence of MAWC's decision in this case. There has been no detrimental reliance by MAWC on a position later repudiated by the Commission because the Commission had not yet determined that the decision was prudent.

MAWC's remaining ground for striking the subject testimony also relies on the theory of equitable estoppel: MAWC contends that Public Counsel and the SJ Industrials should be estopped from advocating positions in the present case contrary to those they took in Case No. WA-97-46. This argument fails for a number of reasons. First, the Commission is an administrative tribunal, not a court, and cannot do equity. See Soars v. Soars-Lovelace, Inc., 142 S.W.2d 866, 871 (Mo. 1940). Second, the law requires that the Commission consider all relevant factors in setting rates. See State ex rel. Midwest Gas Users' Association v. Public Service Commission, 976 S.W.2d 470, 479 (Mo. App., W.D. 1998); State ex rel. Missouri Water Co. v. Public Service Commission, 308 S.W.2d 704, 719

(Mo. 1957). Section 393.270.4, RSMo 1994, which defines the Commission's duties as to ratemaking, states:

In determining the price to be charged for gas, electricity, or water the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable rate of return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

This Commission "is purely a creature of statute" and its "powers are limited to those conferred by the [Missouri] statutes, either expressly, or by clear implication as necessary to carry out the powers specifically granted." State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 47 (Mo. banc 1979); State ex rel. City of West Plains v. Public Service Commission, 310 S.W.2d 925, 928 (Mo. banc 1958). Those powers include the duty to consider all relevant factors when setting just and reasonable rates.

In Kansas City Power & Light Co. v. Midland Realty Co., 93 S.W.2d 954, 959 (Mo. 1936), the Court stated that:

the statute purporting to preserve existing contracts does not operate to exempt such contracts from the scope of the exercise of the police power of the state to protect or promote the general or public welfare by regulating rates of public utilities so as to raise or lower, as the case may be, previously existing contract rates.

Likewise, estoppel cannot operate to render the police power of the state powerless to protect the general public. "[T]he authority of the Commission is referable to the police power of the State which power may never be abridged." St. ex rel. Public Service Commission v. Blair, 347 Mo. 220, 228, 146 S.W.2d 865, 868 (banc 1941).

In a similar case, a water company asserted that the Commission was equitably estopped from finding its water storage contract to be imprudent because, among other things, the Commission had approved the

contract prior to its execution. St. ex rel. Capital City Water Company v. Public Service Commission, 850 S.W.2d 903, 909 (Mo. App., W.D. 1993). The court held, "equitable estoppel is not applicable if it will interfere with the proper discharge of governmental duties, curtail the exercise of the state's police power or thwart public policy." *Id.*, at 910. Equitable estoppel only applies against the government where "the governmental action on which the claim is based constitutes affirmative misconduct." *Id.* MAWC has neither alleged nor shown affirmative misconduct here. See Lynn v. Director of Revenue, 689 S.W.2d 45, 49 (Mo. banc 1985); Coalition to Preserve Education v. Kansas City School District, 649 S.W.2d 533, 539 (Mo. App., W.D. 1983).

Likewise, the Missouri Court of Appeals has recently held that equitable estoppel will not lie to prevent the Commission from setting and regulating utility rates:

Equitable estoppel may run against the state, but only where there are exceptional circumstances and a manifest injustice will result. Equitable estoppel is not applicable if it will interfere with the proper discharge of governmental duties, curtail the exercise of the state's police power or thwart public policy, and is limited to those situations where public rights have to yield when private parties have greater equitable rights. The setting and regulation of utility rates by the PSC is a duty of state government.

Missouri Gas Energy v. Public Service Commission, 978 S.W.2d 434, 439 (Mo. App., W.D. 1998) (citations omitted).

Because the testimony which MAWC sought to strike is not, in fact, subject to being stricken for the reasons asserted by MAWC, the motion to strike must be denied. Likewise, MAWC's motion for summary judgment on the issue of prudence, which depended upon the motion to strike, is also denied.

## Discussion

Pursuant to the Commission's Order Adopting Procedural Schedule, the parties jointly developed a list of contested issues to be resolved by the Commission and filed position statements in which each party set out its position with respect to each of these issues:

1. St. Joseph Treatment Plant and Related Facilities Valuation:

What valuation should be included in rate base for the water treatment plant and related facilities necessary to provide water for the St. Joseph District?

2. St. Joseph Treatment Plant and Related Facilities Capacity:

What is the appropriate capacity for St. Joseph Treatment Plant and Related Facilities that should be included in rate base?

3. AFUDC Capitalization Rate:

Should MAWC's rate base be adjusted to reflect a different capitalization rate for AFUDC?

4. Accounting Authority Order (AAO):

Should MAWC be allowed to include in the cost of service, through rate base and expense adjustments, amounts related to post-in-service AFUDC and deferred depreciation expense for the period from the in-service date of the new St. Joseph water treatment plant to the operation of law date in this case?

5. Premature Retirement:

Shall the net plant investment associated with the existing St. Joseph water treatment plant facilities that are no longer providing service to St. Joseph customers be included in MAWC's rate base and amortized to expense?

6. Deferred Income Taxes:

Should MAWC's rate base be adjusted to reflect the amount of deferred taxes existing on the books of Missouri Cities Water Company prior to its acquisition by MAWC? If so, what is the appropriate adjustment?

7. Return on Equity:

What return on equity is appropriate for MAWC?

8. Rate Design:

a. Single Tariff Pricing, District Specific Pricing or Compromise:

Shall MAWC's rates be designed consistent with a single-tariff rate design, district-specific rate design, or some other methodology?

b. Phase-In:

Should MAWC's rate increase be phased in over a number of years? If so, what is the appropriate phase-in amount, and what is the appropriate phase-in period?

c. Allocation of Corporate District Expense:

What is the proper allocation of MAWC's corporate district investment and expense?

d. Allocation of Cost/Revenue Among Classes:

On what basis shall the portion of revenues to be borne by MAWC's various customer rate classes be determined?

There were also certain uncontested issues:

a. Sewer Rates:

Increase proposed of \$2,363.00.

b. Depreciation:

MAWC agrees to perform study prior to filing next rate case; to provide actuarial retirement histories to Staff in Gannett-Fleming format; to provide at least 15 years of cost of removal and gross salvage date.

c. Collection and Provision of Billing Information:

MAWC and Staff agree to cooperate in collecting and sharing billing information to be used for weather normalization.

d. Change to Monthly Billing in St. Joseph District:

The Commission will order MAWC to change to monthly meter reading and billing in its St. Joseph District.

e. Pension and Other Post-Retirement Employee Benefits:

MAWC agrees to make adjustments in determining revenue requirement, in future rate cases, using the methodology proposed by Staff, for pension and other post-retirement employee benefits expenses, which amortize unrealized gains and losses.

f. Capital Structure:

MAWC, Staff and Public Counsel have agreed to use the capital structure and embedded cost of preferred stock and long-term debt as of April 30, 2000, as described by Roberta McKiddy in her True-up Direct Testimony, Ex. 110.

### **Findings of Fact**

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

### **The Parties:**

MAWC is a public utility engaged in providing water service and sewer service to the public in the State of Missouri, subject to the jurisdiction of the Commission.

The Staff of the Commission is represented by the Commission's General Counsel, an employee of the Commission authorized by statute to "represent and appear for the Commission in all actions and proceedings involving this or any other law [involving the Commission.]" Section 386.071, RSMo 1994.<sup>12</sup>

The Public Counsel is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]" Sections 386.700 and 386.710.

Some of the remaining parties are political subdivisions located within MAWC's service areas and whose residents, in part or in whole, receive water service from MAWC.<sup>13</sup> Others are political subdivisions which purchase water from MAWC for resale to their residents.<sup>14</sup> Still others are industrial, commercial or institutional water customers of MAWC.<sup>15</sup> One is a competitor of MAWC.<sup>16</sup> Three others are industrial customers of a sister corporation of MAWC.<sup>17</sup> The final party is an association of trade unions.<sup>18</sup>

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<sup>12</sup> Unless otherwise specified, all statutory references herein are to the Revised Statutes of Missouri (RSMo), revision of 1994.

<sup>13</sup> The cities of Joplin, Mexico, O'Fallon, Riverside, St. Joseph, St. Peters, Warrensburg, and Weldon Spring, and St. Charles County.

<sup>14</sup> The St. Joseph Area PWSD Intervenor, including PWSD Nos. 1 and 2 of Andrew County, PWSD No. 1 of DeKalb County, and PWSD No. 1 of Buchanan County

<sup>15</sup> AGP, Central Missouri State University, Friskies, Harmon Industries, Hawker Energy, Stahl Specialty, Swisher Mower & Machine, and Wire Rope.

<sup>16</sup> PWSD No. 1 of St. Charles County.

<sup>17</sup> MIEC, comprised of Boeing, Ford Motor Co., and Hussman Refrigeration, customers of St. Louis County Water Company.

<sup>18</sup> St. Joseph Building & Construction Trades Council.



## **The Company:**

MAWC provides public water service to 94,962 customers in seven, noncontiguous districts in Missouri, and public sewer service to 101 customers in one district.<sup>19</sup> MAWC acquired all of these districts, except Joplin and St. Joseph, by its purchase on August 31, 1993, of Missouri Cities Water Company and subsequent merger. MAWC paid \$15.9 million for the common stock of MCWC. MAWC's water customers are organized into six classes on the basis of the use made of the water and the nature of the customer, as follows:

### **Number of Customers in Each Class in Each District:**

District	Residential	Commercial	Industrial	O.P.A. <sup>20</sup>	Resale	Pvt. Fire
Brunswick	398	73	3	6	1	5
Joplin	18,502	3,085	60	135	8	268
Mexico	4,321	479	13	99	2	63
Parkville	4,043	303	11	45	3	60
St. Charles	25,002	807	2	59	0	101
St. Joseph	27,237	3,188	107	191	11	334
Warrensburg	5,207	587	14	127	2	60
TOTAL:	84,710	8,522	210	662	27	891

Additionally, MAWC treats its corporate headquarters as a separate district and attributes certain assets, income and expenses to it.

Pursuant to the rates approved by this Commission, effective November 14, 1997, MAWC realized revenue from its public water service and public sewer service operations, and incurred operational expenses, on an annual basis as follows:<sup>21</sup>

<sup>19</sup> The single sewer district is Parkville.

<sup>20</sup> "O.P.A." stands for "other public authority."

<sup>21</sup> For the twelve months ended September 30, 1999 (the "test year"), adjusted for known and measurable changes through December 30, 1999, and trued-up with respect to certain quantities as of April 30, 2000.

### Assets, Income and Expenses by District:

District <sup>22</sup>	Assets (Dollars)	Income (Dollars)	Expense <sup>23</sup> (Dollars)	Net Income (Dollars)	Net Income (% of Assets)
Brunswick	805,489	112,039	227,994	-115,955	-14.3956
Joplin	19,491,941	7,491,426	5,391,985	2,099,441	10.7708
Mexico	11,306,701	1,557,551	1,423,061	134,490	1.1894
Parkville Water	8,231,735	1,514,285	1,498,226	16,059	0.1951
St. Charles	24,297,209	7,941,428	6,072,223	1,869,205	7.6931
St. Joseph	84,259,978	9,989,687	8,095,364	1,894,323	2.2481
Warrensburg	8,774,520	1,867,376	1,428,373	439,003	5.0031
TOTAL WATER:	157,167,573	30,473,792	24,137,226	6,336,566	4.0317
Parkville Sewer <sup>24</sup>	39,691	47,196	90,381	-43,185	-109.0778
TOTAL COMPANY:	157,207,264	30,520,988	24,227,607	6,293,381	4.0032

Although MAWC earned sufficient annual revenue, based on the test year, to meet its obligations and to realize a net profit on its Missouri operations, its actual effective rate of return on its assets dedicated to public service was only 4.0032 percent. On October 15, 1999, therefore, MAWC filed its proposed tariff sheets seeking an additional \$16,446,277 in water service revenue, an increase of 53.97 percent, and an additional \$2,363 in sewer service revenue, an increase of 5.0 percent, which would yield a rate of return of approximately 11.0 percent.<sup>25</sup> In support of its request for a rate increase, MAWC pointed out that it had invested approximately \$96,000,000 in additional water service assets, including about \$74,684,000 for a new water treatment plant, pipeline and well field in St. Joseph; \$4,500,000 for a hydrogen sulfide removal plant in

<sup>22</sup> The corporate district is not shown because its assets, income and expenses are here allocated to the operating districts and included in their figures.

<sup>23</sup> Including operating expenses, other operating expenses, and income taxes.

<sup>24</sup> In considering the Parkville Sewer figures, it is important to note that the system was operated at a loss of only \$6,239 before income taxes and that most of the negative Net Operating Income figure results from a deduction of \$41,351 in deferred income taxes.

<sup>25</sup> Calculated as follows: \$6,293,381 plus 66% of the increase (a "gross down" for income taxes; \$16,446,277 + \$2,363 = \$16,448,640 x 0.66 = \$10,856,102) equals \$17,149,483, which is 10.909 percent of \$157,207,264.

Warrensburg; and \$5,050,000 for plant improvements in Mexico.<sup>26</sup> MAWC further stated:

Missouri-American must have income to sufficiently and properly provide for all expenses of an efficient public utility, to market its securities, to attract replacement capital for maturing debt and to attract new capital, all at reasonable costs. The rates presently charged by the Company are insufficient to meet its requirements, because they no longer are compensatory and are therefore unfair, unreasonable and unjust.

*Statement of Reason for Rate Increase, filed on October 15, 1999.*

### **Capital Structure and Return on Equity:**

Historically, MAWC's dividend-payout ratio has varied from a high of 94.31 percent in 1994 to a low of 69.97 percent in 1998. MAWC's dividend-payout ratio has averaged 75.00 percent over the last two years. MAWC's return on year-end common equity steadily increased from 7.95 percent in 1994 to 11.18 percent in 1996, with a decline to 9.40 percent by 1998. MAWC's 1998 return on year-end common equity of 9.40 percent was below the average of 10.40 percent earned by other water utilities according to The Value Line Investment Survey: Ratings & Reports, February 4, 2000. Value Line also estimates that the water utility industry will earn 11.00 percent return on equity for both 1999 and 2000.

MAWC's pre-tax interest coverage ratio for 1998 was 2.21 times, which is below the industry average of 3.12 times as reported by Edward Jones & Company's Financial & Common Stock Information - Water Utility Industry, June 30, 1999.

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<sup>26</sup> The cited improvements amount only to \$84,234,000.

As of April 30, 2000, MAWC's capital structure was as follows:

Common stock equity:	\$ 62,693,188	42.27 percent
Preferred Stock:	2,702,806	01.69 percent
Short-term Debt:	0	0 percent
Long-term Debt:	<u>89,765,483</u>	<u>56.05 percent</u>
	\$160,161,477	100.00 percent

The embedded cost of preferred stock on that date was 9.09 percent. The embedded cost of long-term debt was 6.77 percent. Because MAWC's common stock is not publicly traded, its cost of common equity cannot be determined using standard methods. However, the common stock of MAWC's parent, American Water Works Company (AWWC), is publicly traded. Staff expert Roberta McKiddy testified that she used the Discounted Cash Flow (DCF) method to determine AWWC's cost of common equity, and then applied that value to its wholly owned subsidiary, MAWC. This attribution was reasonable, Ms. McKiddy testified, because AWWC and MAWC are in the same line of business and have comparable capital structures. McKiddy testified, and the Commission finds, that MAWC and AWWC have a similar level of risk. Ms. McKiddy's calculation resulted in a range of figures, from 9.5 percent to 10.75 percent. The result is expressed as a range, rather than as a single value, because the growth rate variable used by Ms. McKiddy was a range rather than a single value.

As a check on the cost of equity determined by the method above, Ms. McKiddy performed a risk premium cost of equity analysis for AWWC. The result was a range between 10.70 percent and 10.94 percent. Ms. McKiddy also performed a capital asset pricing model analysis for AWWC, and produced a range between 9.30 percent and 9.82 percent.

Ms. McKiddy testified that the return on equity range that she proposes for MAWC, 9.50 percent to 10.75 percent, yields a pre-tax interest coverage ratio range of 2.79 times to 3.02 times. This range is in line

with Standard & Poor's "A" rating and "Average" business position water utilities benchmark of 2.95 times. Ms. McKiddy further testified that the low end of her suggested range permits MAWC to meet its Net Earnings Requirement of one and one-half times the annual interest requirements pursuant to provisions of its Supplemental Indenture.

### **Deferred Income Taxes:**

In 1993, MAWC purchased Missouri Cities Water Company (MCWC) from its parent, Avatar. The Commission approved the acquisition in Case No. WM-93-255. MCWC had an amount on its books for deferred income taxes, which amount remained with Avatar and was not acquired by MAWC. The effect for ratepayers was an increase in rate base, and thus in rates. Staff has proposed to reduce rate base by \$712,191 to reflect these deferred income taxes.

### **The New St. Joseph Water Treatment Plant and Related Facilities:**

On November 6, 1997, when the Commission issued its Report and Order concluding MAWC's last rate case, the new treatment plant and related facilities in St. Joseph were planned, but work had not yet started. In the Matter of Missouri-American Water Company's Tariffs Designed to Increase Rates for Water Service Provided to Customers in the Missouri Service Area of the Company, Case Nos. WR-97-237, SR-97-238, WO-97-249 (Report & Order, issued November 6, 1997), at page 9. The cost of the planned project was estimated at about \$76,000,000.<sup>27</sup> *Id.*, at page 10.

An important factor in MAWC's decision to build the new St. Joseph Water Treatment Plant and related facilities was the flood of the Missouri River in the summer of 1993. That flood was unprecedented in size; it surpassed the previous record high water level at St. Joseph, set in 1881, by 5.5 feet. The flood caused MAWC's existing water treatment plant in

<sup>27</sup> Specifically, \$74,684,000.

St. Joseph to cease operation for four days. Water initially entered the plant in 1993 from the landward side, where a ballasted railroad embankment prevented MAWC from erecting a levee. For some days before the plant flooded, the high water conditions prevented normal entry and egress of the plant and chemicals and personnel had to be delivered to the plant by boat. MAWC considered this practice to be unduly hazardous to its employees. This problem also seriously impaired MAWC's ability to flood-proof the old plant. In 1989, an unusually low river level had also caused the old St. Joseph plant to cease operations for some days.

MAWC's existing water treatment plant in St. Joseph was located in the flood plain, four miles north of the city, directly adjacent to the river. It drew its water supply from the river and was, consequently, subject to interference by both high water and low water river conditions. Some parts of the structure were over 100 years old.<sup>28</sup> A riverine water source poses public health concerns not encountered with well water. Additional processing is necessary to remove dangerous organisms and agricultural chemical runoff from the water.

The old plant included two raw water intakes, raw and finished water pumping equipment, pre-sedimentation clarifiers, flocculation and sedimentation basins, filtration, chemical feed systems, and finished water storage. Its rated capacity was 21 million gallons daily, although this capacity was historically exceeded from time to time. Its site was selected because of convenient access to the river, to the railroad, and to adjacent 300 foot high bluffs where finished water was stored in a reservoir. Gravity fed water from the reservoir to the city distribution system. Coal-fired steam boilers originally provided power for drawing water from the river and pumping it up to the reservoir; they were eventually replaced with electric pumps in 1963.

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<sup>28</sup> Construction began on the old plant in 1881.

The old plant was modified and renovated numerous times after 1881. Sedimentation basins and rapid sand filters were added. Chemical and flocculation facilities were added. Numerous modifications were made to the raw water intakes. However, many additional renovations and improvements were needed by 1996. Filter and pump equipment were outdated and close to the end of their useful lives; filter capacity was deficient. Chlorine handling was unsatisfactory and potentially very dangerous, due to inadequacies in the chemical facilities. The extreme turbidity of the river water, and the large amount of sediment dissolved in it, required numerous additional treatment steps, some of which were difficult given the design of the plant. The water quality laboratory facilities were inadequate and were a fire hazard. The old plant returned to the river the impurities and toxins removed during the treatment process. Increasingly stringent federal standards were expected to require the construction and operation of a waste treatment facility to treat this effluent in the near future. Likewise, increasingly stringent processing to remove biological toxins was also likely to be required. It was not clear whether the road to the plant could be improved or replaced. Finally, the river water presented ongoing aesthetic problems that proved difficult to resolve. Some of these conditions could not be remedied at the existing plant location.

While MAWC planned to renovate and upgrade its existing St. Joseph plant prior to 1993, it changed its plan in the light of the flood and determined to build a new plant, with a new supply source, above the limit of the flood. At the height of the flood in August 1993, the design work on a renovation of the old plant was about 30 percent complete. At about that time, in May 1993, the construction costs alone of the proposed renovation project were estimated at \$26,630,000 (in 1993 dollars). This estimate did not include AFUDC, engineering costs, other project management

costs, or subsequent improvements. A revised total project cost estimate, prepared in June 1993 and based upon the May 1993 construction cost estimate, amounted to \$44,100,000 (in 1993 dollars). This figure did not include an intake, low service pumps, a third pre-sedimentation clarifier, ozonation, flood protection, switchgear for the distributive pumps, or replacement of the distributive pumps.

In late 1995, when MAWC determined that the cost of necessary improvements to the old plant almost equaled the cost of a new one, MAWC decided to pursue the new plant and new water supply source option.<sup>29</sup> This option was selected by MAWC from among four options: (1) improvements to the existing surface water plant; (2) new surface water plant; (3) new ground water plant; and (4) interconnection with Kansas City. These four options were first proposed in December 1994, following the 1993 flood, in a planning study. In 1996, a detailed feasibility study was produced to formally present the various factors considered by MAWC in evaluating the economic aspects of each of the four options.

In addition to the serious limitations and problems of the old plant itself, ground water is superior to river water as a source of public drinking water for a number of reasons. Its characteristics, such as temperature, hardness, mineral content, organic content, and turbidity are much more consistent. Rapid changes do not occur and such changes as do occur happen slowly. River water, on the other hand, is subject to drastic, rapid changes with respect to these characteristics. Dangerous organisms, such as chlorine-resistant *cryptosporidium* and *lamblia giardia*, are more common in river water than in ground water.

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<sup>29</sup> MAWC's 1996 Feasibility Study compared the estimated cost of renovation of the old plant, at \$63,300,000, to the estimated cost of the new plant (without AFUDC) at \$63,700,000 (1995 dollars).



MAWC's new St. Joseph water treatment plant and its related facilities--well field and pipeline--were constructed for a total project cost of \$70,097,840, which is several million dollars less than the estimated cost of the project. The new plant is located above the flood plain. It draws its water supply from an alluvial well field. These wells, while close enough to the Missouri River that they are recharged by it, are located more than 200 feet away from it and, consequently, are free from certain public health dangers posed by river water.<sup>30</sup> The new plant is largely automated and is designed to operate with a minimum number of employees present. This feature is possible only with raw water of consistent characteristics, that is, ground water.

The new plant has a firm capacity of 30 million gallons of water daily, of which 28.5 million gallons are available for distribution; the remaining 1.5 million gallons are used by the plant for its internal purposes. "Firm capacity" means that the plant can operate at the rated capacity even with the largest unit of any major component out of service. With every component in service at operating at rated capacity, the plant's daily capacity is 36,288,000 gallons daily. However, for the first year of operation, the Missouri Department of Natural Resources (DNR) has imposed a limitation on the plant so that it will operate at a firm capacity of only 21,600,000 gallons daily; 25,920,000 if all components are on-line.<sup>31</sup>

Peak day demand in St. Joseph has consistently been 23.0 million gallons daily for some years; average daily demand in 1999 was 16.0 million gallons. In 1991, with about 3,000 fewer customers, MAWC pumped

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<sup>30</sup> Much attention was paid at hearing to the question of whether or not the water from the new well field is to be classified as "ground water under the influence of surface water." It is clear from the licensing documents for the new facilities that the water is not to be so classified.

<sup>31</sup> These calculations have to do with the plant's filters. There are six filters, each with a surface area of 750 feet. They are rated at 5.6 gallons per minute per foot; however, DNR will not permit operation at more than 4.0 gallons per minute per foot for the first year.

25.6 million gallons per day in St. Joseph. MAWC projects maximum day demand for the St. Joseph district in 2009 to be 27.7 million gallons daily. MAWC used 2009 as the design year for the new plant. The Design Guide for Community Public Water Supplies of the Missouri Department of Natural Resources (DNR), at section 2.1, states that "[t]he system shall be designed for maximum day demand at the design year."

The peak day demand of 23.0 million gallons daily that the plant is presently producing could have been met with only five vertical wells at the well field, rather than seven; two clarifiers rather than three; and three 300-horsepower distributive pumps rather than two 300-horsepower pumps and two 200-horsepower pumps which MAWC actually installed. The clearwell could have been constructed as two 750,000 gallon units rather than as two 1,000,000 gallon units. The aggregate capital cost represented by these unnecessary items is \$2,271,756.

During the construction in St. Joseph, beginning on November 14, 1997, and continuing until April 30, 2000, MAWC capitalized AFUDC with respect to the new plant using the rate of return authorized in its most recent rate case, Case No. WR-97-237. MAWC typically uses short-term debt to finance construction projects. On December 31, 1999, MAWC had approximately \$35 million outstanding in short-term debt. The adjustment of MAWC's pre-in-service AFUDC to reflect the carrying charges of its short-term debt would mean a reduction of rate base of \$1,289,674.

The St. Joseph project entered service on April 30, 1999, approximately four and one-half months prior to the earliest date on which the new construction could be included in rate base. Under the Uniform System of Accounts (USOA), made mandatory by Commission Rule 4 CSR 240-50.030(1), MAWC was required to start depreciating the new St. Joseph facilities, and to stop capitalizing the associated carrying costs, as of the in-service date. These expense items, depreciation and carrying costs,

amount to an aggregate of \$319,000 monthly, and \$1.6 million over the four and one-half month period. If these deferred items were entirely disallowed by the Commission, MAWC's return on equity for 12-month periods ending on the last day of April, May, June, July, August, and September, 2000, would fluctuate between 9.14 percent and 13.71 percent. For the same periods, MAWC's interest coverage ratios would fluctuate between 3.33 times to 2.72 times.

On the day that the old St. Joseph plant was taken out of service, its value was \$2,832,906. Its original book value was \$6,885,094 and accumulated depreciation by April 1, 2000, equaled \$4,052,188. MAWC estimated that it would cost about \$500,000 to retire the old St. Joseph plant. Mr. Young testified in June 2000 that the old plant had been demolished.

### **Other New Construction:**

In addition to the new facilities in St. Joseph, MAWC also made capital investments and built new, or improved old, facilities in Warrensburg, Mexico, Joplin, and Parkville.

In Warrensburg, MAWC added ozonation and phosphate sequestration processes to its treatment plant in order to address aesthetic concerns; the cost was \$3,950,000. These concerns centered on hydrogen sulfide odors and scaling. MAWC also added an additional well with necessary equipment and facilities. Hydrological studies and several test wells were necessary as part of this project to ensure acceptable water quality. The cost was \$950,000, for a total Warrensburg cost of \$4,900,000.

In Mexico, MAWC refurbished its existing plant and increased its capacity from 3.0 million gallons daily to 4.5 million gallons daily. A new lime feed building with two feeders was installed, together with a new lime storage facility; a new mixing-chamber and flocculator were installed;

as well as two new concrete settling basins, a third sand filter, a filter surface wash system, a fourth high service pump, and new controls and monitors. Finally, MAWC also added an additional well and raw water main in Mexico. The cost of the Mexico project was \$5,050,000.

In the Parkville district, MAWC constructed a new water tank and booster station. MAWC also automated the water treatment plant, installed a new chlorine storage and feed system and chlorine scrubber, replaced the lime feeder and slaker, installed an ammonia storage and feed system, upgraded the plant water system, and installed an ion exchange water softener. These new facilities will increase total water supply in that district. The cost of the water tank and booster station was \$2,338,000 and the cost of the plant automation was \$1,828,535, for a total of \$4,166,535.

In Joplin, a dam on Shoal Creek, which creates an impoundment used as a source of supply, was reinforced and refurbished. This project cost \$225,000.

All of these facilities are now in service. Staff engineer Jim Merciel testified that each of these projects was reasonable and necessary. The aggregate cost of these facilities is \$14,341,535.

### **Conclusions of Law**

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

#### **Jurisdiction:**

The Missouri Public Service Commission has jurisdiction over MAWC's services, activities, and rates pursuant to Section 386.250 and Chapter 393, RSMo.

## **Burden of Proof:**

Section 393.150.2 provides in part, "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . water corporation or sewer corporation, and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

## **Applicable Statutes and Legal Standards:**

The Missouri Public Service Commission was created by the General Assembly in 1913. State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 49 (Mo. banc 1979). The General Assembly delegated to the Commission the police power to establish utility rates, subject to judicial review of the question of reasonableness. State ex rel. City of Harrisonville v. Public Service Commission of Missouri, 291 Mo. 432, 236 S.W. 852 (1922); City of Fulton v. Public Service Commission, 275 Mo. 67, 204 S.W. 386 (1918), *error dis'd* 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; City of St. Louis v. Public Service Commission of Missouri, 276 Mo. 509, 207 S.W. 799 (1919); Kansas City v. Public Service Commission of Missouri, 276 Mo. 539, 210 S.W. 381 (1919), *error dis'd* 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; Lightfoot v. City of Springfield, 361 Mo. 659, 236 S.W.2d 348 (1951).

The Commission's purpose is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity. *Id.*; May Dep't Stores Co. v. Union Electric Light & Power Co., 341 Mo. 299, 107 S.W.2d 41, 48 (1937). While "the dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental," State ex rel. Crown Coach Co. v. Public Service Commission, 238 Mo. App.

287, \_\_\_, 179 S.W.2d 123, 126 (1944), the Commission must also permit the utility to recover a "just and reasonable" return on the assets it has devoted to the public service. Utility Consumers' Council, 585 S.W.2d at 49. "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment." State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

In 1925, the Missouri Supreme Court stated:

The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. \* \* \* These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

State ex rel. Washington University et al. v. Public Service Commission et al., 308 Mo. 328, 344-45, 272 S.W. 971, 973 (en banc).

The Public Service Commission has exclusive jurisdiction to establish public utility rates. May Department Stores Co. v. Union Electric Light & Power Co., 341 Mo. 299, \_\_\_, 107 S.W.2d 41, 57 (1937). A public utility has no right to fix its own rates and cannot charge or collect rates that have not been established by the Public Service Commission, *Id.*; neither can a public utility change its rates without first seeking authority from the Commission. Deaconess Manor Ass'n v. Public Service Com'n, 994 S.W.2d 602, 610 (Mo. App., W.D. 1999). A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and

reasonable. May Department Stores, supra, 341 Mo. at \_\_\_, 107 S.W.2d at 50.

Section 393.130, in pertinent part, requires a utility company's charges to be just and reasonable and not in excess of charges allowed by law or by order of the commission. Section 393.140 authorizes the Commission to determine just and reasonable rates. A "just and reasonable" rate is one that is just and reasonable to both the utility and its customers. State ex rel. Valley Sewage Co. v. Public Service Commission, 515 S.W.2d 845 (Mo. App., K.C.D. 1974). A just and reasonable rate is no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested." State ex rel. Washington University, supra.

Section 393.150, in pertinent part, authorizes the Commission to suspend for a period of time any schedule stating new rates, charges, rules, regulations, or practices, and to hold "a hearing concerning the propriety of such rate, charge, . . . rule, regulation or practice." Section 393.270 provides in paragraph 4 that in determining the price to be charged, "the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question . . . ." The courts have held that this statute means that the Commission's determination of the proper rate must be based on consideration of all relevant factors. State ex rel. Missouri Water Co. v. Public Service Comm'n, 308 S.W.2d 704, 719 (Mo. 1957); State ex rel. Midwest Gas Users' Ass'n v. Public Service Commission, 976 S.W.2d 470, 479 (Mo. App., W.D. 1998); State ex rel. Office of Public Counsel v. Public Service Com'n of Missouri, 858 S.W.2d 806 (Mo. App., W.D. 1993). Section 393.230.1 authorizes the Commission to value the property of water and sewer utilities in Missouri.

Finally, Section 393.270 provides:

\* \* \*

2. After a hearing and after such investigation as shall have been made by the commission or its officers, agents, examiners or inspectors, the commission within lawful limits may, by order, fix the maximum price of . . . water or sewer service not exceeding that fixed by statute to be charged by such corporation or person, for the service to be furnished; and may order such improvement . . . in the distribution or supply of water, in the collection, carriage, treatment and disposal of sewage, or in the methods employed by such persons or corporation as will in its judgment be adequate, just and reasonable.

3. The price fixed by the commission under sections 393.110 to 393.285 shall be the maximum price to be charged by such corporation or person for . . . water for the service to be furnished within the territory and for a period to be fixed by the commission in the order, not exceeding three years, except in the case of a sliding scale, and thereafter until the commission shall, upon its own motion or upon the complaint of any corporation or person interested, fix a higher or lower maximum price of . . . water or sewer service to be thereafter charged.

4. In determining the price to be charged for . . . water the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable average return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

5. In determining the price to be charged for sewer service the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable average return upon the value of the property actually used in the public service and to the necessity of making reservations out of income for surplus and contingencies.

### **Uncontested Issues:**

MAWC submitted its Joint Recommendation with respect to certain uncontested issues. These include: a rate increase for sewer service amounting to \$2,363.00; the performance by MAWC of a depreciation study



prior to its next rate case and its sharing of certain depreciation and weather normalization information with Staff; the change to monthly meter reading and billing in the St. Joseph District; and changes by MAWC with respect to the determination of revenue requirement associated with pensions and other post-retirement employee benefits. No party objected to the Joint Recommendation.

### **The New St. Joseph Plant--Valuation:**

Several parties, notably the SJ Industrials and Public Counsel, question the prudence of MAWC's decision to build a new treatment plant in St. Joseph and contend that only the cost of renovating the old plant should be included in rate base. Based on the estimations made by the expert witnesses sponsored by the SJ Industrials and Public Counsel, this would amount to a disallowance of approximately half the cost of the new plant and related facilities, that is, about \$35,000,000.

As a preliminary matter, MAWC contends that this prudence issue has already been litigated and determined by the Commission in MAWC's favor. MAWC is incorrect and evidently misunderstands the Commission decision upon which it relies.

MAWC relies on the Commission's prior decision, In the Matter of Missouri-American Water Company, Case Nos. WA-97-46 and WF-97-241 (*Report and Order*, issued October 9, 1997), which has already been discussed herein in connection with MAWC's motion to strike. In that pair of cases, MAWC sought a certificate of public convenience and necessity for the new project, necessary because it is located in part outside of MAWC's original St. Joseph service area, as well as approval of the financing for the project. MAWC attempted in that case to also secure preapproval by the Commission of the project. However, after a lengthy analysis, the Commission refused to preapprove the project, stating:

Therefore, the Commission will make no finding regarding the prudence of the actual costs incurred and the management of construction of the proposed project. However, based on the extensive evidence presented, the Commission finds that the proposed project, consisting of the facilities for a new groundwater source of supply and treatment at a remote site, is a reasonable alternative.

Missouri-American Water Company, *supra*, at page 11 (internet version). This language, together with the reservation of ratemaking treatment in Ordered Paragraph No. 5, already quoted in full herein, make it plain that the Commission purported to do no more in Case Nos. WA-97-46 and WF-97-241, than to grant a certificate of public convenience and necessity and to approve a proposed scheme of financing.

We turn now to the issue of prudence. The Commission has previously had occasion to inquire into the reasonableness of a transaction or other decision made by a public utility. State ex rel. Capital City Water Co. v. Missouri Public Service Commission, 850 S.W.2d 903, 912 (Mo. App., W.D. 1993); State ex rel. General Telephone Company v. Public Service Commission, 537 S.W.2d 655, 664 (Mo. App., W.D. 1976). The Commission's power and duty to inquire into the reasonableness of the conduct or decision in question includes the right to determine a reasonable standard of judgment consistent with statutory and constitutional limitations. *Id.*

The Federal Power Act imposes on the Company the "burden of proof to show that the increased rate or charge is just and reasonable." Edison relies on Supreme Court precedent for the proposition that a utility's cost are [sic] presumed to be prudently incurred. However, the presumption does not survive "a showing of inefficiency or improvidence." As the Commission has explained, "utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent . . . However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent."

In the Matter of Union Electric Company, 27 Mo.P.S.C. (N.S.) 183, 193 (1985) (*quoting Anaheim, Riverside, etc. v. Federal Energy Regulatory Commission*, 669 F.2d 779, (D.C. Cir. 1981)) (citations omitted).

The Commission has adopted a standard of reasonable care requiring due diligence as the standard for evaluating the prudence of a utility's conduct. Union Electric, 27 Mo.P.S.C. (N.S.) at 194. The Commission has described this standard as follows: "The Commission will assess management decisions at the time they are made and ask the question, 'Given all the surrounding circumstances existing at the time, did management use due diligence to address all relevant factors and information known or available to it when it assessed the situation?'" *Id.*

To recapitulate: In the context of a rate case, the parties challenging the conduct, decision, transaction, or expenditures of a utility have the initial burden of showing inefficiency or improvidence, thereby defeating the presumption of prudence accorded the utility. The utility then has the burden of showing that the challenged items were indeed prudent. Prudence is measured by the standard of reasonable care requiring due diligence, based on the circumstances that existed at the time the challenged item occurred, including what the utility's management knew or should have known. In making this analysis, the Commission is mindful that "[t]he company has a lawful right to manage its own affairs and conduct its business in any way it may choose, provided that in so doing it does not injuriously affect the public." State ex rel. City of St. Joseph v. Public Service Commission, 325 Mo. 209, 223, 30 S.W.2d 8, 14 (banc 1930). The Commission notes, as well, that the burden of a public utility engaged in building a new plant is "to build the best plant at the lowest cost." Union Electric, *supra*, at 208.

Turning to the case at hand, we first ask whether the challengers herein have made a showing of inefficiency or improvidence sufficient to require MAWC to prove the prudence of its decision? In Union Electric, *supra*, for example, the sufficient showing was a two billion dollar cost overrun. *Id.*, at 193.

The challengers attempted to make this showing through the expert testimony of Charles D. Morris, Ph.D., and Ted Biddy. Dr. Morris, sponsored by the SJ Industrials, is a professor of engineering at the University of Missouri-Rolla. Dr. Morris teaches the design of water treatment plants and has participated in many such projects. Dr. Morris testified that, in his expert opinion, MAWC's decision to replace an existing and operational plant and riverine source was imprudent. Dr. Morris further testified that, in his opinion, MAWC inflated its estimates of the cost of renovating and improving the old plant in order to justify its decision. Dr. Morris opined that \$40.3 million dollars would have sufficed to flood-proof and renovate the old St. Joseph plant.

Ted Biddy is a civil engineer and surveyor. He has served as supervising engineer on a number of water treatment and wastewater treatment projects. Mr. Biddy testified that, in his professional opinion, MAWC's decision to build a new treatment plant and to develop a new ground water supply source "was not prudent at all" and was undertaken in the absence of "detailed studies of the engineering and economic feasibility of expanding and upgrading the existing plant to meet functional requirements at a cost-effective price." Mr. Biddy opined that \$36.3 million would have been sufficient to renovate and improve the old St. Joseph plant.

On cross-examination, Mr. Biddy admitted that he had never designed a water treatment plant supplying public drinking water from a surface water source. He had participated in the 1960s, as one of six design engineers, in the design and construction of a large surface water

plant that produced non-potable water for industrial cooling. In 37 years of practice, this was the extent of his experience with surface water treatment. He had not studied the soil conditions at the old plant site to determine whether or not a levee could be undermined.

On cross-examination, Dr. Morris admitted that his figures represented preliminary cost estimates, based on experience rather than on detailed design and engineering analysis. He admitted that any levee or flood-proofing work at the old plant site would require detailed soil analyses, in apparent contradiction to Mr. Bidby's position.

Jim Merciel of the Commission Staff testified in rebuttal to Mr. Bidby and Dr. Morris. Mr. Merciel testified that, in his opinion, MAWC would have been imprudent to retain the existing St. Joseph plant in operation. Mr. Merciel reviewed Mr. Bidby's proposed improvements to the old plant and found them to be inadequate. Mr. Merciel suggested that Mr. Bidby had not estimated the price of his proposed alternative properly and that Mr. Bidby's estimate was too low.

Likewise, Mr. Merciel criticized the figures proposed by Dr. Morris. For example, Dr. Morris believed that certain figures derived from a Company document included costs for residuals handling when, in fact, they did not. Dr. Morris proposed significantly more construction than did Mr. Bidby, for not much more money. Mr. Merciel testified that this discrepancy caused him to doubt Dr. Morris' estimates. Mr. Merciel also testified that Dr. Morris unreasonably discounted the flood risk at the old plant site. John Young, an engineer employed by an affiliate of MAWC, criticized other aspects of Dr. Morris' cost estimates, such as his failure to include any amounts for project administration, construction supervision, inspection, material testing, shop drawing review, and the like. Mr. Young also criticized Dr. Morris' failure to recognize the cost impact of AFUDC. Mr. Young noted that, including AFUDC, all

nonconstruction-related costs would likely amount to 30 to 35 percent of construction costs. Dr. Morris estimated \$3.0 million for a new river intake, whereas, according to Mr. Young, American Water System is presently building a smaller intake at Alton, Illinois, for about \$6.0 million. Finally, Mr. Young criticized Dr. Morris' five percent contingency figure as inadequate for a preliminary cost estimate. Mr. Young testified that 20 percent was a more realistic figure for that type of rough cost projection. Mr. Young testified that Mr. Bidy and Dr. Morris both had proposed improvements and renovations of inadequate scope and that they both had underestimated both construction costs and nonconstruction costs.

The Commission finds the testimony of Mr. Merciel and Mr. Young to be credible and persuasive. Additionally, the Commission notes that Mr. Bidy was shown on cross-examination to be inexperienced in the design of surface water treatment plants. Both Mr. Bidy and Dr. Morris were shown on cross-examination to have misunderstood planning and financial documents obtained from the Company through discovery. Both Mr. Bidy and Dr. Morris relied on very rough and preliminary cost figures which they used as a basis to criticize the far more detailed estimates developed by MAWC. Under all the circumstances, the Commission finds the cost estimates of Mr. Bidy and Dr. Morris to not be credible. The Commission finds that Dr. Morris has not substantiated his allegation that MAWC purposefully understated the cost of the ground water source/new treatment plant option. The Commission expressly finds the testimony of Bidy and Morris to lack credibility and to be unpersuasive.

The Commission concludes that the challengers have not made a showing of inefficiency or improvidence sufficient to require MAWC to prove the prudence of its decision. Nonetheless, evidence was tendered on this question and the Commission will consider it under the reasonable care requiring due diligence standard.

The record shows that MAWC was aware in late 1995, when the decision to build the new St. Joseph plant and related facilities was made, that extensive renovations and improvements were needed in St. Joseph. The nature of the existing plant site made some of these renovations and improvements difficult, or perhaps impossible. The regulatory and environmental outlook was such that the use of a riverine source, and the return of residuals to that source, would necessarily result in ever-increasing costs to the company. There were aesthetic problems with the river water that could not be readily resolved. Finally, the flood of 1993 demonstrated that the reliability of St. Joseph's public water supply could not be assured in the case of a treatment plant located in the flood plain.

MAWC assessed four options, one being to renovate and improve the existing plant, and another, that ultimately selected, being the construction of a new plant above the flood plain, the development of a ground water source of supply, and a pipeline linking the two. The other options were a new surface water treatment plant above the flood plain and interconnection with the Kansas City system. The preliminary numbers developed by MAWC suggested that the ground water source/new plant option was about as expensive as any of the other options, and perhaps less expensive than some of them. This option would include all the benefits associated with a ground water supply source: consistent raw water characteristics; diminished public health concern with organisms and other toxins; easier control of aesthetic factors, among others. Likewise, this option would remove the threat posed by another flood.

On the basis of the record made in this case, the Commission finds and concludes that the management of MAWC did use due diligence to address all relevant factors and information known or available to it when it assessed the situation and reached the decision to build a new treatment

plant and develop a new ground water source of supply in St. Joseph. Consequently, the Commission must conclude that the decision to build the new plant and related facilities was not imprudent. Therefore, the total project cost of \$70,097,840 shall be recognized in rate base.

The reasonable care test does not ask, and the Commission does not conclude, that the decision actually made by management was the best possible decision. "In accepting a reasonable care standard, the Commission does not adopt a standard of perfection." Union Electric, supra, at 194. Neither does the test ask whether the members of the Commission would have made the same decision were they controlling the company. The Commission's authority to regulate does not include a right to dictate the manner in which a company shall conduct its business. State ex rel. Kansas City Transit, Inc. v. Public Service Commission, 406 S.W.2d 5, 11 (Mo. banc 1966).

### **The New St. Joseph Plant--Capacity:**

The Staff contends that not all of the capacity of the new plant and related facilities is presently used and useful and that the sum of \$2,271,756 should consequently be excluded from rate base. Public Counsel proposes that 19.55 percent of the cost of the new St. Joseph plant and related facilities should be excluded from rate base, based on Mr. Biddy's estimate that only 80.45 percent of the new plant is used and useful.

The record shows that the available portion of the rated capacity of the new plant, 28.5 million gallons daily, is in excess of present needs, whether those needs are expressed as the average day figure of 16.0 million gallons or the peak day figure of 23.0 million gallons. Two methods have been proposed by which to deduct this excess capacity from rate base. Public Counsel's proposal is to simply estimate the percentage of capacity that is excess and then to trim that percentage of the cost of



the plant from rate base. This method yields a disallowance of \$13,704,127. Staff, on the other hand, proposes a disallowance of \$2,271,756, based on Mr. Merciel's identification and valuation of specific items and components built to an excess capacity. It is within the province of the Commission to determine the methodology used for rate-making. Missouri Gas Energy v. Public Service Com'n, State of Mo., 978 S.W.2d 434, 440 (Mo. App., W.D. 1998); State ex. rel. Associated Natural Gas Co. v. Public Service Com'n of Missouri, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985). The Commission concludes that the method proposed by Staff is the better method, because not all items included in rate base are equally susceptible to a straight-line, percentage reduction for excess capacity. The amount of \$2,271,756 shall be deducted from the value of the new St. Joseph plant included in rate base.

#### **Capitalization Rate for AFUDC:**

Allowance for Funds Used During Construction (AFUDC) is the carrying cost that a utility is allowed to capitalize and recover as part of the cost of a construction project. In the absence of specific Commission authorization to the contrary, capitalization of AFUDC ceases when the construction ends and the new facility becomes used and useful. The AFUDC at issue here is pre-in-service AFUDC relating to the new St. Joseph plant.

MAWC has proposed capitalizing AFUDC at the rate of return on rate base authorized in its most recent rate case. MAWC contends that this is consistent with the approach taken by the Company in past rate cases. Staff, on the other hand, contends that applying the previous rate case's rate of return to the monthly balances of Construction Work in Progress (CWIP) overstates the amount of AFUDC.

Staff proposes that AFUDC should be capitalized at a modified rate, reflecting the carrying charges on the outstanding amount of short-term debt available to the Company. Staff proposes that the rate for the construction balance in excess of the amount of short-term debt should then be based on the composite rate of the other sources of financing available to the Company during the construction period.

MAWC responds that, if the proposed capitalization rate is adopted by the Commission, the Company would be required to record this adjustment in the month of September 2000, resulting in an immediate write-off of \$1,257,930.<sup>32</sup> MAWC argues that, if the Commission decides the AFUDC rate should change, it should do so only on a going forward basis.

The Commission agrees that the actual carrying costs of MAWC's \$35 million in short-term debt should be reflected in rates. The use of the actual cost of any item is preferred, where known. The amount of \$1,289,674 shall be deducted from rate base to reflect this change in the capitalization rate of AFUDC.

### **Accounting Authority Order (AAO):**

Another issue relating to the construction in St. Joseph has to do with an Accounting Authority Order (AAO). As noted in the discussion of the previous issue, MAWC is permitted to capitalize the carrying costs of its construction financing from the beginning of the construction project to the moment the new facility becomes used and useful. For MAWC's St. Joseph plant, the in-service date was April 30, 2000. However, the earliest that the new facility can be recognized in rates is September 14, 2000, about four and one-half months later. During this lag period, although MAWC is earning nothing on its new plant, it must depreciate the plant and can no longer capitalize the carrying costs, that is, it must

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<sup>32</sup> Staff's figure is \$1,289,674.

recognize two new significant items of expense, without the offset of any new revenue. The value of these two expense items is \$319,000 each month, aggregating \$1.6 million for the period between April 30, 2000, and September 14, 2000. Consequently, MAWC sought an AAO to permit it to continue to capitalize the AFUDC, and to defer depreciation, between April 30, 2000, and September 14, 2000. The Commission granted the AAO on March 30, 2000. The issue now is whether to permit recovery in rates of any of the deferred expenses.

MAWC contends that elimination of the post-in-service AFUDC and deferred depreciation results in an interest coverage ratio of only 1.81 times for the 12-month period ending April 30, 2000, through September 30, 2000. Staff, in response, contends that none of the deferred amounts at issue here should be recovered because none of them is extraordinary. The construction of a water treatment facility is, after all, Staff observes, hardly an unusual or extraordinary activity for a water utility. Staff suggests that MAWC's true motive here is to reduce regulatory lag.

An AAO is an accounting mechanism that permits deferral of costs from one period to another. In the Matter of Missouri Public Service, 1 Mo.P.S.C.3d 200, 202 (Dec. 20, 1991). The items deferred are booked as an asset rather than as an expense, thus improving the financial picture of the utility in question during the deferral period. *Id.* During a subsequent rate case, the Commission determines what portion, if any, of the deferred amounts will be recovered in rates. AAOs should be used sparingly because they permit ratemaking consideration of items from outside the test year:

The deferral of cost from one period to another period for the development of a revenue requirement violates the traditional method of setting rates. Rates are usually established based upon a historical test year which focuses on four factors: (1) the rate of return the

utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. State ex. rel. Union Electric Company v. Public Service Commission, 765 S.W.2d 618, 622 (Mo. App. 1988).

Missouri Public Service, 1 Mo.P.S.C.3d at 205.

The Commission agrees with Staff that none of the post-in-service deferred amounts may be recovered. As the Commission has said previously, "Lessening regulatory lag by deferring costs is not a reasonable goal unless the costs are associated with an extraordinary event." Missouri Public Service, *supra*, at 207. MAWC's witness, James Salser, testified that MAWC seeks to insulate its shareholders from the effects of regulatory lag. MAWC has entirely failed to show any extraordinary or unusual event such as would support permitting recovery of any of these deferred amounts in rates.

The Commission has also said previously that "[m]aintaining the financial integrity of a utility is also a reasonable goal." *Id.* However, the Commission agrees with Staff that MAWC has failed to show that any financial emergency will result from this disallowance. MAWC's customers are being asked to accept significantly higher rates as a result of MAWC's decision to build a new plant and related facilities in St. Joseph.

### **Premature Retirement:**

Another issue arising from the St. Joseph project is that of the premature retirement of the old St. Joseph plant. Depreciation is an accounting convention that approximates an asset's loss of value through use. At the end of its useful life, the asset is considered to have lost all value except residual salvage value. If the accounting convention were perfect, an asset would be fully depreciated at time it is actually retired, that is, removed from service. See In the Matter of St. Louis

County Water Company, 4 Mo.P.S.C.3d 94, 102-3 (1995); In the Matter of Depreciation, 25 Mo.P.S.C. (N.S.) 331. In the case of the old St. Joseph treatment plant, the accounting convention yielded an imperfect result and the plant was not yet fully depreciated at the moment of its retirement.

MAWC and Staff agreed that the original cost of the plant should be deducted from both plant-in-service and accumulated depreciation in order to "preserve" the old plant's remaining, undepreciated value of \$2,832,906 until a proper depreciation study can be performed. Additionally, the retirement cost for the plant—estimated at \$500,000—should also be deducted from accumulated depreciation, thereby "preserving" \$3,332,906, at the time when the retirement actually occurs. MAWC and Staff would then cooperate in performing the necessary depreciation study.

Public Counsel opposes the treatment proposed by MAWC and Staff. Testimony presented by the Public Counsel asserted that the normal accounting process representing the retirement of a utility plant is to remove the original cost of the plant from both the utility plant-in-service and the depreciation reserve accounts. Public Counsel contends that this would be inappropriate in this case because it would result in a net increase to rate base of \$2,832,906, thus causing ratepayers to pay for a plant no longer in service. This would occur because the original cost of the plant exceeds the accumulated depreciation on the plant by its net original cost of \$2,832,906. Thus, deducting the original cost of the plant from the depreciation reserve would diminish that reserve by more than the depreciation accumulated therein with respect to the old St. Joseph plant, causing a net increase in rate base. As an alternative, Public Counsel proposes that the original cost of the plant should be deducted from utility plant-in-service, while only the recorded amount of depreciation should be deducted from the accumulated depreciation reserve. The difference should be written off.

MAWC is permitted a reasonable return only on the value of its assets actually devoted to public service. From the moment of its retirement, a moment controlled by MAWC, the old plant was no longer used and useful in public service. In an early case involving the retirement of utility assets, the Missouri Supreme Court stated:

The abandonment of property which is never replaced, but is superseded by another instrumentality, as gas lamps by electric lights, or by another agency or company, is an extraordinary supersession. Its loss is "one of the hazards of the game," just as the extraordinary increase in values following the war was an unexpected gain . . . . It follows that the abandoned property, lights, service mains, and the like should not be considered for the purpose of determining the annual depreciation reserve.

State ex rel. City of St. Louis v. Public Service Com'n of Missouri,  
329 Mo. 918, 941, 47 S.W.2d 102, 111 (1931).

It follows that the treatment proposed by Public Counsel is correct. Utility plant-in-service will be reduced by the original cost of the old St. Joseph plant, while the depreciation reserve will be reduced only by the amount of depreciation accumulated with respect to the plant. The difference, the plant's net original cost of \$2,832,906, will be written off. Likewise, any amount expended by MAWC to retire the old plant is also not recoverable in rates.

### **Property Taxes:**

This is yet another issue arising from the new St. Joseph plant. MAWC will eventually face a net increased local property tax liability with respect to the new plant. Staff contends that this cost should be excluded from revenue requirement because it will not be due and payable until well after the end of even the true-up period, much less the test year. MAWC responds that this is a typical true-up item as it is a known quantity. Staff suggested, and MAWC insists, that a refundable surcharge be author-

ized to collect the amount of the net increased property tax liability, to be reviewed as part of the next rate case and any overcollection refunded.

The Commission will authorize MAWC to collect a reasonable amount for the net increased property tax liability through a surcharge to begin on January 1, 2001. This issue will be reviewed as part of the next rate case and any overcollection refunded to the ratepayers.

### **Other New Construction:**

The record shows that MAWC undertook new construction in several other districts in addition to St. Joseph. Testimony offered by the Staff confirms that these new facilities are in service and are reasonable and necessary. No party has raised any objection to any of these facilities, much less made any showing of imprudence with respect to them. Consequently, their aggregate cost of \$14,341,535 will be added to rate base.

### **Deferred Income Taxes:**

This issue arises from MAWC's purchase, in 1993, of Missouri Cities Water Company (Mo Cities). The Commission approved the acquisition in Case No. WM-93-255. Mo Cities had an amount on its books for deferred income taxes, which amount remained with its parent, Avatar, and was not acquired by MAWC. Staff has proposed to reduce rate base by \$712,191 to reflect these deferred income taxes.

Deferred income taxes are an artifact of the differing treatment accorded depreciation for federal income tax purposes as opposed to regulatory purposes. Rates are calculated using straight-line depreciation, while taxes are paid using accelerated depreciation. The result is that the utility collects money for taxes from its ratepayers now that it need not actually pay until later. Consequently, the utility finds itself holding a pool of interest-free cash, contributed by ratepayers with

respect to the utility's income tax liability. Like other donations and contributions, this money is deducted from rate base because the company has no right to earn a return on it.

When MAWC purchased Mo Cities, the rate base increased by the value of the deferred income taxes because the offsetting cash did not transfer to MAWC. The effect on ratepayers was a rate increase. Staff seeks to re--establish the offset for the pre-merger deferred income taxes and thereby to reduce rates.

MAWC contends that this issue has already been resolved by the Commission in MAWC's 1995 rate case, In the Matter of Missouri-American Water Company, Case Nos. WR-95-205 and SR-95-206, 4 Mo.P.S.C.3d 205 (1995). In that case, the Commission denied MAWC's attempt to recover the acquisition premium it paid on its purchase of Mo Cities, largely because of the impact on ratepayers of the deferred income taxes issue:

The Commission finds in this case that the Company has failed to justify an allowance for the acquisition adjustment. The Commission finds that as argued by OPC, the ratepayers will already suffer one negative effect from the sale of MCWC stock. Because the transaction is considered a "sale of assets" for federal tax purposes, the deferred taxes that have accumulated throughout the life of the property will be lost.

Missouri-American Water Company, *supra*, at 217.

The Commission agrees with MAWC. Having already dealt once with the issue of the pre-merger deferred income taxes, it is not appropriate to deduct any amount from rate base now with respect to those taxes.

### **Capital Structure, Return on Equity and Rate of Return:**

MAWC and Staff have agreed to use the capital structure outlined by Staff's expert, Roberta McKiddy, in her True-up Direct Testimony, Exhibit 110.

The cost of capital for a utility company may be determined by calculating the weighted cost of each capital component by multiplying its



dollar value as of a specific moment in time by its appropriate embedded cost or, in the case of common equity, its estimated cost. The sum of these figures is the total weighted cost of capital, which is synonymous with the fair rate of return for the utility.

A matter of dispute is the value to be used for the cost of common equity, also referred to as the Return on Equity (ROE). Staff suggests the range of values developed by Ms. McKiddy, 9.50 percent to 10.75 percent. MAWC proposes a value of 11.654 percent. Public Counsel proposes 9.92 percent.

Staff's position was developed using the Discounted Cash Flow (DCF) model. The Commission has favored this method, Staff reminds the Commission, for over 30 years. MAWC's position was supported by the testimony of its expert witness, Harold Walker. Walker developed his figure by comparing MAWC to other water utilities and determining its comparable risk level. In Walker's opinion, MAWC presents greater risk than many other water utilities because of its small size, its greater proportion of debt in capital, and its capital intensity. Mr. Walker also employed the DCF model. Public Counsel's expert witness, Mark Burdette, also used the DCF method to develop his proposal. The Commission notes that Public Counsel's figure is within the range proposed by Staff.

As Staff points out, the DCF method is one which "the Commission has approved in many previous cases." In the Matter of Missouri Cities Water Company, 1 Mo.P.S.C.3d 119, 128 (1991):

The Commission has consistently found Discounted Cash Flow (DCF) analyses to be appropriate for determining a rate of return on equity. . . . This is because it is relatively simple to apply and measures investor expectations for a specific company. . . . [T]he DCF analysis is considerably more systematic and allows this Commission to treat all utilities it regulates in a consistent manner.

In the Matter of the Joint Application of Missouri Cities Water Company,  
26 Mo.P.S.C. (N.S.) 1, 26-27 (1983). However, in this case, all three  
competing positions were developed using the DCF method.

The DCF method is used to determine the cost of common equity.  
Where, as here, the common stock is not publicly traded, the DCF method  
must be modified. The three proposals before the Commission differ in part  
in the nature of the modifications each relies upon. Staff simply applied  
the DCF method to the publicly-traded common stock of MAWC's parent, AWWC,  
and imputed that result to MAWC. MAWC contends that Staff's modification  
to the DCF method is inappropriate because MAWC differs from AWWC in having  
a higher risk. MAWC's higher proposed ROE reflects this higher risk.  
Another point of difference between the proposals is the growth factor.  
MAWC used a higher growth factor than did Public Counsel.

After considering all of the evidence and the arguments of the  
parties, the Commission determines that the appropriate ROE for MAWC is  
10.00 percent. This figure is within the range proposed by Staff and close  
to the value proposed by Public Counsel. It is somewhat higher than Public  
Counsel's proposal to reflect the fact that the method employed is, after  
all, an estimation rather than a measurement.

Using this ROE figure, a weighted total cost of equity figure can  
be developed:

<u>Type of Capital:</u>	<u>Percentage Of Total:</u>	<u>Embedded Cost:</u>	<u>Weighted Cost:</u>
Common Stock	42.27%	10.00%	4.22%
Preferred Stock	1.69%	9.09%	0.15%
Long-term Debt	56.05%	6.77%	3.79%
Short-term Debt	0.00%	0.00%	0.00%
	100.00%		8.16%

The total weighted cost of capital figure, 8.16 percent, is also  
the overall rate of return (R) used in the following formula under the Cost

of Service method to calculate MAWC's Revenue Requirement, where the Cost of Service equals the Revenue Requirement:

$$RR = C + (V - D) R$$

RR = Revenue Requirement  
C = Prudent Operating Costs, including Depreciation and Taxes  
V = Gross Value of Utility Plant in Service  
D = Accumulated Depreciation  
R = Overall Rate of Return

### **Rate Design:**

Perhaps the most difficult issue presented by this case is the issue of rate design. In resolving this issue, the Commission notes that it has broad discretion to set just and reasonable rates. St. ex rel. Utility Consumers Council, v. Public Service Commission, 585 S.W.2d 41, 49 (Mo. banc 1979); St. ex rel. Capital City Water Co. v. Missouri Public Service Com'n, 850 S.W.2d 903, 911 (Mo. App., W.D. 1993). A "just and reasonable" rate is one that is fair to the ratepayer and fair to the utility. It is one which covers the cost of service and a reasonable return on assets dedicated to public use, and no more. See State ex rel. Washington University, supra, 308 Mo. at 344-45, 272 S.W. at 973. "[I]t is not methodology or theory but the impact of the rate order which counts in determining whether rates are just, reasonable, lawful, and non-discriminating." State ex rel. Associated Natural Gas Co. v. Public Service Commission of Missouri, 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

Much public attention was devoted to the debate between the proponents of Single Tariff Pricing (STP) and District Specific Pricing (DSP). The former is a rate design theory under which all customers of a system with multiple service areas, whether interconnected or not, pay the same rate, regardless of differences in the actual cost of providing the service to the various customers. DSP, on the other hand, sets different rates for each of the service areas, based upon the discrete cost of

service in each district. MAWC, along with its parent and affiliates, favors STP. In the past, this Commission has permitted MAWC to move toward STP in its rate design, although that goal was never attained.

The Staff opposes STP and endorses DSP, as does the Public Counsel. The SJ Industrials, together with the City of Riverside, oppose STP strongly. They contend that it is, in fact, unlawful. The Cities of Joplin, Warrensburg, O'Fallon, and Weldon Spring, St. Charles County, and the Warrensburg Industrials also oppose STP. They, too, contend that it is unlawful in Missouri. The St. Joseph Area PWSD Intervenors, on the other hand, argue for the continuation of STP, as does the City of St. Joseph.

The Commission will move away from STP and toward DSP. One factor for consideration in determining just and reasonable rates is public perception. The testimony adduced at the Local Public Hearings held in this matter was strongly in favor of DSP. MAWC, therefore, must set its rates separately for each service area in order to recover the appropriate revenue requirement for each service area. As the Company requested, no phase-in of rate increases shall be permitted. In moving toward DSP, however, the Commission will adhere to the principle that no district will receive a rate decrease.

As an alternative to DSP, MAWC suggests modifying an STP rate design by use of a Capital Addition Surcharge. With respect to major projects such as the new St. Joseph plant and supply source, part of the rate impact would be distributed to all of the districts under STP and the rest recovered solely from the St. Joseph district by means of a surcharge. The St. Joseph Area PWSD Intervenors strongly oppose this option as "the worst of all possible worlds." Staff also opposes it, as do the Municipal Intervenors. The Commission will not adopt MAWC's surcharge proposal because it is in conflict with the Commission's basic decision to move toward DSP.

The Commissions decision herein should not be read to suggest that the Commission agrees with those parties that contend that STP is not lawful in Missouri. Their theory is that STP creates undue preferences for some customers and unlawfully discriminates against others, in violation of Section 393.130. The Commission agrees with the Staff that the Missouri Supreme Court disposed of that view some years ago:

We are able to discern no legitimate reason or basis for the view that a utility must operate exclusively either under a systemwide rate structure or a local unit rate structure, or the view that an expense item under a systemwide rate structure must of necessity be spread over the entire system regardless of the nature of the item involved. Experts in utility rates may well conclude that a 'hybrid system' or a 'modified system' of rate making, wherein certain expense items are passed on to certain consumers and certain items are thereby treated on a local unit basis and others on a systemwide basis, is the system which will produce the most equitable rates. And it would appear to be the province and duty of the commission, in determining the questions of reasonable rates, to allocate and treat costs (including taxes) in the way in which, in the commission's judgment, the most just and sound result is reached.

State ex rel. City of West Plains v. Public Service Commission, 310 S.W.2d 925, 933 (banc 1958).

In determining rates under a DSP methodology, the assets, liabilities, income, and expenses booked by MAWC to its Corporate District must be allocated among the operating districts. MAWC and Staff have suggested the use of different factors by which to allocate these amounts. Staff suggests allocation based on composite payroll factors, following the practice of the Federal Energy Regulatory Commission; MAWC advocates allocation based on corporate labor. The difference between the two options is minimal; MAWC stated in its brief, "[I]t is the Company's expectation that the use of Staff's allocation factors with a comparable revenue requirement and rate base would produce results very close to those that the Company developed." Having considered the evidence and the

arguments of the parties, the Commission concludes that the composite payroll allocation method proposed by Staff is superior and ought to be utilized.

The final issue in the rate design is the allocation of rate increases in each district across customer classes. Some parties have proposed inter-class allocation shifts, others oppose them.

Both Staff and MAWC advocate the use of the Base-extra Capacity (BXC) method to allocate costs among the various customer classes of within each district. This method allocates costs in proportion to each class's use of the commodity, facilities and services involved. Its purpose is to accurately allocate costs on a causal basis. Once costs are allocated to customer classes using this method, rates can be developed to recover the necessary revenue from each class.

The BXC method considers four categories of costs: base costs, extra capacity costs, customer costs, and fire protection costs. Base costs vary with usage and are the costs of providing service under average load conditions. Extra capacity costs are costs incurred to meet usage in excess of average load. Customer costs are those costs associated with providing water service regardless of usage, such as billing and collections, and meter reading. Finally, fire protection costs are associated with meeting peak fire protection demands. Each category of costs is allocated among the customer classes using allocation factors. Rates are then developed to recover the allocated cost from each class.

Staff witness Randy Hubbs applied the BXC method on a DSP basis; MAWC's witness Stout applied it on a company-wide, STP basis. Staff and MAWC are evidently in agreement that, if the Commission adopts a DSP rate design, then Mr. Hubbs' class cost of service study should be employed; if the Commission adopts an STP rate design, then Mr. Stout's class cost of service study should be used.

The St. Joseph Area PWSO Intervenor urge that any rate increase in any district be spread on an across-the-board basis throughout the Company's existing rate schedule for that district. The Municipal Intervenor agree. Staff objects that significant inter-class subsidies will exist in such a design.

Public Counsel advocated a rate design that shifted increases away from residential customers to industrial and resale customers. While Public Counsel's expert, Hong Hu, purportedly used the BXC method, she modified it to recognize what she termed "economies of scale." Her class cost of service study was criticized by almost all of the other parties.

Having considered the evidence and the arguments of the parties, the Commission concludes that Staff's class cost of service study, developed using the BXC method, is the appropriate method by which to allocate costs among customer classes in each district and to design rates by which to recover appropriate revenues within each district.

**IT IS THEREFORE ORDERED:**

1. That the Motion to Strike Testimony and for Summary Determination filed by Missouri-American Water Company on June 2, 2000, is denied.

2. That all other pending motions and applications, not specifically ruled herein, are denied.

3. That the water service tariff sheets filed by Missouri-American Water Company on October 15, 1999, Tariff File No. 00000366, are rejected.

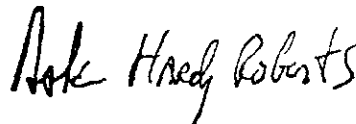
4. That the sewer service tariff sheets filed by Missouri-American Water Company on October 15, 1999, Tariff File No. 00000367, are approved for service rendered on and after September 14, 2000. The specific tariff sheets approved are:

5. That Missouri-American Water Company is directed to comply with the provisions of the Joint Recommendation filed herein, including changing to a monthly meter-reading and billing schedule in its St. Joseph service area.

6. That Missouri-American Water Company is hereby authorized to file proposed tariff sheets in compliance with this Report and Order.

7. That this Report and Order shall become effective on September 14, 2000.

**BY THE COMMISSION**



**Dale Hardy Roberts**  
**Secretary/Chief Regulatory Law Judge**

( S E A L )

Lumpe, Ch., Schemenauer and Simmons,  
CC., concur;  
Drainer, C., dissents, with dissenting  
opinion attached;  
Murray, C., dissents, with dissenting  
opinion to follow;  
certify compliance with the provisions  
of Section 536.080, RSMo 1994.

Dated at Jefferson City, Missouri,  
on this 31st day of August, 2000.



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

In the Matter of Missouri-American    )  
Water Company's Tariff Sheets        )  
Designed to Implement General Rate    )  
Increases for Water Service Provided   )  
to Customers in the Missouri Service   )  
Area of the Company                    )

Case No. WR-2000-281

**DISSENTING OPINION OF VICE CHAIR M. DIANNE DRAINER**

Although I find that Missouri American Water Company (MAWC) presented evidence that clearly supported its decision to construct the new groundwater treatment plant and demonstrated that the expenses incurred in that construction were prudent, I must nevertheless respectfully dissent from the Report and Order as I disagree with numerous positions taken by the majority.

With respect to the return on equity (ROE) that should be authorized for MAWC, the evidence clearly demonstrated that by using the traditional discounted cash flow (DCF) method supported by the Missouri Public Service Commission Staff (Staff) and presented in MAWC testimony, 10.5 percent is the fair and reasonable ROE. Since 1992 this Commission has authorized ROE rates in 37 cases from a high of 13 percent to a low of 10.5 percent, with an average of 10.95 percent using the DCF method. Even Staff presented a midpoint ROE above 10 percent. Therefore, I find the 10 percent ROE authorized in this case to be an unreasonable departure from established setting of such rates by the DCF method in the past, detrimental to MAWC and unsupported by the weight of the evidence. Thus the 10 percent ROE is neither a fair nor a reasonable return for MAWC's investment.

With respect to the issue of excess capacity, I disagree with the majority's disallowance for excess capacity. The evidence in the record clearly showed that MAWC management has built in less than a 10 percent growth rate for the new plant and that it will reach full capacity in fewer than 10 years. MAWC management would have been imprudent had they not built in some minimum level of growth. It would indeed have been both imprudent and economically inefficient to construct two 750,000-gallon-clearwell units only to replace them in fewer than ten years with two 1,000,000-gallon-clearwell units as suggested by Staff. Therefore, I find that the minimum excess capacity built into the St. Joseph plant to be both a reasonable and prudent management decision.

With respect to the issue of premature retirement, Staff proposed that neither the net plant investment nor the cost of removal and demolition be amortized until a depreciation study is performed to evaluate the accuracy of the reserve and depreciation rates for the major accounts of MAWC. MAWC agreed to perform such a study prior to the filing of its next rate case. The approach taken by Staff and MAWC would have allowed the retirement issue to be addressed in the most reasonable and comprehensive manner.

With respect to the rate design established by the majority, I have my most serious objections. The rates established by the Commission must be just and reasonable for ALL customers of the utility. The issue of rate design impact must be analyzed for all customer classes in all districts served by MAWC. In the past the move to a single tariffed price (STP) for the customers of MAWC has resulted in rates that were just and reasonable and resulted in no undue rate shock. All MAWC customer classes would continue to have rates that are just and reasonable under STP with no undue rate shock. Unfortunately, because of the complexity of the Staff rate design proposal for district specific pricing (DSP) one must analyze very closely the

impact of Staff's proposal on all customer classes in all districts to understand the detrimental impact this proposal has on the public. Although the public hearings indicated a preference for DSP over STP, nowhere was the public informed of the actual impact of DSP on their district rates for each customer class. Rather the public was given only the worse case scenario of a 51 percent increase in rates from STP with the false indication that DSP would result in lower rates for all customers. The reality is that DSP will have a far different impact on customers' rates as can be seen from a review of the Staff's revenue requirement that will be the approximate outcome from this case. For example, Staff's rate design proposal adopted in this case will result in increased rates to residential customers in Mexico and Parksville of over 60 percent while Joplin and St. Charles will have little or no rate increase for their residential customers. (It should be noted that in a past rate case St. Charles capital improvements have been spread over the other districts.) Mexico, Parksville and St. Joseph sale for resale customers (the water districts) will receive rate increases of approximately 197 percent, 171 percent and 268 percent respectively, while Joplin's sale for resale customers receive no rate increase. Industrial customers in Mexico and St. Joseph will receive rate increases of approximately 135 percent and 200 percent respectively, while Joplin's industrial customers receive no rate increase.

Although the Commission can and should look at the cost of service to each district and each customer class in a rate case, cost of service is only one of the guidelines reviewed by the Commission. Other guidelines the Commission should review in setting rates are equity issues in changing rates among customer classes and gradualism in changing rates to avoid excessive rate shock. The final responsibility of the Commission is to assure that all rates set in a rate case are just and reasonable. The Commission should have continued its support of STP rate design. MAWC offered a viable modification to straight STP with a proposed surcharge on the St.

Joseph district. All customers would have received rate increases far less detrimental with STP and the surcharge added to the St. Joseph district. The modified STP alternative should have been adopted by the Commission in order to maintain fair, reasonable and just rates for all the customers in all the MAWC districts.

Therefore, I find that not only specific districts but specific customer classes, such as the residential, sale for resale and industrial customers in many of the districts will receive such a rate shock from this case that their future rates can only be viewed as unjust and unreasonable. Further, I find the rate design adopted in this case results in gross inequities and is detrimental to the public interest.

Respectfully submitted,

  
M. Dianne Drainer, Vice Chair

Dated at Jefferson City, Missouri  
On the 31<sup>st</sup> day of August, 2000.

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

In the Matter of Missouri-American Water	)	
Company's Tariff Sheets Designed to Implement	)	<b><u>Case No. WR-2000-281</u></b>
General Rate Increases for Water and Sewer	)	Tariff No. 200000366
Service Provided to Customers in the Missouri	)	Tariff No. 200000367
Service Area of the Company.		

**DISSENTING OPINION OF COMMISSIONER CONNIE MURRAY**

This Commission is charged with setting just and reasonable rates for water and sewer utilities. In order to be just and reasonable to both the utility and its customers, the rates should be fully compensatory for all prudently incurred costs of service. Otherwise, customers may eventually suffer the very severe harm of having no financially viable utility to provide their essential water and sewer services. The rates set herein by the majority fall far short of being fully compensatory. Furthermore, the rate design adopted by the majority creates for certain customers a disproportionate burden that amounts to unnecessary rate shock. For these reasons, I respectfully dissent from the Report and Order.

I agree with the majority to the extent that it found that MAWC acted prudently in its decision to build a new treatment plant in St. Joseph. The Commission's Report and Order in Case Nos. WA-97-46 and WF-97-241, issued on October 9, 1997, stated that we had reviewed extensive evidence in those cases and found the proposed project to be a reasonable alternative. There was nothing convincing presented in the record herein to

prove that the decision to build a new plant was anything other than a prudent, reasonable alternative.

This opinion will address my areas of disagreement with the majority in the order in which those issues were addressed in the Report and Order.

### **The New St. Joseph Plant—Capacity**

The Company was not imprudent in designing and sizing the St. Joseph plant to meet anticipated needs of the district until the year 2009. To the contrary, it would seem imprudent *not* to design and size a new plant to meet the needs of the district beyond the immediate time period. Therefore, I would not have adjusted the value of the new St. Joseph plant on the grounds of excess capacity.

### **Capitalization Rate for AFUDC**

I do not agree with the majority that the method of capitalizing AFUDC should be changed in this proceeding. If such a change is warranted it should only be made prospectively.

### **Premature Retirement**

I agree with Staff and MAWC that a depreciation study should be conducted to determine the appropriate amount and recovery period for the remaining net plant investment that was never depreciated, as well as for the cost of removal of the old plant. The majority's disallowance of over three million dollars for this issue is, in my opinion, not supported by the record.

### **Return on Equity and Rate of Return**

I would allow a return on equity that appropriately reflects the unique risk characteristics of MAWC and not adopt Staff's DCF analysis that uses the parent company, AWWC, for comparables and makes no adjustment for risk. It is MAWC, not

its parent, which we regulate and which provides service to Missouri ratepayers. Staff's comparison to AWWC without risk adjustment resulted in an inadequate return on equity and an inadequate rate of return.

The majority quoted, on page 37 of its Report and Order, from a 1925 Missouri Supreme Court opinion. It is appropriate to make reference here to that same quote, because I believe that the majority did not follow those directions from the Supreme Court in setting this company's return on equity and rate of return.

### **Rate Design**

I would adopt the company's alternative proposal, which is a hybrid single-tariff pricing with a capital addition surcharge (CAS). I would spread the increases evenly among the classes, as proposed by the St. Joseph Area PWSD Interveners and the Municipal Interveners. The result would more closely approximate reasonable increases for all districts and all classes of customers. This Commission would thereby maintain its previously declared support for the concept of system-wide rates for the company.

The record supports a rate design that spreads costs uniformly except where, as here, expenditure in one district exceeds 15% or 20% of present revenues. The record also supports mitigation of the impact of the St. Joseph Treatment Plant on the rates in other districts by applying a surcharge to bills in the St. Joseph district. Such a surcharge could be applied to other districts that experience capital additions in the future that have an impact on total company revenues that exceed 15% or 20%. That approach would permit maintenance of unified rates and simultaneously allow districts that incur capital costs above the threshold to take on more of the burden of paying such costs. The evidence of record demonstrates that a hybrid rate design using a CAS based on a 15% threshold results in rate increases to all districts except St. Joseph of approximately 28%,

and to St. Joseph of approximately 89%. The evidence demonstrates that using a 20% threshold results in a rate increase to St. Joseph of approximately 79% and to all other districts of approximately 33%. Spreading these increases evenly among the classes within the districts would avoid rate shock to any particular class, but it would also cause St. Joseph to bear the heaviest burden where the heaviest capital addition costs are caused by St. Joseph. By contrast, the rate design adopted by the majority will result in increases to some classes in some districts of as much as 269%.

#### **Conclusion**

For the reasons stated herein, I respectfully dissent.

**Respectfully submitted,**

  
**Connie Murray, Commissioner**

Dated at Jefferson City, Missouri,  
on this 31<sup>st</sup> day of August, 2000