BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of St. Joseph Light & Power Company's proposed tariffs to increase rates for electric service provided to customers in the Missouri service area of the Company.	)	Case No. ER-93-41
The Staff of the Missouri Public Service Commission, Complainant, vs. St. Joseph Light & Power Company, a Missouri corporation, Respondent.	)	Case No. EC-93-252

REPORT AND ORDER

Date Issued: June 25, 1993

Date Effective: July 5, 1993

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APPEARANCES

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HEARING EXAMINER

Janet L. Sievert

Procedural History

On August 7, 1992, St. Joseph Light & Power Company (SJLPC) submitted to this Commission tariffs reflecting increased rates for electric service provided to customers in the Missouri service area of the company. The proposed tariffs bear a requested effective date of September 7, 1992. The proposed tariffs are designed to produce an increase of approximately 8.8 percent ($6.1 million) in charges for electric service. On September 1, 1992, the Commission suspended the tariffs to July 5, 1993, and established a procedural schedule. On February 24, 1993, the Staff of the Missouri Public Service Commission (Staff) filed a complaint against SJLPC alleging that SJLPC's current rates are excessive and are not just and reasonable. Staff alleged in its complaint that SJLPC's revenues should be reduced by approximately $7 million in order to produce a fair and reasonable rate of return for SJLPC.

Pursuant to the procedural schedule, prefiled testimony was filed. The hearings in this matter were held on April 19-23, 1993, as scheduled. Briefs were filed pursuant to the briefing schedule.

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.

CAPITAL STRUCTURE/RETURN ON EQUITY

Capital structure is the relationship between a company's debt and equity. Capital structure generally influences the overall cost of capital. It is assumed that there is an optimum structure that will produce the minimum cost. A utility must meet its obligations and maintain a flexible capital structure so that it can raise capital whenever necessary. Additionally, the capital structure should result in the ability to generate the needed financing at a reasonable cost. Capital structure is based on the relationship between a company's debt and equity percentages. The most difficult and most important issue in the determination of a company's revenue requirement is that of finding the appropriate return on common stock equity. Common stock equity is the foundation of the capital structure and makes it possible for a company to borrow funds or to sell debt securities. Each of the parties in this proceeding has developed proxy groups to validate the capital structure it is supporting. Each has used different criteria to select and to develop its proxy group.

SJLPC proposes that the actual capital structure as of September 30, 1992, updated to December 31, 1992, including a capital lease obligation related to the Cooper-Fairport-St. Joseph (CFSI) line, be used to establish its rate of return. SJLPC, therefore, is recommending a capital structure of 40.10% long-term debt, 57.93% common equity and 1.97% capital lease obligation. SJLPC has no preferred stock or short-term debt. SJLPC states that its proxy group's capital structure has an average of 46.7% long-term debt with a range of 38.9% to 52.4%, an average of 53.3% equity component which includes preferred as well as common stock, with a range of 47.6% to 61.1% and no preferred stock or short-term debt. SJLPC argues that the average capital structure of its proxy group demonstrates that its capital structure is reasonable.

Staff proposes to use a hypothetical capital structure in determining SJLPC's capital structure. Staff contends that its review of SJLPC's capital structure has disclosed an equity ratio that, in Staff's assessment, is higher than normal for a regulated utility. Staff states that its proxy group's long-term debt ranges from 47.15% to 50.32% with an average of 48.80%, preferred stock ranges from 4.47% to 10.96% with an average of 6.91%, common equity ranges from 39.30% to 47.5% with an average of 44.29% and no short-term debt. Based on the proxy group, Staff proposes a hypothetical capital structure of 49.47% long-term debt, 5.71% preferred stock, 44.82% common equity and no short-term debt. Staff states that it included preferred stock in its capital structure, even though SJLPC has no preferred stock, because its use is prevalent among similar companies in the electric utility industry and it is a less expensive form of capital (on a pre-tax basis) than either debt or common equity. Furthermore, Staff states that it is proposing the hypothetical capital structure because it does not appear to be detrimental to SJLPC's credit rating and it will lower capital costs, benefitting ratepayers through lower rates.

Staff, in the alternative, proposes that if the Commission does not adopt its hypothetical capital structure, that SJLPC's actual capital structure without any adjustments, as of December 31, 1992, of 40.90% long-term debt and 59.10% common equity (SJLPC has no preferred stock or short-term debt) be used to establish a return on equity for SJLPC. Staff does not include a capital lease component in SJLPC's actual capital structure.

Even though AGP did not actually propose a hypothetical capital structure for SJLPC, its proxy group resulted in an average long-term debt of 48.6%, an average preferred stock of 6.6% and an average common stock of 44.8%. AGP used these percentages in its discount cash flow calculations to determine its proposed return on equity, which is discussed below.

Public Counsel proposes a hypothetical capital structure consisting of 48.29% long-term debt and 51.71% common equity. Public Counsel did not make an adjustment for the CFSI lease line. Public Counsel's proxy group has a capital structure of 48.29% long-term debt, which incudes 5.76% preferred stock, 47.903% common equity, which is the average range for the years 1989-1992, and no short-term debt. The standard deviation of Public Counsel's proxy group is 3.78% and the interval about the mean that falls within plus or minus one standard deviation is 44.15% to 51.71% equity. Public Counsel advocates that the equity ratio of 44.15% to 51.71% represents the appropriate "zone of reasonableness" for utilities with operating characteristics similar to SJLPC.

Public Counsel states it established the following criteria upon which to develop its proxy: (1) publicly traded, (2) no Missouri regulated operations, (3) percentage of electric revenues greater than seventy (70) percent, (4) covered by Value Line, (5) no diversified or non-regulated operations, (6) total capital less than $6 million, total revenues less than $3.5 million, and (8) a Standards and Poor's bond rating BBB+ or greater. Public Counsel states that from this criteria it established its eleven (11) company proxy group composed of mid-sized, non-diversified, non-nuclear, mid-western electric and electric/gas utilities which are a fair and reasonable characterization of the operations of SJLPC.

Public Counsel states that in calculating the long-term debt it included 5.76% of preferred stock, the average level of preferred stock contained in the capital structures of the comparable companies. Public Counsel reasoned that it is appropriate to allocate all of the preferred stock to long-term debt in the hypothetical capital structure because the average cost of the preferred stock issued by the eleven (11) comparable companies is actually below the cost of long-term debt for SJLPC and preferred stock possesses more characteristics of long-term bonds than common equity. Public Counsel's evidence showed that preferred stock is considered a hybrid security, but is more similar to long-term debt than preferred stock. Public Counsel asserts preferred stock, like bonds: (1) provides investors with prior claims on income and assets, (2) the level of current income is usually fixed for the life of the issue, (3) can carry call features and sinking fund provisions, (4) a firm can have more than one issue of preferred stock outstanding at any point in time, and (5) it usually trades on the basis of its yield and is, in fact, priced in the marketplace like fixed-income obligations and, as a result, is considered by many investors to be competitive with bonds.

The portion of common equity in a company's capital structure is important for ratemaking purposes because common equity is the most expensive form of capital. The cost differential between common equity and debt is even greater when the income tax treatment of debt is considered. Interest expense or the cost of debt is tax-deductible, while dividends to shareholders are not. The evidence clearly demonstrates that Staff, Public Counsel and AGP support the position that SJLPC's capital structure is too heavily weighted with common equity. The Commission agrees that SJLPC's capital structure is too heavily weighted with equity. In comparing SJLPC's own assessment of its capital structure with that of its proxy group's average capital structure, the Commission cannot find that SJLPC's capital structure is even in line with its own proxy group. SJLPC's long-term debt ratio of 40.10% is nowhere near the proxy group's long-term debt average of 46.7% which includes only one company with long-term debt lower than that of SJLPC. Similarly, SJLPC's proxy group contains only one company with a common equity ratio higher than its own. The second highest common equity ratio in its proxy group is 51.2%, which is not even close to SJLPC's own equity level of 57.93%. The average common equity of the proxy group is 53.3%, which the Commission, unlike SJLPC, does not believe places SJLPC's common equity of 57.93% reasonably close to its proxy group's average. The Commission cannot support a capital structure for a company such as SJLPC that is so heavily weighted with common equity. The Commission, in its duty to protect the ratepayers, cannot establish rates based on this skewed capital structure. The Commission is of the opinion that if SJLPC chooses to continue with its current debt/equity ratio then its stockholders should bear the burden of its management's decisions and not the ratepayers.

Therefore, the Commission finds that the hypothetical capital structure as proposed by Public Counsel should be used in setting rates in this proceeding. The Commission is aware that each party in this proceeding developed its proxy group with the criteria it believes to be the most relevant. The Commission finds Public Counsel's hypothetical capital structure the more reasonable alternative to the other proposals. The evidence shows that the eleven (11) companies which comprise Public Counsel's proxy group are representative of SJLPC's operations. The Commission finds it particularly relevant that none of the companies in Public Counsel's proxy group have any nuclear facilities, as nuclear facilities tend to have a higher risk factor than non-nuclear facilities. The Commission also finds, in developing a hypothetical capital structure for SJLPC, it is more appropriate in this instance to include a ratio for preferred stock in long-term debt than to establish a ratio for preferred stock as a separate component of the capital structure. The evidence demonstrated that preferred stock is considered a hybrid stock classified between long-term debt and common equity. However, based on the evidence presented, in this case preferred stock more closely resembles long-term debt (bonds) than common equity. The Commission determines that in establishing a hypothetical capital structure for SJLPC, including preferred stock in the ratio for long-term debt results in a capital structure that most closely resembles the composition of SJLPC's capital structure. Furthermore, Public Counsel's approach is reasonable because it advocates that companies with similar risk characteristics actually exist within a range of debt versus equity trade-offs. The adoption of Public Counsel's structure is further supported since the Commission is adopting the high end of Public Counsel's equity range, thereby, placing SJLPC in the zone of reasonableness for utilities with operating characteristics similar to SJLPC.

By adopting a hypothetical capital structure for SJLPC, the Commission is not indicating a preference for hypothetical capital structures in establishing revenue requirements for a company. The Commission, in other cases, has utilized the actual capital structure whenever the debt equity ratio has not been shown to be outside a zone of reasonableness. However, when as in this case, the actual capital structure is so entirely out of line with what the Commission considers to be a reasonable range, a hypothetical capital structure must be adopted to balance properly the interests of the shareholders and ratepayers.

The Commission, therefore, determines that the hypothetical capital structure as proposed by Public Counsel should be adopted in this proceeding.

RETURN ON EQUITY

The rate of return on equity for a company is established by estimating its cost of common equity and combining it with its costs for debt and preferred stock. All parties in this proceeding used the discounted cash flow (DCF) method for estimating the cost of common equity. The purpose of the DCF analysis is to estimate the return on equity necessary to attract investors to a company given the future value of the stock based upon its projected price and expected dividend per share. The DCF model is a market-oriented approach that uses three variables to determine the cost of equity of a company. These variables are the expected dividend, the current stock price and the growth factor. Under the formula for the DCF, the return on equity is obtained by dividing the expected dividend by the current stock price and adding a growth factor. Normally a difference occurs in the DCF calculations due to differences in factors used to develop the growth rate. In this proceeding, not only were different growth factors employed, but also the parties used different expected dividend prices.

SJLPC proposes that a 12.78% cost of equity be adopted in this proceeding. SJLPC used growth in dividends per share, earnings per share, book value and market value as growth factors in its DCF calculation. Additionally, SJLPC used $1.82 for the annual expected dividend rate as of January, 1993. SJLPC arrived at this figure by rounding the current dividend of $1.72 to the nearest 1/2 cent on a quarterly basis.

Staff proposes that a 11.10% cost of equity be adopted in this proceeding. In calculating its DCF, Staff used historical data on earnings per share and dividends per share. Additionally, Staff reviewed projections made by various investor services and research firms, such as Value Line and Standard & Poor's. In determining the annual dividend for input into its application of the DCF model, Staff used an expected dividend of $1.78 for the months of October, November and December of 1992, and $1.76 for the month of January, 1993. Staff's DCF calculations determined that a reasonable cost of equity for SJLPC lies in the range of 10.14% to 11.27%, with the mid-point range being 10.71%. Staff then adjusted the cost of equity for its primary recommendation in this case by forty (40) basis points in recognition of the lower equity ratio in its proposed hypothetical capital structure. Staff based this adjustment on the consideration that as the amount of debt increases a company faces more leverage risk. This is the risk that a company may not be able to maintain expected earnings to service its debt which, if this occurs, causes the equity holders to bear the losses.

As the Commission has previously determined that SJLPC's actual capital structure is inappropriate to use to establish rates in this proceeding, Staff's alternative return on equity recommendation using SJLPC's actual capital structure will not be addressed.

AGP recommends that the Commission adopt a 9.3% return on equity for this proceeding. AGP conducted DCF calculations on SJLPC's stock and that of eighty-five (85) other electric companies and then performed a comparative analysis using: (1) companies with a Value Line safety rating of "2", (2) companies with a Standard & Poor's stock rating of "A" and (3) companies with a Standard & Poor's bond rating of "A+" to get an average cost of equity for each of these groups. AGP states it based its recommendation on a comparative analysis, as opposed to company specific analysis to avoid establishing a return on equity that will lock a company with low growth rates into a return that is lower than the average and, in the reverse, avoid locking a company with high growth rate returns into a return which is above average.

Public Counsel proposes that SJLPC be allowed a rate of return on common equity of 10.08% to 10.76%. Public Counsel studied five (5) different growth rates to determine the appropriate growth rate to use in the cost of equity calculations. These growth rates are: (1) the historic annual compound growth rate and earnings per share, dividends per share, and book value per share, (2) the average Value Line's five (5)- and ten (10)- year growth rates in earnings, dividends and book value, (3) the projected growth rate in earnings per share, dividends per share and book value per share, (4) the historic retention growth rate, and (5) the projected retention growth rate. Furthermore, to calculate the dividend yield, Public Counsel used an expected dividend of $1.76. Public Counsel determined its stock price for the DCF model by averaging the stock price over the twelve-week period beginning October 16, 1992 through December 31, 1992. Public Counsel used this twelve-week period to avoid daily fluctuations and because it is recent enough to capture stock prices which are representative of current investor expectations. Due to the relatively high degree of volatility that SJLPC's stock price experienced during October 16, 1992 through December 31, 1993, Public Counsel examined the trend in SJLPC's stock price for the first five (5) weeks of 1993. The results of this examination showed that SJLPC's stock price was maintaining at a higher level than that of the October through December, 1992 time period. Public Counsel stated that in an effort to be fair to SJLPC, it used the lower stock prices from the October-December time period in its DCF calculation.

The Commission finds that the high end, 11.27%, of the return on equity range as proposed by Staff, adjusted by forty (40) basis points, to 11.67%, is the most reasonable return on equity for SJLPC. Upon consideration of the evidence, which showed that SJLPC is smaller than the companies used by the parties to establish the proxy groups and develop the hypothetical capital structure, the Commission determines that it is reasonable to adjust SJLPC's return on equity to recognize its smaller size, components of the structure adopted by the Commission and other factors affecting the company's risk. The addition of forty (40) basis points added to the high end of Staff's range properly reflects these factors.

The Commission specifically rejects SJLPC's calculation of the DCF formula as part of its calculation was based on an expected dividend of $1.87 which is eleven (11) cents higher than the actual annual dividend rate of $1.76 for 1993.

Furthermore, the Commission does not find it necessary to base DCF estimates strictly on a comparable company's basis as AGP recommends. The Commission may find this approach appropriate where there is not enough available information on a company if, for example, it is not publicly traded. This is not the case in this proceeding and the Commission finds it is more reasonable to establish the return on equity on a company-specific basis.

The Commission recognizes that each of the DCF calculations is based upon an expert's determination of the factors included in the DCF calculation. The Commission, even though adopting Public Counsel's capital structure, finds that Public Counsel's DCF calculation results in a return on equity range that does not take into account the average risk associated with the hypothetical capital structure. Therefore, the Commission is of the opinion that it is inappropriate to employ Public Counsel's return on equity range.

The Commission, for these reasons, determines that Staff's rate of return on equity is the appropriate one upon which to base its decision. In that context, the Commission further determines 11.67% should be adopted as the most just and reasonable return on equity.

OVERALL WEIGHTED COST OF CAPITAL

The Commission adopts the capital structure used by Public Counsel for SJLPC as follows with weighted costs:

Capital Component	Percent of Total	Cost	Weighted Average Cost Of Capital
Short-term debt	00.0	00.0	00.0
Long-term debt	48.29	8.914%	4.305%
Preferred stock	00.0	00.0	00.0
Common equity	51.71	11.67%	6.035%
Total	100.00%		10.34%

INCOME TAXES

This issue relates to the different treatment by Staff and SJLPC of Schedule M items. Schedule M adjustments refer to adjustments shown on SJLPC's tax return, Form 1120, Schedule M. Public utilities are allowed to take deductions for tax purposes for some items at times other than when the items are expensed for book purposes. They adjust the book taxable income for items which are: (1) income taxable in a period other than recorded on the books, (2) expenses deductible in a period other than recorded on the books and (3) expenses recorded on the books which are not deductible for tax purposes. Schedule M items can be either tax-timing differences, where they originate in one period and turn around in another, or permanent differences where no turn around occurs.

Tax Straight Line Depreciation

Both SJLPC and Staff agree that book depreciation and tax depreciation are completely different. Book depreciation is an expense recorded by a company at rates authorized by the Commission through the useful life of an asset, that is until it is retired. The Internal Revenue Code (IRC) allows a deduction for depreciation of an asset (until it is fully depreciated) as an item of expense in calculating the federal income tax liability. This tax depreciation may, under authority of the IRC, be calculated on an accelerated basis thereby increasing the income tax deduction for depreciation associated with a particular asset early in the useful life of that asset. If the taxpayer elects to accelerate depreciation on a particular asset for tax purposes, then the income tax deduction for depreciation associated with that asset is reduced later in the useful life of that asset. The IRC precludes regulatory bodies from using, in the ratemaking process, an income tax deduction for depreciation that exceeds book depreciation, 26, U.S.C.A. Section 167 (1). The Commission routinely normalizes accelerated depreciation as it cannot flow through the entire deduction to the immediate benefit of ratepayers. Tax straight line depreciation is book depreciation adjusted to exclude amounts already treated as an income tax deduction reflecting asset recovery.

The dispute in this issue centers on the amount of the tax straight line depreciation. SJLPC and Staff agree on the amount of tax depreciation. However, that is the limit of their agreement on this issue. Both SJLPC and Staff have used different methods to develop their straight line depreciation and each alleges that the other is the incorrect method to use.

SJLPC proposes that its ratepayers not receive a tax deduction for the over-accrual of depreciation (on pre-1965 property) due to its mass asset depreciation methodology. SJLPC further proposes to limit the deduction related to post-1964 through pre-1971 property.

Staff states that it bases its position upon the assumption that SJLPC's current depreciation rates are reasonable; and, therefore, that the over-recovery of book depreciation on pre-1971 property is actually related to under-recovery of book depreciation on post-1970 property under the mass asset depreciation methodology. Staff asserts that SJLPC will receive a tax deduction on the over accrual of the pre-1971 property either through tax depreciation on post-1970 property or through the additional deduction for any unrecovered investment at the time of retirement. Staff contends that as the ratepayer will continue to provide book depreciation for the pre-1971 property, the ratepayer should receive the related tax deductions.

The Commission finds that Staff's adjustment on this issue is the more reasonable approach. Furthermore, as no evidence was presented that SJLPC's current depreciation rates are unreasonable, the Commission adopts this adjustment on the assumption that SJLPC's current depreciation rates are reasonable. From the evidence, the Staff's method normalizes the effects of the accelerated depreciation allowed by the IRC. Staff's method of developing the tax straight line depreciation follows the usual manner in which the Commission authorizes this adjustment, thereby giving the ratepayers the tax benefit of the depreciation they are required to pay. SJLPC has not presented any evidence that convinces the Commission to deviate from its normal practice.

The Commission, therefore, determines that Staff's position on Straight Line Depreciation should be adopted.

Normalization v. Flow-through of Repair Allowance

SJLPC proposes to normalize repair allowance for tax treatment purposes. SJLPC asserts that the repair allowance, Schedule M, should be normalized because it corresponds with accelerated depreciation which Schedule M normalizes. SJLPC asserts that in order for it to take a repair allowance deduction it must reduce the basis of property additions in that year which thereby reduces tax depreciation over the life of that property. Therefore, SJLPC argues that unless the amount of the repair allowance is normalized to match the tax life of the property, future generations of customers will not receive a tax deduction for ratemaking purposes.

Staff proposes that the repair allowance should be treated as a flow-through item for tax purposes. Staff asserts that this is the proper treatment as it equates the amounts provided by ratepayers for the income tax expense with the amounts paid the taxing authority by the utility.

The Commission finds that repair allowance should be treated as a flow-through item for tax treatment to equate the amount of funds provided by the ratepayers for income tax expense with the amounts paid the taxing authorities by the utility. The Commission finds that normalization of this expense is not appropriate as it will eliminate tax-timing differences for ratemaking purposes so that income tax expense is based solely on the book income effect of these timing differences. The Commission has found, in some situations, where a company is experiencing a cash flow problem that normalizing repair allowance is appropriate. However, the Commission finds that since there is no evidence that

SJLPC is experiencing a cash flow problem that it is inappropriate to normalize repair allowance in this proceeding.

The Commission, therefore, determines that Staff's position that repair allowance be treated as a flow-through item for tax purposes should be adopted.

INTEREST SYNCHRONIZATION (INTEREST EXPENSE TAX DEDUCTION)

This issue concerns the amount of SJLPC's tax deductible interest expense. The interest expense is calculated by multiplying the jurisdictional rate base by the weighted cost of debt. This method assures that the amount of interest expense used in the calculation of income tax expense, for ratemaking purposes, equals the interest expense the ratepayer is required to provide the company in rates. Since the revenue requirement is based on a rate of return computation, the interest synchronization method allows an interest deduction consistent with the rate of return computation which is applied to rate base.

SJLPC is in agreement with Staff that an interest expense adjustment calculation is appropriate, but only when its actual capital structure is used. Staff proposes an interest synchronization based on its hypothetical capital structure.

As the Commission has determined that the appropriate capital structure upon which to set rates in this proceeding is the hypothetical capital structure as proposed by the Public Counsel, the Commission finds that it is reasonable to calculate interest expense on the weighted cost of debt (4.305%) as calculated by Public Counsel. The Commission finds that even though using the hypothetical capital structure weighted cost of debt rather than that of the actual capital structure results in a larger income tax deduction, it reduces income tax expense and thereby reduces SJLPC's revenue requirement. Therefore, the Commission finds this is the most reasonable approach to establish interest expense in this proceeding.

The Commission, therefore, determines that the interest expense tax deduction based on the weighted cost of debt (4.305%) as calculated in Public Counsel's hypothetical capital structure should be adopted.

MAINTENANCE

SJLPC proposes the adoption of a five (5) year historical maintenance expense average, adjusted for inflation. SJLPC asserts that as maintenance expenses are made up of labor, material and service costs, all of which are, and have been, affected by inflation, an adjustment to reflect present cost levels should be made to the historical levels for ratemaking purposes. SJLPC, therefore, proposes to adjust the five (5) year historical maintenance expense, through the Consumer Price Index to reflect what the historical dollars will be in today's dollars.

Staff proposes the adoption of SJLPC's actual maintenance expense as of December 31, 1992. Staff argues that its proposal is consistent with the actual test-year, with what SJLPC actually has experienced since the end of the test-year and with the Commission-ordered update period ending December 31, 1992.

The intent of the Commission in establishing maintenance expense, in setting rates, is to determine a level of maintenance expense which a company is likely to incur in the future. The Commission determines that the maintenance expense for this case should be the five (5) year historical level, less the allocation for steam, as proposed by SJLPC. The evidence presented illustrates that SJLPC's maintenance expense is declining. However, taking into consideration the age of SJLPC's plant, the Commission finds it more reasonable to establish maintenance expense on a five (5) year historical average to allow for fluctuations in yearly maintenance expense. The Commission is aware that, as SJLPC's plant continues to age, maintenance expenses will likely recur on a more frequent basis. However, the Commission finds no reasonable basis to adjust the maintenance expense based on the Consumer Price Index. The Consumer Price Index only reflects certain portions of national price increases and is not related to company-specific information. The Commission does not believe maintenance expense set upon a national Consumer Price Index is reasonable. Each company is different and expense adjustments should be set on an individual company's expenses and not upon statistical extrapolation based on an index which measures a wide array of unrelated prices.

The Commission, therefore, determines that a five (5) year historical average less the allocation for steam with no adjustment for the Consumer Price Index should be adopted in this proceeding for maintenance expense.

RATE CASE EXPENSE

SJLPC proposes to include in its cost of service an adjustment for incremental expenses incurred as a result of this case as well as similar expenses associated with its defense of Case No. EC-92-214. Furthermore, SJLPC proposes that it be allowed to amortize its rate case expense over a two (2) year period. SJLPC asserts that this is the period of time during which the rates established in this case will likely be in effect as it anticipates filing another rate case in two (2) years due to the recent increase in Missouri corporate tax rates and a possible increase in federal corporate tax rates.

Staff proposes to exclude any rate case expense from SJLPC's cost of service if the Commission finds SJLPC to be over-earning. Staff asserts that no rate case expenses should be allowed if SJLPC is found to be over-earning, as all such expenses will have been incurred for the purpose of overcharging ratepayers for a longer period of time to benefit the shareholders. Staff alternatively proposes that any rate case adjustment allowed by the Commission be amortized over a three (3) year period because SJLPC's last rate reduction was in 1988 and its last filed rate case, before the present proceeding, was in 1981.

The Commission finds that the rate case expense for this proceeding should be allowed. The Commission does not want to put itself in the position of discouraging necessary rate cases by discouraging rate case expense. This is a particularly treacherous area for the Commission to be addressing in that the Commission cannot be viewed as having a dampening effect upon a regulated company's statutory procedural rights to seek out a rate increase when it believes that facts so justify it. Disallowing prudently incurred rate case expense can be viewed as violating the company's procedural rights. At the same time, if it is determined by clear and convincing evidence that a rate case was frivolously filed, then the Commission would be under a duty to protect ratepayers from imprudently incurred costs. The Commission finds that in order to uphold SJLPC's statutory rights to seek what it believes to be a necessary rate increase expenses for this proceeding (Case No. ER-93-41) should be allowed.

The Commission further determines that the expenses incurred by SJLPC in Case No. EC-92-214 should be equally shared between SJLPC's ratepayers and shareholders and amortized over a two (2) year period. The Commission strongly supports a company's right to defend itself against a complaint initiated by Staff and, under normal circumstances, would allow the company to include the expense of its defense in the cost of service. However, the Commission finds that this rate complaint proceeding is different than other rate complaints or rate proceedings that have come before the Commission. The Commission points to SJLPC's insistence on filing its case on the wrong test year, which not only prolonged the hearing, but made it impossible to try the proceeding on an issue-by-issue basis. The Commission finds that the ratepayers should not be required to bear the entire burden of SJLPC's management decision to deliberately violate the Commission's test year order, thus unduly complicating and prolonging that case. Therefore, SJLPC's shareholders should bear part of the burden of this management decision.

The Commission is of the opinion that the rate case expense of $205,584.16 as requested by SJLPC for Case No. EC-92-214 should be reduced to $102,792.08 and allowed for complaint case expense in that proceeding and SJLPC should be allowed to recover $205,292 for rate case expense in this proceeding. Furthermore, in light of SJLPC's contention that it will be filing a rate proceeding in approximately two (2) years, the Commission finds that it is appropriate to amortize these expenses over a two (2) year period.

FUEL AND INTERCHANGE

Capacity Purchase Demand Charges

Purchase capacity demand charges represent an amount of money paid to an electrical generator to reserve a fixed amount of electric generating capacity, measured in megawatts (1,000 Kilowatts), for use whenever needed by the purchaser. Demand charges generally cover the selling utility's cost of owning the capacity. Demand charges do not include any fuel costs or operation and maintenance costs for the purchase of electric energy from the capacity which is being purchased. Purchase capacity demand charge is paid by one utility to another for the cost of reserving capacity for the other utility's system without any actual energy production from that capacity. The dispute in this issue centers on whether or not to include purchase capacity demand charges for purchase capacity demand beginning May 1, 1993. Staff proposes to exclude the demand charges from the cost of service calculation, while SJLPC proposes to include these charges in the cost of service.

SJLPC proposes to include the capacity demand charges in its cost of service because they are known and measurable and used and useful in providing electric service to its customers.

Staff proposes that the purchase capacity demand charges beginning May 1, 1993 should be excluded from the cost of service calculation because they are an isolated adjustment and, instead, endorses the amount for capacity purchase demand charges which was actually experienced by SJLPC during the test year. Staff's position on this issue has become, as stated by Staff, an admittedly messy and confusing process of which the Commission fully agrees. It appears from the evidence that Staff is now, after initially including, excluding these costs because it is an isolated adjustment and studies by the Staff demonstrate that the revenues and system requirements do not support the necessity for the increased capacity.

The Commission, in its order establishing the test year for this case, made an allowance for isolated adjustment outside of the test year. This issue qualifies as such an isolated adjustment as the charges that are in dispute occurred beginning May 1, 1993. However, the Commission finds that it is inappropriate to include an adjustment for this issue as SJLPC has failed to include any corresponding 1993 revenues in its case, thus distorting the test year relationship of rate base/revenues/expenses by including the capacity purchase expense and failing to acknowledge the additional revenues associated with this purchase. Two different SJLPC witnesses addressed this issue in their testimony. Both witness clearly set forth that SJLPC included the effect of this additional capacity in developing the annualized costs for purchase power and that the capacity purchases at May 1, 1993, had been factored into the price of purchased energy for both SJLPC's filed and updated case. Even though the evidence demonstrated that the additional capacity purchases are intended to replace other more expensive purchases and also the more expensive Lake Road generation, the Commission cannot extrapolate from this testimony that the increased revenues from this purchase have been included in this case.

The Commission, therefore, finds that Staff's position concerning Capacity Purchase Demand charges should be adopted in this proceeding.

CLASS COST OF SERVICE/RATE DESIGN

Implementation of EO-88-158 Report and Order

This issue stems from Commission Case No. EO-88-158, In the Matter of the Investigation of the Electric Class Cost of Service for St. Joseph Light & Power Company, which was established by the Commission for SJLPC to perform an electric class cost of service study. The Report and Order (Report and Order) in this case was issued December 11, 1992, wherein the Commission ordered SJLPC to implement the rate design approved in the Report and Order in either the then pending Case No. EC-92-214 and/or pending Case No. ER-93-41, but not later than the operation-of-law date of July 5, 1993 in Case No. ER-93-41. In its order issued March 19, 1993 in Case No. EO-93-41, consolidating Case Nos. ER-93-41 and EC-93-252, the Commission expressly stated that it would not issue an order in Case No. EC-92-214 as the $7 million reduction alleged in Case No. EC-93-252 surpasses the $3.5 million reduction requested in Case No. EC-92-214. The Commission, therefore, fully expects for its Report and Order issued in Case No. EC-88-158 to be implemented in this proceeding. In its Report and Order, the Commission clearly found that the revenue responsibility should be shifted among the customer classes of SJLPC as follows: residential by 4.50%; general service by 3.00%; and large power by a negative 5.05%.

Staff, SJLPC and AGP all correctly interpret the Report and Order to require that the percentage shifts ordered by the Commission in Case No. EO-88-158 should be made first after which any increase or decrease in overall revenue requirement ordered by the Commission in this case should be distributed among all customer classes on an equal percentage basis. Public Counsel, on the other hand, has chosen to interpret the Report and Order to require that the dollar amounts associated with the percentage changes be shifted rather than the percentages. The Commission does not understand Public Counsel's misinterpretation of the Report and Order. It is not logical that the Commission would have intended a dollar shift in revenues from the test period in Case No. EO-88-158, the twelve (12) months ending December, 1990, and then apply the results of that case on a dollar basis to the test period in this proceeding, the twelve (12) months ending September 30, 1992, updated through December 31, 1992. The intent of the Commission's decision in Case No. EO-88-158 was that class revenues should be changed by the percentages set forth in its Report and Order and that the application of those percentages would be applied to the new level of revenues in this case.

Therefore, the Commission finds that the rate design percentages as set forth in Case No. EO-88-158 should be implemented in this proceeding as directed in the Report and Order issued in EO-88-158.

Rate Design Proposal

SJLPC, Staff and Public Counsel agreed to a settlement of the rate design issue in this proceeding. Based on the agreement, Staff recommends that the Commission approve the settlement as a reasonable resolution of the rate design issues that were presented in this proceeding. The Staff contends that the rate design changes set forth in the settlement represent appropriate movement towards cost-of-service. Staff further states that by the adoption of this settlement, the Commission can mitigate the impact that will result from implementing Phase II of the investigation of SJLPC's class cost-of-service and rate design.

AGP opposes the settlement agreement on the grounds that there is no cost of service data in this case to support this settlement. Furthermore, AGP alleges that the settlement addresses Phase II issues in a manner that is inconsistent with all of the cost of service results produced in Phase I and alleges that the settlement directly conflicts with the Commission's Report and Order by making rate design changes that are expressly deferred to Phase II of SJLPC's class cost of service study.

The Commission rejects the settlement agreement as proposed by Staff and SJLPC. The Commission finds that sufficient evidence has not been presented to deviate from its original intention of implementing its rulings in Case No. EO-88-158 in this proceeding. The Commission anticipates, and is of the opinion, that if future rate design changes are to be implemented they will result from Phase II of the cost-of-service proceedings.

The Commission, therefore, finds that the rate design as determined in Case No. EO-88-158 should be implemented in this proceeding.

Economic Development Rider

This issue was raised by Public Counsel and stems from the economic development rider approved by the Commission for SJLPC in Case No. ER-93-162. There is no revenue adjustment associated with this issue. SJLPC supports the continuation of the economic development rider as ordered by the Commission. Staff takes no position on this issue. AGP opposes the continuation of the economic development rider on the grounds that, in its present form, it unlawfully discriminates against current customers. Public Counsel opposes the economic development rider on the grounds that it is discriminatory, since certain customers will be charged a rate different from the rate paid by other members of the same class, even though usage patterns are similar and, if service is provided to economic development rider customers at rates that are less than the long-run marginal costs, the non-economic development rider customers will be harmed. To alleviate its objections to the economic development rider, Public Counsel has proposed numerous modifications which AGP supports.

The Commission is of the opinion that the additional language as proposed by Public Counsel should be rejected. The economic development rider granted to SJLPC by the Commission is similar to economic development riders granted to other utilities. The purpose of the economic development rider is to encourage economic development in the service areas of the utilities granted such riders. The inclusion of the language proposed by Public Counsel will place an undue burden on SJLPC and inhibit the underlying policy of economic development intended by the Commission.

The Commission, therefore, determines that the language as proposed by Public Counsel to modify the economic development rider as ordered in Case No. ER-93-162 should not be adopted in this proceeding.

PURPA Regulations

This issue was raised by AGP. Neither Staff nor Public Counsel has taken a position on this issue. AGP opposes SJLPC's standby or supplementary electric service rate, Schedule "770", as unlawful because it does not allow parallel operation. AGP states that Rate Schedule "770" relates to the sale of power to the customer with its own generation and, as such, does not comply with the Public Utility Regulatory Policies Act of 1978 (PURPA) regulations as it does not offer the customer the option to operate in parallel with qualifying facilities.

SJLPC contends that AGP is misinformed on this issue as Schedule "770" is designed for supplemental or standby service where customers request SJLPC to provide capacity on demand and does not address parallel operations. SJLPC states that Schedule "775" is available for qualifying facilities under the requirements of PURPA and does provide for parallel operations.

The Commission finds it interesting that AGP, the party raising this issue, did not address this issue in either its initial or reply briefs. However, the Commission finds that AGP is mistaken in its understanding of this issue. SJLPC specifically has Schedule "775" which is approved by the Commission and provides for parallel operations.

The Commission, therefore, rejects AGP's position on this issue that SJLPC is not in compliance with PURPA regulations, as SJLPC has a Commission approved tariff which provides for parallel operations.

INTEGRATED RESOURCE PLANNING

The Integrated Resource Planning Rule, 4 CSR 240-22.010 (rule), promulgated by the Commission, became effective May 6, 1993 and applies to the five (5) investor-owned electric utilities in Missouri, one of which is SJLPC. The purpose of this rule is to set minimum standards to govern the scope and objectives of the resource planning process that is required of electric utilities subject to Commission jurisdiction in order to ensure that the public interest is adequately served.

SJLPC estimates that its cost of compliance with this rule will be $1,396,575, but proposes to include only $755,700 in its cost of service. SJLPC argues that $755,700 should be included in its cost of service as this cost will be incurred to comply with a Commission rule which will not generate any corresponding revenue increases.

The Staff proposes to disallow any adjustment to SJLPC's cost of service for this rule as the costs associated with the rule are projected costs and violate the ratemaking principal of revenue/expense/investment relationship that is necessary to develop an accurate revenue excess/requirement determination. Staff further opposes this adjustment as it is not known and measurable at this time. Staff states that the costs associated with this rule are not known and measurable in that the costs have not occurred and cannot be accurately quantified. Furthermore, Staff states that any costs associated with the rule will occur outside of the test year established by the Commission for this case.

The Commission finds that the $755,700 adjustment to the cost of service proposed by SJLPC should not be allowed. The Commission finds that the costs associated with this rule are not known and measurable and that any costs associated with this rule will occur outside of the test year established in this case. Furthermore, the evidence demonstrated that SJLPC will not be required to comply with the rule until the year 1996. The mere fact that the Commission has promulgated this rule does not make the costs known and measurable.

Therefore, the Commission determines that the Staff's position on this issue should be adopted and the $755,700 adjustment to the cost of service as proposed by SJLPC should be disallowed.

ALLOCATIONS

This issue arises out of Staff's complaint Case No. EC-93-252, which was consolidated with SJLPC's request for a rate increase. The dispute centers on three sets of allocation factors that Staff has used to allocate: (1) portions of the generating plant at Lake Road, (2) portions of Lake Road operation and maintenance expenses, and (3) portions of the SJLPC's overall administrative and general expenses. Staff contends that the allocation method utilized by SJLPC places too large of a percentage of the cost for the above set forth items on its electric ratepayers and that some of these costs should be shifted to its steam customers. Public Counsel supports Staff's position on this issue. SJLPC contends that the allocation methods it currently employs should not be changed. AGP supports SJLPC's position on this issue.

Staff contends that as a portion of the Lake Road plant produces steam at 900 pounds per square inch ("psi" or "900#") for two purposes: (1) to sell to industries which operate in the general vicinity of the plant, and (2) to operate turbine generators to produce electricity for sale to customers throughout SJLPC's service area, the Commission must determine what portion of the common plant must be borne by SJLPC's electric customers. Staff developed a fuel, plant, payroll, and other A&G expense allocators upon which its proposed allocations are based. Staff recommends that the Commission implement the allocation of the Lake Road costs according to the following percentages: electric customers should pay for (1) 14.18% of the 900# system's fuel costs, because the electric customers consume this percentage of the fuel heat energy expended in the 900# system, (2) 29.01% of the 900# system's common plant costs, because electric customers use 43.84% of the capacity used on the day of peak demand. This allocation factor was developed from a composite of energy and demand figures, (3) 13.91% of the 900# systems other operating expenses, because electric customers consume 13.91% of the total heat energy (i.e., heat from the well water plus heat from the fuel flowing from the 900# system). Furthermore, the Staff proposes that Administrative and General Expenses be allocated to its electric jurisdiction on the following basis: 88.0025 percent of payroll-related expenses, because this is the percentage of payroll expense which SJLPC incurs in serving its electric customers, and 74.1368 percent of the cost of other A&G expenses, because this is the percentage which benefits SJLPC's electric customer.

Staff's proposed allocation results in approximately $1,048,568 worth of plant and $1,680,795 of expenses being shifted from the electric to steam jurisdictions. This results in an approximately fifty (50) percent and seventy-seven (77) percent increase in plant and expense, respectively, being shifted from the electric to steam jurisdictions over what is presently being allocated.

The Commission is of the opinion that Staff's allocation approach should not be implemented without further study and a consideration of all relevant data. The Commission is of the opinion that careful consideration should be given to implementing allocation factors that result in such a significant cost shift to the steam customers or any other customer class. The Commission is unwilling to make the allocation shifts as proposed by Staff as the evidence provided is not clear and convincing that it is based on the appropriate time frame or best possible data source. The evidence demonstrated that Staff's fuel expense allocator is based on data obtained from the twelve (12) month test year established in this case, whereas in an effort to weather normalize its calculation SJLPC based its fuel expense allocation on the most recent three (3) years of fuel usage. The Commission, while not necessarily approving SJLPC's method of developing its fuel expense allocator, finds that a fuel expense allocator based on a three (3) year usage period is preferable to one based on a twelve (12) month period. Where the adoption of a proposed fuel expense allocation has such a dramatic effect on a particular class of customers, the most accurate data is especially required.

Furthermore, the Staff's evidence states that the best data for developing a plant expense allocator, hourly data on the integrated steam flow from the header to the industrial customers, was not available. Lacking this more accurate data, Staff prepared its adjustment based on daily steam flows data. The evidence further indicated that hourly integrated steam flow information could be made available _if_ SJLPC would install integrated steam volume flow meters in the proper location for an approximate cost of $50,000. The Commission is of the opinion that $50,000 is a relatively small price to pay to assess the appropriate allocation of over $1.5 million as to this issue for this company. The installation of these meters in the proper locations will provide the data, coincident peak hourly demand computations, upon which Staff can rely rather than on the less precise daily information Staff resorted to in calculating the plant expense allocation.

Moreover, the Commission is unwilling to adopt Staff's proposed Administrative and General (A&G) expense allocations at this time. Staff bases this allocation on the benefit received by the customer. As the Commission has rejected Staff's proposed allocation adjustments for fuel and plant cost, the Commission finds it reasonable to also reject Staff's proposed A&G expense allocations. Since Staff has based this allocation on the benefit received by the customer, the Commission is of the opinion that if Staff's allocations of the fuel and plant are not adopted, then Staff's A&G allocator cannot be adopted because it will have a different benefit to the customer. The Commission finds that more convincing evidence should be developed and presented in order to change SJLPC's current allocations of fuel, plant and A&E expenses. Short of this type of more accurate evidence, those expenses should remain as allocated by SJLPC.

Therefore, the Commission is of the opinion that a docket should be established for the purpose of conducting Phase II of SJLPC's class cost of service study. Also, as part of the Phase II cost of service study, expenditures are hereby authorized by SJLPC to install integrated steam volume flow meters in the proper locations to obtain the more accurate hourly data.

Therefore, the Commission determines that the allocation shifts as proposed by the Staff should not be adopted and the cost allocations associated with this issue should be maintained as currently allocated until Phase II of SJLPC's cost of service study has been completed.

STATEMENT OF FINANCIAL ACCOUNTING STANDARDS (FAS) NO. 106

Financial Accounting Standard (FAS) 106 is an accounting standard issued by the Financial Accounting Standards Board (FASB) in 1990 which requires that employers account for "other post employment benefits" (OPEBs), also called "other post retirement benefits" (OPRBs) by an accrual accounting method rather than a "cash" or "pay-as-you-go" accounting method. OPEBs are benefits other than pensions, such as health care, dental care and life insurance. FAS 106 mandates that companies use an accrual method of accounting for financial reporting of OPEBs after December 15, 1992. Currently, utility companies under the Commission's jurisdiction, including SJLPC, have accounted for OPEBs as they are paid on a cash basis. Accrual accounting under FAS 106 requires the employer, SJLPC, to accrue the cost of these benefits in the same period the employees are earning the benefits. Thus, FAS 106 requires companies to record OPEB expense, for financial reporting purposes, in the amount of the benefit obligation that it estimates its employees have earned during the period, plus an amortization of OPEB costs of prior periods which have not been previously recorded as expense.

FASB has no direct authority over the ratemaking authority of the Commission. FASB's standards apply to Missouri companies through the Federal Securities and Exchange Commission. Prior to FAS 106, OPEBs have been recognized, both for financial reporting and ratemaking purposes, on a pay-as-you-go basis. Under the pay-as-you-go method, OPEBs expenses are booked at the time the utility pays cash benefits to its employees. The result of moving from a cash basis to an accrual basis will increase the amount of OPEB expense recorded on SJLPC's financial statement. To change from pay-as-you-go to accrual accounting, utilities will incur a transition obligation. The transition obligation represents the OPEB benefits related to employee service already rendered at the time of the change in accounting methods. The transition obligation may be amortized over the average remaining active service period of employees prior to eligibility for retirement or, if longer, 20 years. FAS 106 involves a mismatch of service costs and benefits by permitting companies to amortize over a future period the portion of estimated future OPEB obligations which the accrual accounting method attributes to past service. Accounting for OPEBs, under the accrual accounting, will increase SJLPC's operating expenses by $886,586 per year.

SJLPC recommends that the Commission adopt the accrual accounting method for determining OPEBs for ratemaking purposes. SJLPC asserts that the accrual method will provide a more objective tool for measuring OPEBs expense for rate allowance, will make comparisons between regulated and non-regulated companies more meaningful and will result in inter-generational equity between customer classes. Additionally, SJLPC contends it will not be able to create a regulatory asset unless it conforms with the guidance provided by the Emerging Issues Task Force (EITF) Consensus.

The Staff recommends that the Commission require a continuation of the pay-as-you-go or cash accounting method for ratemaking purposes. Staff's main opposition to converting from a pay-as-you-go to an accrual accounting method centers on the fact that, unlike pensions, nuclear decommissioning and depreciation, OPEBs are not long-term legal obligations of a company because these benefits, and any obligation to fund them, can be altered or eliminated at will by the company. Staff, therefore, reasons that there cannot be any legally imposed requirement to provide current funding for future payments. Furthermore, Staff objects to the adoption of the accrual method because of the difficulty in estimating OPEBs benefit obligations fifty (50) years in the future and the fact that FAS 106 is more sensitive to changes in actuarial assumptions than pension costs determined under FAS 87.

Public Counsel objects to the implementation of accrual accounting as required by FAS 106, and proposes that the Commission continue the pay-as-you-go method of accounting for OPEBs. Public Counsel's objections are similar to those of Staff. In addition to Staff's objections to the accrual accounting method, Public Counsel contends that the expense level of OPEB under FAS 106 is not known and measurable as it is based on uncertain, speculative assumptions and estimates of events happening years in the future.

The Commission has addressed the issue of OPEBs in three previous cases through accounting authority orders: Case No. Case No. EO-92-179, In Re: Union Electric; Case No. EO-93-35, In Re: Empire District Electric Company; Case No. GO-93-201, In Re: Western Resources d/b/a Gas Service. Essentially, the Commission treated Union Electric and The Empire District Electric Company the same wherein the Commission allowed these companies to defer OPEB costs in excess of the pay-as-you-go amount in Account 186. The Commission made a general statement of intent to allow prudently incurred OPEB costs in rates in the future and reserved rate treatment for OPEB costs for future rate cases, including determination of any amortization of a recovery period.

Western Resources received different treatment due to its request to utilize external funding to address FAS 106. In Western Resources' case the Commission approved special accounting treatment for both OPEB's and Western Resources' Company Owned Life Insurance (COLI) net income. Western Resources was granted the ability to book COLI interest start-up costs and COLI expenses in excess of income in the early years of the program (when a deficit occurs) to Account 186, Miscellaneous Deferred Debit. In regard to OPEBs, Western Resources was granted authority to book the difference between the accrual expense as calculated under FAS 106 and the pay-as-you-go amount as a regulatory asset, also under Account 186. The COLI start-up costs and expenses in excess of income and OPEB expense, all booked to Account 186, are then to be amortized to expense in direct relation to the net income stream from the COLI program, which will be booked above the line to Account 926, Employee Pensions and Benefits. In granting this treatment to Western Resources, the Commission emphasized that its order accepting Western Resources' application is dependent upon the specific facts and circumstances underlying Western Resources' proposal. The Commission stated in Case No. GO-93-201 that its order in that proceeding should not be construed as an endorsement of the use of FAS 106 accrual methodology for OPEBs for ratemaking purposes or an endorsement of the issuance of accounting authority orders for OPEBs conforming to the EITF pronouncement for utilities in Missouri, absent the specifics of Western Resources' proposal in that proceeding.

Furthermore, in that proceeding, the Commission found Western Resources' plan and Staff's recommendation a reasonable and acceptable approach in dealing with the implementation of FAS 106 and the accompanying EITF pronouncement. The Commission also found that expenses related to the adoption of FAS 106 are extraordinary or unusual items which qualify for deferral and later amortization. The Commission further determined that Western Resources' proposal to use its COLI program as an offset to the sharp increase in OPEBs expense as a result of FAS 106 is a reasonable and prudent mechanism for the avoidance of substantial detrimental impact for both the ratepayer and shareholder alike.

The Commission will grant SJLPC an accounting authority order similar to those granted to Union Electric and The Empire District Electric Company. Specifically, the Commission will authorize SJLPC to continue to use the pay-as-you-go methodology for calculating the amounts charged to post-retirement benefit expenses other than pensions on its financial statements after January 1, 1993, based on actual payments to retirees. The differential between the expense amount calculated under FAS No. 106 and the pay-as-you-go amount shall be booked to Uniform System of Accounts No. 186, Miscellaneous Deferred Debt, as a regulatory asset. Furthermore, the Commission intends to allow prudently incurred OPEB costs to be recovered in the future on a pay-as-you-go basis. OPEBs are legitimate and historically approved costs of providing service and, absent evidence that they are excessive or imprudently incurred, they will continue to be recovered by SJLPC on a pay-as-you-go basis. Moreover, the Commission believes that it is probable that OPEBs capitalized as a regulatory asset, as a result of adopting FAS No. 106, will likewise be recovered in rates.

In the alternative and upon proper application, the Commission would be willing to grant SJLPC an accounting authority order to initially defer in Account 186 the costs associated with an externally funded program, as in Case No. GO-93-35, and allow SJLPC to amortize the deferred externally funded program costs, deferred OPEB costs and the current year OPEB expense under FAS 106 that exceed current year OPEB payments. This amortization would be limited to an amount which offsets the cumulative OPEB, externally funded program deferral, and current year OPEB expense under FAS 106 that exceeds current year PBOP payments. Additionally, the Commission would be willing to adopt the following position with regard to the accounting treatment approved for FAS 106 under this method:

1. That OPEBs are legitimate and are historically approved costs of providing service, and, absent evidence that they are excessive or imprudently incurred, they will continue to be recovered by SJLPC. Further, SJLPC is initially authorized to accumulate and defer in Account 186 those PBOP expenses related to the adoption of FAS 106 which will exceed OPEB payments. The Commission intends to authorize the prudently incurred capitalized OPEB expenses to be recovered in rates to the extent they are not offset by the net income generated as a result of SJLPC's externally funded program.

2. That the Commission intends to allow recovery of prudently incurred deferred externally funded costs to the extent they are not offset by an income stream generated as a result of SJLPC's externally funded program.

3. That the findings with respect to the appropriate accounting and ratemaking treatment of PBOPs and externally funded income and expense are subject to change by subsequent order of the Commission.

Therefore, the Commission finds that the cash basis accounting method is the appropriate method to determine OPEB expense for ratemaking purposes. In addition, the Commission will authorize SJLPC to continue to use the pay-as-you-go method for calculating the amounts charged to post-retirement benefit expenses other than pensions on its financial statements, based on actual payments to retirees. The differential between the expense amount calculated under FAS 106 and the pay-as-you-go amount shall be booked to Uniform System of Accounts No. 186, Miscellaneous Deferred Debt, as a regulatory asset.

Statement of Financial Accounting Standards No. 87

Pensions are legal obligations to employees and retirees requiring post-retirement payments to covered retirees. The source of this obligation is a Company's pension plan. Many of the terms, including the vesting of legal rights in employees and retirees, are required by federal law, The Employees Retirement Income Security Act of 1974 (ERISA), as amended, 29, U.S.C.A. Sections 1001-1145; 26 U.S.C.A. Section 1201, et seq.; 29 U.S.C.A. Section 1201, et seq.. ERISA requires that employers estimate, by accrual and actuarial techniques, the company's annual pension expense. ERISA also requires that a separate pension fund be established and maintained and sets minimum required contributions, while the IRC establishes the maximum tax deductible contributions to the fund. The minimum contribution assures that sufficient assets will be available to provide the promised benefits, while the maximum contribution prevents use of pension funding to avoid federal income tax. The accounting industry has promulgated FAS 87 to govern the representation of pension liabilities in a company's financial reports. This accounting standard also requires a company to estimate this pension expense by use of accrual and actuarial techniques. The accounting industry does not impose legal vesting or funding requirements on its clients.

SJLPC proposes that pension benefits be treated on an accrual basis for ratemaking purposes as an expense incurred during the years employees are engaged in active service. SJLPC proposes its ratepayers receive a benefit of its over-funded pension plans in the form of a negative expense of $1,098,646. SJLPC proposes that this negative expense will offset an estimated $561,173 expense increase attributable to adoption of SFAS 106 relating to OPEBs.

Staff proposes to set pension expense on the basis of the minimum pension contribution requirement under ERISA regulation, which is $0. Staff proposes to utilize the ERISA minimum funding requirement of $0 because SJLPC's pension fund is over-funded. Staff contends that SJLPC should be allowed ratemaking treatment for the funds necessary to adequately fund its test year pension plan obligation. Staff states that the minimum contribution under ERISA regulation is intended to insure that deferred benefits pension plans are adequately funded.

Staff and Public Counsel contend that the Commission should follow ERISA for ratemaking treatment for pension expense. However, both SJLPC and Staff agree that the ratemaking treatment for OPEBs and pensions should be the same. Witnesses for both SJLPC and Staff testified that as both OPEBs and pension expense are for the same type of benefits, subsidization of retirement benefits that are being provided to the employees, their ratemaking treatment should be consistent.

There is no dispute as to the level of funding in this issue. The dispute centers on the adoption of an accounting method: accrual accounting (FAS 87) as advocated by company or a funding cash contribution (ERISA) as advocated by Staff and Public Counsel. In its case SJLPC takes the position that the Commission has previously adopted FAS 87 for ratemaking treatment of SJLPC's pension expense and that if a funding cash contribution is now adopted a turn around cost of approximately $3.5 million will have to be written off by SJLPC. The Commission finds based upon its review of SJLPC's rate proceedings since 1987 that the Commission has never adopted FAS 87 for ratemaking purposes. These proceedings have resulted in stipulated cases wherein an overall dollar amount was accepted with no ratemaking treatment designated for the individual issues. The Commission, therefore, is of the opinion that the application of a funding cash contribution should not result in a write off as advocated by SJLPC.

The Commission finds that the appropriate method for accounting for pension expense and for funding pension expense is a funding cash contribution method, which results in a $0 cost in this case for which no actuarial evidence supports the need for any contribution above the ERISA minimum. This method is consistent with the Commission's decision on FAS 106 in this case and with other Commission cases, and over the long term will ensure that the pension liability of the company will be in compliance with federal guidelines.

Furthermore, the Commission fully intends to allow prudently incurred pension costs to be recovered in the future on a funding cash contribution basis. Pensions costs are legitimate, historically approved costs of providing service, and, absent any evidence that they are excessive or imprudently incurred, they may be recovered by SJLPC on a funding cash contribution basis. The Commission believes it is probable that these pension costs booked under SFAS 87 above the minimum ERISA contribution, capitalized as a regulatory asset, will be recovered in rates.

SETTLED ISSUES

On April 23, 1993, the Staff and SJLPC filed a Stipulation and Agreement, attached as Exhibit A and incorporated herein by reference, which set forth the issues resolved by Staff and SJLPC to which neither Public Counsel nor AGP expressed objection. These issues are: the AM/FM Accounting Authority Order, Salvage (sub-issue under Income Taxes), Management Incentive Plan, 401-K Discretionary Match, Sales/Purchases for Resale (sub-issue under Fuel and Interchange), Fuel Prices (sub-issue under Fuel and Interchange), Fuel Inventory, Leased Line, Depreciation Reserve-Iatan Precipitator, Heat Recovery Steam Generator #7 (a sub-issue under Allocations: Lake Road), Auxiliary Power (a sub-issue under Allocations: Lake Road), General Plant (a sub-issue under Allocations: Administrative and General Expenses/General Plant), and Deferred Tax Reserves issues were resolved subsequent to the filing of the Hearing Memorandum. The revenue requirement associated with these items are reflected in the reconciliation. Staff and SJLPC, as part of the settlement, request that the Commission adopt the following agreements as part of its Report and Order in this case:

CFSI

> For purposes of setting rates in this case, the CFSI line and related facilities shall be treated as operating leases. This agreement shall not preclude SJLPC from requesting capital lease treatment for these leases or any other capital lease in the future.

Dispatch

> SJLPC agrees to include as part of its monthly 4 CSR 240-20.080 filings information sufficient to determine the level of spinning reserve required by the Southwest Power Pool and the level of Spinning reserve maintained by the company. SJLPC further agrees to cooperate with the Staff in modeling fuel and purchase power expense on an on-going basis consistent with actual system operations.

Ash Disposal (Amortization)

> The parties agree that the Commission shall authorize SJLPC to amortize these costs over a three-year period so that SJLPC is not required to write off the total amount in a single year. However, this agreement does not indicate acceptance by the Staff or other parties of accounts booked by SJLPC for this item and does not preclude the Staff from challenging, in future cases, amounts booked by SJLPC.

Transportation

The Commission shall authorize SJLPC to change the depreciation rates for Account 392 - Transportation Equipment and Account 312.2 - Boiler #5 Precipitator at Lake Road to zero percent (0%) to be effective upon the effective date of the Report and Order in this case until the Commission authorizes a different rate.

RECORDS

The Commission shall order SJLPC to:

(1) allocate and maintain its depreciation reserve by primary plant account, to be completed no later than 12 months after the effective date of the Report and Order in this case;

(2) specify and maintain in its continuing property record what units of property are directly assignable to electric, steam and common plan operations, to be completed no later than 24 months after the effective date of the Report and Order in this case;

(3) update and maintain its continuing property records so as to capture annual additions and retirements by year installed and year retired since 1980, to be completed no later than 24 months after the effective date of the Report and Order in this case;

(4) provide a data base by primary plant account for both gas and electric plant consisting of annual additions, retirements by year of installation and year retired and a history of the annual salvage and cost of removal for the past ten years, to be completed no later than 24 months after the effective date of the Report and Order in this case;

(5) develop and maintain a property unit catalog, to be completed no later than July 1, 1996;

(6) develop and maintain property accounting instructions to be included with their property unit catalog, to be completed no later than July 1, 1996;

(7) develop and maintain current material costs from which to allocate labor costs to the various units of property, to be completed no later than 12 months after the effective date of the Report and Order in this case;

(8) advise Staff of its conclusion to proceed or cancel the AM/FM (Automated Mapping Facilities Management)(system development project when the analysis of the test project is concluded. Such advice will include justification for the decision made.

The parties acknowledge that the Commission must adopt this agreement as part of the Report and Order in this case.

The Commission is of the opinion that when the matters of agreement between parties appear to be reasonable and proper they should be accepted. Therefore, as the agreement between Staff and SJLPC appears reasonable and no other party has expressed any objections, the Commission will adopt the foregoing settlement of the aforestated issues as proposed by Staff and SJLPC.

Summary of Revenue Issues

Staff and SJLPC provided the Commission with responses to scenarios that provide the dollar amount to the issues decided in this proceeding. The chart below begins with Staff's proposed revenue reduction and that amount is adjusted based upon the Commission's decision on each issue as reflected in Exhibit No. 136. As can be seen the revenue reduction based upon this decision is $875,880.

Staff's Revised Recommendation	(3,888,688)
St. Joseph Light & Power's Position	3,115,410
Issues	**Revenue Requirement**
Allocations	
A. Lake Road	
Rate Base (net)	145,357
O & M	1,267,531
Depreciation	87,611
B. Adm. & Gen. Expense/Steam - A & G	389,471
C. Operations and Maintenance (O & M) Expense	0
Post-Employment Benefits	
A. Pension SFAS 87	0
B. OPEBs	0
Fuel and Interchange	
A. Capacity Purchase-Demand Charges	0
Maintenance	61,131
Integrated Resource Planning (IRP) Rule	0
Income Taxes	
A. Tax Depreciation - Straight Line	0
- Excess of S/L	0
B. Normalization v. Flow-through of Repair Allowance	0
C. Interest Synchronization (Interest	

Expense Tax Deduction)	0
Rate Case Expense	157,445
Return on Equity Adjustment based on 11.67% Return on Equity (Return on Rate Base):	904,262
Revenue Requirement based on above scenario:	(558,636)
Tax Effect:	(317,244)
Revenue Requirement based on above scenario Adjusted for tax effect:	(875,880)
The Percentage of total revenue increase exclusive of gross receipts & sales tax on annual basis over current revenues is:	(1.2127%)
Effect of Revenue Requirement on Class of Service:	
A. Residential	3.2045%
B. General Service	1.7098%
C. Large Power	(6.2393%)

Conclusions of Law

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

SJLPC is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 393, RSMO 1986, as amended. SJLPC is an electric company which provides electric service in the State of Missouri. SJLPC's tariffs herein were suspended pursuant to authority vested in the Commission by Section 393.150, RSMo 1986, which places upon SJLPC the burden of proof to show that the proposed increase in rates is just and reasonable. The complaint filed by the Staff, Case No. EC-93-252, was filed pursuant to Sections 386.240, 393.130.1, RSMo 1986, and 4 CSR 240-2.070. Under these sections, the Commission has the authority to determine whether the rates charged by SJLPC are unjust and unreasonable and to set just and reasonable rates for service. The Commission consolidated the rate Case No. ER-93-41 and EC-93-252. In consolidating these cases, the Commission determined that it would not issue an order in the then pending complaint case No. EC-92-214, as the $7 million reduction alleged in Case No. EC-93-252 surpassed the $3.5 million reduction requested in Case No. EC-92-214 and is based on a different test year. The

Commission, upon issuance of this Report and Order, will close Case No. EC-92-214 as being moot.

The Commission, in determining whether there should be a reduction in SJLPC's revenue requirement, may consider all facts which, in its judgement, have any bearing upon a proper determination of setting just and reasonable rates. The Commission has considered the evidence in these consolidated proceedings and has determined that SJLPC's revenue requirement should be reduced by $875,880.

Pursuant to Section 536.060, RSMo 1986, the Commission may approve a Stipulation and Agreement concluded between parties to a contested case. The Commission has determined that the agreements between Staff and SJLPC, to which the other parties have not objected, as to the AM/FM Accounting Authority Order, CFSI Line, Ash Disposal or Handling (both amortization and ongoing), Salvage (sub-issue under Income Taxes), Records, Management Incentive Plan, 401-K Discretionary Match, Sales/Purchases for Resale (sub-issue under Fuel and Interchange), Fuel Prices, (sub-issue under Fuel and Interchange), Dispatch (sub-issue under Fuel and Interchange), Fuel Inventory, Leased Line, Depreciation Reserve-Iatan Precipitator, Heat Recovery Steam Generator #7 (a sub-issue under Allocations: Lake Road), Auxiliary Power (a sub-issue under Allocations: Lake Road), General Plant (a sub-issue under Allocations: Administrative and General Expenses/General Plant), Deferred Tax Reserves and Transportation Depreciation issues are reasonable and, therefore, the Commission concluded that these Stipulations should be approved.

The Commission has made findings regarding which rates should be reduced to reflect the revenue reductions found to be reasonable. The Commission concludes that SJLPC's rates, as reflected in this Report and Order, shall be reduced as described.

Based upon the revenue reduction found reasonable in this Report and Order, the Commission concludes that SJLPC shall implement revised tariffs for electric service which reflect a decrease in its Missouri jurisdictional gross annual revenues of $875,880 exclusive of license, occupation, franchise, gross receipts or other similar fees or taxes and in compliance with the rate design changes ordered herein.

IT IS THEREFORE ORDERED:

1. That the tariff sheets filed by St. Joseph Light & Power Company on August 7, 1992, reflecting an increase in its annual electric revenues of approximately $6.1 million be, and are, hereby rejected.

2. That St. Joseph Light & Power Company shall file, for approval of the Commission, tariffs designed to reduce revenues by $875,880 and reflect the rate design as described in this order.

3. That the tariffs to be filed pursuant to this Report and Order shall be effective for service rendered on or after July 5, 1993.

4. That St. Joseph Light & Power Company is hereby authorized to continue to use the pay-as-you-go methodology for calculating the amounts charged to post-retirement benefit expenses other than pensions on its financial statements based on actual payments to retirees, with the differential between the expense amount calculated under Financial Accounting Standard 106 and the pay-as-you-go amount to be booked to Uniform System of Accounts No. 186, Miscellaneous Deferred Debt as a regulatory asset.

5. That Exhibit No. 82, Exhibit No. 121, Exhibit No. 122, Exhibit No. 123, Exhibit No. 130, Exhibit No. 131, Exhibit No. 132, Exhibit No. 133, Exhibit No. 134 and Exhibit No. 135, and Exhibit No. 136 are received into evidence.

6. That any objections not heretofore ruled upon are overruled and any outstanding motions are hereby denied.

7. That Docket No. EO-93-351 be, and is, hereby established for the purpose of conducting Phase II of St. Joseph Light and Power Company's class cost of service study.

8. That St. Joseph Light & Power Company be, and is, hereby authorized to install integrated steam volume flow meters for the purpose of collecting data for Case No. EO-93-351.

9. That this Report and Order shall become effective on the 5th day of July, 1993.

BY THE COMMISSION

Brent Stewart

Brent Stewart
Executive Secretary

(S E A L)

Mueller, Chm., McClure, Perkins
and Kincheloe, CC., Concur and certify
compliance with the provisions of
Section 536.080, RSMo 1986.
Crumpton, C., Absent.

Dated at Jefferson City, Missouri,
on this 25th day of June, 1993.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of St. Joseph Light & Power Company's proposed tariffs to increase rates for electric service provided to customers in the Missouri service area of the company.	)	Case No. ER-93-41
The Staff of the Missouri Public Service Commission, Complainant, vs. St. Joseph Light & Power Co., a Missouri corporation, Respondent.	)	Case No. EC-93-252

STIPULATION AND AGREEMENT

The AM/FM Accounting Authority Order, CFSI Line, Ash Disposal or Handling (both amortization and ongoing), Salvage (sub-issue under Income Taxes), Records, Management Incentive Plan, 401-K Discretionary Match, Sales/Purchases for Resale (sub-issue under Fuel and Interchange), Fuel Prices, (sub-issue under Fuel and Interchange), Dispatch (sub-issue under Fuel and Interchange), Fuel Inventory, Leased Line, Depreciation Reserve-Iatan Precipitator, Heat Recovery Steam Generator #7 (a sub-issue under Allocations: Lake Road), Auxiliary Power (a sub-issue under Allocations: Lake Road), General Plant (a sub-issue under Allocations: Administrative and General Expenses/General Plant), Deferred Tax Reserves and Transportation Depreciation issues were resolved subsequent to the filing of the Hearing Memorandum. The revenue requirement associated with the settled issues is reflected in the Reconciliation (exhibit 2).

In consideration for and as a condition of settling the above-listed issues, the signatory parties stipulate and agree as follows:

a) **DISPATCH**

SJLP agrees to include as part of its monthly 4 CSR 240-20.080 filings information sufficient to determine the level of spinning reserve required by the Southwest Power Pool and the level of spinning reserve maintained by the Company. SJLP further agrees to cooperate with the Staff in modeling fuel and purchase power expense on an on-going basis consistent with actual system operations. The parties acknowledge that the Commission must adopt this agreement as a part of the report and order in this case.

b) **CFSI LINE**

For purposes of setting rates in this case, the CFSI line and related facilities shall be treated as operating leases. This agreement shall not preclude SJLP from requesting capital lease treatment for these leases or any other capital lease in future cases. The parties acknowledge that the Commission must adopt this agreement as part of the report and order in this case.

c) **ASH DISPOSAL (AMORTIZATION)**

The parties agree that the Commission shall authorize SJLP to amortize these costs over a three-year time period so that SJLP is not required to write off the total amount in a single year. However, this agreement does not indicate acceptance by the Staff or other parties of amounts booked by SJLP for this item and does not preclude the Staff from challenging in future cases amounts booked by SJLP. The parties acknowledge that the Commission must adopt this agreement as part of the report and order in this case.

d) **TRANSPORTATION DEPRECIATION**

The Commission shall authorize SJLP to change the depreciation rates for account 392 - Transportation Equipment and account 312.2 - Boiler #5 Precipitator at Lake Road to 0% (zero percent) to be effective upon the effective date of the report and order in this case until the Commission authorizes a different rate. The parties acknowledge that the Commission must adopt this agreement as part of the report and order in this case.

e) RECORDS

The Commission shall order SJLP to:

1) allocate and maintain its depreciation reserve by primary plant account, to be completed no later than 12 months after the effective date of the report and order in this case;

2) specify and maintain in its continuing property record what units of property are directly assignable to electric, steam and common plant operations, to be completed no later than 24 months after the effective date of the report and order in this case;

3) update and maintain its continuing property records so as to capture annual additions and retirements by year installed and year retired since 1980, to be completed no later than 24 months after the effective date of the report and order in this case;

4) provide a data base by primary plant account for both gas and electric plant consisting of annual additions, retirements by year of installation and year retired and a history of the annual salvage and cost of removal for the past ten years, to be completed no later than 24 months after the effective date of the report and order in this case;

5) develop and maintain a property unit catalog, to be completed no later than July 1, 1996;

6) develop and maintain property accounting instructions to be included with their property unit catalog, to be completed no later than July 1, 1996;

7) develop and maintain current material costs from which to allocate labor costs to the various units of property, to be completed

no later than 12 months after the effective date of the report and order in this case;

8) advise Staff of its conclusion to proceed or cancel the AM/FM (Automated Mapping Facilities Management) system development project when the analysis of the test project is concluded. Such advice will include justification for the decision made.

The parties acknowledge that the Commission must adopt this agreement as part of the report and order in this case.

Respectfully submitted,

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Attorney for the City of Maryville, MO

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record this 23rd day of April, 1993.

Robert J. Hack