BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE MISSOURI

In the Matter of Missouri Public Service, a Division of UtiliCorp United Inc.'s Tariff Designed to Increase Rates for for Electric Service to Customers in the Missouri Service Area of the Company.	)	<u>**Case No. ER-97-394**</u>
In the Matter of the Filing of Tariff Sheets by Missouri Public Service, a Division of UtiliCorp United Inc., Relating to Real-Time Pricing, Flexible Rates/Special Contracts, Line Extension Policy and Energy Audit Program.	)	<u>**Case No. ET-98-103**</u>
The Staff of the Missouri Public Service Commission, Complainant, vs. UtiliCorp United Inc., d/b/a Missouri Public Service, Respondent.	)	<u>**Case No. EC-98-126**</u>

REPORT AND ORDER

Issue Date: March 6, 1998

Effective Date: March 18, 1998

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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The Staff of the Missouri Public Service Commission, Complainant, vs. UtiliCorp United Inc., d/b/a Missouri Public Service, Respondent.	)	**Case No. EC-98-126**

APPEARANCES

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REGULATORY LAW JUDGE: **Joseph A. Derque III.**

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REPORT AND ORDER

Procedural History

On March 21, 1997, UtiliCorp United Inc. (UtiliCorp) d/b/a Missouri Public Service (MPS) initiated ER-97-394 by filing with the Missouri Public Service Commission (Commission) tariffs designed to increase rates for electric service to its Missouri customers in the amount of approximately $25 million, an increase of 9.3 percent. Included as a part of that filing were charges referred to as transition charges. The requested increase was exclusive of occupational and franchise taxes. On April 4, 1997, the Commission issued an order suspending the proposed tariffs until March 18, 1998.

On August 18, 1997, UtiliCorp filed tariffs relating to real-time pricing, flexible rates, special contracts, line extension policies and an energy audit program in Case No. ET-98-103, all bearing an effective date of September 18, 1997. On September 11, 1997, the Commission issued an order suspending those tariffs consistent with the suspension date of the rate filing and consolidating the two cases, Nos. ER-97-394 and ET-98-103.

On September 16, 1997, the Staff of the Commission (Staff) filed a separate complaint against UtiliCorp, alleging jurisdictional electric over-earnings by MPS of approximately $28.5 million and seeking a reduction in rates. The Staff and Office of the Public Counsel (OPC) filed direct testimony concurrently with the complaint filing. On September 23, 1997, the Commission issued an order consolidating the Staff complaint, Case No. EC-98-126, with the rate case and tariff filings.

On October 9, 1997, the Commission issued an order establishing the historic test year in the consolidated cases as the twelve-month period ending December 31, 1996, updated through June 30, 1997. The Commission granted a true-up period through September 30, 1997.

Intervention was granted to the following parties in the consolidated cases: Union Electric Company (UE), the International Brotherhood of Electric Workers, Local No. 814 (IBEW), the City of Kansas City, Missouri (Kansas City), the Sedalia Industrial Energy Users Association (SIEUA), Jackson County, Missouri (Jackson County), Kansas City Power & Light Company (KCPL), St. Joseph Light & Power Company (SJLP) Missouri Gas Energy (MGE) and The Empire District Electric Company (EDE).

The evidentiary hearing was held from December 8, 1997 through December 12, 1997, and from December 15, 1997 through December 19, 1997 and, after briefing, this case was submitted to the Commission for decision on February 4, 1998.

Findings of Fact

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

The Commission has reviewed and considered all of the evidence and argument presented by the various parties and intervenors in this case. Due to the volume of material presented to the Commission, some evidence and positions on certain issues may not be addressed by the Commission. The failure of the Commission to mention a piece of evidence or the position of a party indicates that, while the evidence or position was considered, it was not found to be necessary to the resolution of the issue.

For the purposes of organization and ease of understanding, the issues will be addressed in the order in which the issues and corresponding dollar amounts appear on the Revenue Summary, page 72, based on information provided in Second Revised Scenario I, entered into evidence as Exhibit No. 161, filed March 2, 1998 and appended to this order as Attachment A. These issues will be addressed beginning with the three issues involving calculation of the appropriate rate of return, denoted E-1 through E-3; then proceeding to the three revenue issues, C-1 through C-3; continuing on to the various expense items, B-1 and D-1 through D-10; and ending with the real-time pricing, flexible rates, special contracts, line extension tariffs, rate design and the UtiliCorp proposal for incentive regulation. Discussion will include consideration of the positions of the OPC pertaining to E-1, E-2 and D-8.

Some evidence was introduced by the parties which is proprietary or highly confidential in nature and is protected by order of the Commission. While all protected material was considered by the Commission in making its decision in this case, no highly confidential or proprietary information will appear in this order except by general reference.

Settled Issues

The true-up reconciliation, filed January 8, 1998, reflects several adjustments of $0 (zero): the issues of the new headquarters building, B-1; property tax, D-7; relocation and recruiting costs, D-9H; and miscellaneous Enterprise Support Function (ESF) costs, D-9K. The zero adjustments indicate that the issues were settled by the parties and no further findings need be made.

Issues

Preface - UtiliCorp Organizational Structure and Change

As reflected in the testimony of Staff witness James Dittmer and other witnesses, the Commission finds the following regarding the organizational structure of UtiliCorp.

UtiliCorp provides regulated gas and electric service, either as a combination or separately, in eight states, including Colorado, Kansas, Nebraska, Iowa, Minnesota, Michigan, West Virginia and Missouri. UtiliCorp also provides energy-related services. UtiliCorp owns gas pipelines, either itself or through its majority ownership of Aquila Gas Pipeline, and an electric company in British Columbia. UtiliCorp has a minority interest in overseas energy utility operations in the United Kingdom, Australia and New Zealand. UtiliCorp has also invested in several electric generation facilities providing service in the United States and in Jamaica.

UtiliCorp's energy-related businesses include natural gas marketing, natural gas pipeline transportation service, appliance service and repair, home security sales and service, and municipal, commercial and industrial consulting services.

MPS is one of seven different divisions comprising UtiliCorp's regulated domestic electric and gas business. UtiliCorp's stock is publicly traded on the New York Stock Exchange.

Rate of Return Issues

Capital Structure - E-1

The capital structure of a company is generally expressed as a ratio of debt to equity. Included in the calculation of capital structure, in percentages, are common equity and preferred stock as balanced against long-term and short-term debt. MPS is an operating division of UtiliCorp, however, and issues neither its own stock nor its own debt. All of the MPS capital comes from its parent UtiliCorp; therefore, a capital structure must be imputed to MPS.

There is substantial difference in theory, and some resulting variance in numbers, in the capital structures proposed by UtiliCorp, the Staff and the OPC. UtiliCorp proposes a capital structure allocated to MPS by UtiliCorp. UtiliCorp refers to this as its "per books" capital structure and uses a capital structure as of December 31, 1996, the end of the test year. The resulting debt to equity ratio is 52.69 percent debt to 47.31 percent equity.

UtiliCorp argues that this is the accurate capital structure for MPS for the following reasons:

1) This is the actual capital structure of MPS at the end of the test year and represents the actual financing of the properties which make up the rate base in this proceeding.

2) The capital structure is similar to the capital structures of comparable electric utility companies. This is the primary standard for determining appropriateness and, in this case, the MPS per books capital structure meets that standard.

3) The capital structure is consistent with the historic and expected capital structure of MPS, and it represents the actual financing required by MPS as the properties and facilities were put in place through time.

4) The capital structure is the result of the application of a system of capital allocation which has been repeatedly audited and market tested and accepted.

5) It has the advantages of consistency, predictability, rationality and responsibility.

6) It insulates MPS from the other activities of UtiliCorp and the other divisions.

7) It has been tested and accepted by this Commission after consideration in the last MPS rate proceeding (ER-93-37).

The Staff maintains that a capital structure based on the actual overall cost of capital to the parent is more reasonable. The Staff proposes applying the UtiliCorp consolidated capital structure as of December 31, 1996, including consideration of short-term debt (adjusted to remove construction work in progress), resulting in a debt-to-equity ratio of 56.14 percent debt to 43.86 percent equity. This results in the proposed Staff adjustment in the amount of approximately $4.1 million from revenue requirement, depending on the rate of return used.

The OPC also takes the position that the UtiliCorp consolidated capital structure should be used, but prefers the consolidated structure on June 30, 1997. This results in a debt-to-equity ratio of 57.63 percent debt to 42.37 percent equity. The OPC states that UtiliCorp retired all outstanding preferred stock as of March 31, 1997, and the June 30, 1997 adjustment period more accurately reflects the current capital structure of UtiliCorp and, therefore, MPS on an ongoing basis. The OPC position results in an additional proposed adjustment of approximately $1.3 million, again based on the rate of return applied, making a total adjustment from the UtiliCorp position of approximately $5.4 million from overall revenue.

Based on substantial evidence of record, the Commission finds that the consolidated capital structure as proposed by the Staff accurately reflects the correct capital structure of UtiliCorp itself, and therefore MPS, during the actual test year.

The Commission adopts the Staff-proposed capital structure of 56.14 percent debt to 43.86 percent equity.

Return on Equity - E-2

The rate of return on common equity, necessary in the calculation of the overall rate of return, must sufficiently reflect an investor's required return on investment to allow a company the ability to publicly trade its stock in the marketplace and raise equity capital. As has been stated, MPS does not sell stock in the marketplace; therefore, an assignment or allocation of a return on equity must be made. UtiliCorp, the Staff and OPC used various comparable companies as surrogates for MPS in applying the discounted cash flow (DCF) model. Jackson County supports the position of the OPC with regard to return on equity.

The DCF model maintains that value (price) of any security or commodity is the discounted present value of all future cash flows. It is based on two fundamental principles: (1) that investors value an asset on the basis of the future cash flows they expect to receive from owning the asset; and (2) that investors recognize the true value of money (i.e. a dollar received in the future is worth less than a dollar received today). This is rendered as an algebraic formula set out in the testimony. The formula is also adjusted to reflect the comparative risk involved in potential equity investment in the subject company.

The testimony reflects the fact that the DCF method is currently accepted as the most appropriate indicator of the cost of common equity and has been used consistently by this Commission for a long period of time.

UtiliCorp states that the most reliable application of the DCF method involves use of companies comparable to MPS rather than applying the DCF method to UtiliCorp itself with an adjustment for risk associated only with MPS.

UtiliCorp selected comparable companies for its analysis from the Value Line Investment Survey and developed an estimated cost of equity for the group. UtiliCorp selected 12 companies, referred to as the "pure play" group, defined as a reasonably homogenous group of publicly traded, well-known and reasonably sized electric utilities. After applying the DCF analysis and factoring in the relative risk of MPS as compared to the group of comparable utilities, UtiliCorp recommended an annual return on equity of 12.5 percent. UtiliCorp found the comparable group to have less risk than MPS and, therefore, an overall lower cost of common equity of 12 percent.

The Staff employed the same companies as UtiliCorp for its comparable group. In testimony, the Staff describes this group as being non-diversified, non-nuclear, located in the central U.S., and having considerably less financial risk than MPS (through UtiliCorp).

The Staff also employed three other methods for determining return on equity as checks of the DCF method. Upon final analysis, the Staff recommended a range of 10 percent to 11 percent. With an adjustment for use of the somewhat more risky consolidated capital of UtiliCorp, the Staff recommended the Commission adopt the midpoint of the upper half of that range, that being 10.75 percent. This produces an overall rate of return of approximately 9.1 percent. The resulting proposed Staff adjustment, assuming the application of the Staff proposed capital structure, is approximately $5.9 million.

The OPC relied on an analysis of the consolidated capital structure of UtiliCorp, with adjustments for the comparative risk between UtiliCorp and MPS. The OPC used the DCF method to analyze a group of electric utilities comparable to MPS in an effort to assist in making adjustments and determining the reasonableness of the outcome of its analysis as applied to MPS. The OPC employed the DCF method but used a group of only seven publicly-traded utilities as being comparable to MPS.

The OPC recommended a maximum rate of return for MPS of 10.70 percent, rendering an overall rate of return of 9.0 percent as of December 31, 1996, and an overall rate of return of 8.9 percent as of June 30, 1997. Application of the OPC proposed rate of return would add an additional $182,500 to the proposed Staff adjustment.

Based on substantial evidence, the Commission finds the return on equity of 10.75 percent as proposed by the Staff to be the most reasonable and appropriate of the choices proposed by the parties. The Commission notes that the OPC's recommendation was within the range proposed by the Staff as was the UtiliCorp proposal, without final adjustments.

The Commission, therefore, adopts a return on equity for use in this case of 10.75 percent.

Cost of Long-Term Debt - E-3

The cost of long-term and short-term debt is an integral part of the calculations of the overall rate of return. The Staff believes the consolidated UtiliCorp capital structure furnishes the most reasonable values for both long-term and short-term debt for ratemaking purposes. The Staff recommends an appropriate embedded cost of long-term debt of 8.179 percent and embedded cost of short-term debt of 6.154 percent.

UtiliCorp alleges that the Staff's short-term debt calculations include international debt not relevant to the operation of MPS. UtiliCorp contends that the cost of debt assigned by it, as explained above, should be used without the inclusion of the cost of short-term or international debt. As of December 31, 1996, UtiliCorp states that the assigned cost of debt (all long-term) for MPS is 8.39 percent.

The OPC states that the embedded cost of long-term debt, as supplied by UtiliCorp in response to a data request, was 8.14 percent on

December 31, 1996, and 7.88 percent on June 30, 1997. The OPC recommends the June 30, 1997 figure.

The Commission finds the cost of long-term debt, including the cost of embedded short-term debt as proposed by the Staff, to be the most reasonable proposal and will adopt the Staff's position.

Revenue Issues

Weather Normalization - C-1

This issue involves the normalization of the influences of historical weather on test year sales and therefore revenues for ratemaking purposes. This is necessary to assist in obtaining a sales revenue amount which reflects and normalizes the influence of variations in the weather patterns over a period of time. A normalized sales revenue amount reflects the anticipated amount of sales in a year in which the weather is as close to "average" as possible.

A weather normalization adjustment is made to modify test year revenues (sales) to reflect a level of sales that would occur under conditions of "normal" historical weather. The revenue requirement value of approximately $1.2 million reflects the difference between UtiliCorp's and the Staff's estimates of the effects of abnormal weather during the test year on revenues. There are two primary factors that cause this difference: 1) the models used to predict sales; and 2) the weather data that is used as an input to these models.

UtiliCorp used a set of econometric models to forecast and weather normalize monthly electric sales. The models project the level of monthly electricity sales for the various rate classes as a function of heating and cooling degree days, economic driver variables (e.g. number of households for the residential classes, commercial employment for the commercial rate codes, and industrial output for the industrial rate codes), energy prices, price elasticities and end-use parameters (for the residential classes only). UtiliCorp states that the variation in monthly sales due to degree day variations shows substantial weather sensitivity for appropriate rate classes.

The Staff used the Electric Power Research Institute (EPRI) Hourly Load Electric Model (HELM) to calculate the weather normalization adjustment to the billing month sales. The Staff uses HELM because it has the advantage in that it bases its weather normalization estimation on daily usage data. The Staff states that there is a direct relationship between the amount of energy a weather sensitive customer uses and the weather experienced on any day. In addition, the response of the weather sensitive customers to daily fluctuations in weather can be dramatic and varied across a group of customers. The Staff argues that because UtiliCorp uses monthly data in its models, it is impossible to obtain detailed information about class usage.

Both UtiliCorp and the Staff selected the weather station at the Kansas City International Airport (KCI) as a source of daily temperature data and used the period from 1961 to 1990 to define normal weather. However, because daily weather data was not collected at KCI prior to 1973, both parties had to manufacture data for the period from 1961 to 1972.

UtiliCorp used statistical regression analysis to fit equations that relate that the temperature measured at the KCI weather station to the temperature measured at the older Kansas City Downtown Airport (KCDT) during a period when both weather stations were reporting. The resulting equations were used to backfill the missing temperature values in the daily series for the KCI weather station. UtiliCorp claims its temperature data is more appropriate for weather normalizing heating and cooling loads because it better matches the normal heating and cooling degree days published by the National Oceanic and Atmospheric Administration (NOAA).

The Staff compiled a data set for the KCI weather station based on two NOAA data sets, one containing adjusted monthly temperature data, and another containing daily temperature data from the selected weather stations. From these data sets, the Staff produced a series of daily minimum, maximum and mean temperatures for the thirty-year period ending December 31, 1990 adjusted so that the average monthly values are equal to the monthly NOAA values published for KCI. The Staff claims that when using the UtiliCorp data set, Staff was unable to closely match the monthly NOAA normal temperature values. In addition, UtiliCorp values tended to show seasonal biases in the spring and summer months.

No other party has taken a position on this issue.

The Commission finds the substantial evidence presented by the Staff to be the most reasonable and appropriate analysis of historical weather on test year sales and will, therefore, adopt the revenue requirement adjustment of the Staff, net of fuel expense.

Economic Development Rider Revenue - C-2

MPS has a current tariff, approved by stipulation and agreement in Case No. ET-92-171, which allows MPS to enter into contracts with certain qualifying customers for reduced electric service rates. This tariff is generally referred to as the economic development rider (EDR) and is offered to large commercial and industrial customers.

The Staff is proposing an adjustment to test year revenues of approximately $821,000 to elevate the test year revenue to the level it would have been absent the EDR discounts. The Staff maintains that

UtiliCorp has not demonstrated that the new load acquired as a result of the EDR discount has offset the "long run marginal" cost of serving the new load and that the EDR will be detrimental to the remainder of the existing ratepayers over the long run.

The Staff bases the above conclusion on the fact that various long-term purchase power contracts will expire in years 1999 and 2000, causing UtiliCorp to build additional generation facilities or negotiate new purchase power contracts. The Staff is of the opinion, based on the most recent MPS integrated resource plan filing, that the cost to replace the purchase power and therefore to serve the increased load will be relatively high compared to the cost under the present contracts. The Staff maintains that, over the long run, the EDR discount will be detrimental in that it would cause an increase in load resulting in the purchase or generation of more expensive power, all paid for by the remainder of the ratepayers.

The Staff admits, however, that because of the present favorable contracts, there probably exists some short-term benefit to the ratepayers in serving the EDR customers because the current cost to serve new load on the system is relatively low.

UtiliCorp states that the EDR tariff is a valuable tool in fostering economic development, both for MPS in particular and for the state in general, in terms of increased employment opportunities and increased customer load. UtiliCorp states that, directly or indirectly, everyone in the state benefits from gaining new business employers on the MPS system through incentives such as the EDR rider.

Of particular note is the rebuttal testimony of UtiliCorp witness Maurice Arnall, who points out on page 4, lines 15 through 21, the various terms used by the Staff consultant in performing a test to determine the long-term benefit of the EDR rider. Mr. Arnall points out that no reference is made to any particular cost as being definitive and each of the referenced costs appears to be different. Mr. Arnall states that it is impossible to evaluate the appropriateness of the test applied by the Staff. In addition, UtiliCorp notes that test year incremental revenues received from EDR customers provide a net gain when compared to test year incremental costs to serve such customers.

Finally, UtiliCorp points out that it would be absurd to speculate that the existence of the EDR rider would be the cause of higher replacement costs.

The OPC notes that UtiliCorp has not tendered a detailed analysis substantiating its claim to some present contribution to fixed costs as a result of the EDR rider. The OPC, therefore, supports the position of the Staff, as does Jackson County.

The Commission finds the position of UtiliCorp to be reasonable in that UtiliCorp has presented sufficient evidence that the use of the EDR rider is of benefit to the state of Missouri and the ratepayers. The Commission will adopt the position of UtiliCorp in this matter and decline to adopt the proposed adjustment of the Staff.

Off-System Sales Revenue - C-3

During the test year of 1996, MPS generated approximately $2.6 million in additional revenue as a result of its sales of excess generation capacity to interconnected utilities and power marketers. UtiliCorp proposes to share this additional revenue by adding half (approximately $1.3 million) to its test year revenues, thereby allowing the other half to devolve to its stockholders. The Staff proposes a $1.3 million adjustment to revenue to reflect the total test year amount collected in off-system sales.

Ancillary to the central issue is the Staff position that the off-system sales amounts should be updated through the June 30, 1997 adjustment period. The Staff states that the test year total revenue is approximately $1.8 million, while the updated total amount is the approximate $2.6 million stated above.

UtiliCorp states that significant risk exists in the current UtiliCorp effort to enhance off-system sales and that there must be some incentive to UtiliCorp and its stockholders to aggressively pursue off-system sales. UtiliCorp explains that, until recently, off-system sales were made usually to neighboring utilities to cover downtime of generating units due to scheduled or forced outages. With the advent of open access transmission and regional transmission pricing, UtiliCorp determined that significant opportunities existed in the marketplace.

UtiliCorp takes the position that the current marketplace for power is similar in nature and operation to a commodities market. In testimony, the UtiliCorp witnesses point out the various expense and other risk factors which can be incurred by active participation in that commodities market. Some of those risk factors include increased risk in the form of infrastructure wear and tear, unplanned outages, additional staff requirements, price volatility, unpredictable weather and competition. UtiliCorp places this risk in two categories, marketplace risk and infrastructure risk.

To fairly compensate the UtiliCorp shareholders for assuming this risk, and as a future incentive, UtiliCorp is proposing to split the revenue derived from its test year sales on a 50/50 basis, including applying one-half of the total in revenue as an offset to rates while holding the other one-half out of revenue. UtiliCorp admits that no exact calculation exists showing that the 50/50 split accurately reflects the respective contributions made to off-system sales by the shareholders and ratepayers.

The Staff maintains that all of the off-system sales revenue should be reflected in the test year revenue for the purposes of setting rates. The Staff has two basic reasons for its position. The first is that UtiliCorp has no coincident proposal to share the costs of producing the off-system sales revenue 50/50 between the ratepayers and shareholders. The Staff alleges that all of the costs incumbent on producing the off-system sales revenue are currently included in rates.

The second reason the Staff objects to the UtiliCorp proposal is that, as a result of the operation of the concept of regulatory lag, MPS is benefiting and will benefit from the increase in annual revenue for the length of time between rate case proceedings.

Regulatory lag is defined as the lapse of time between a change in a utility's revenue requirement and a reflection of that change in the utility's rates. In relation to overall revenue requirement and rate of return, those changes can be either negative or positive. In this case, an increase in revenue without a concurrent increase in expense during the interregnum between rate cases raises the level of revenue passed on to the stockholders or retained by the company without an offsetting lowering of rates. The same phenomenon would occur if expenses were decreased without a decrease in revenue. In regard to the revenue generated from the off-system sales, the Staff maintains that both increased efficiency and increased revenue have occurred since the previous MPS rate case (in 1993) without concurrent lowering of rates.

The Commission finds the Staff provided competent and substantial evidence that all of the off-system sales revenue should be reflected in the test year revenue for the purposes of setting rates. The Staff is correct in stating that, since all of the costs of producing the off-system sales revenue were borne by the ratepayers, and since UtiliCorp has benefited from regulatory lag, the total amount of this revenue should be included in rates.

The Commission adopts the adjustment proposed by the Staff.

Expense Issues

Systems Maintenance - D-1

This issue involves the estimation of the ongoing, normalized, annual expense of MPS for operating systems and computers. The evidence reveals that, in 1995, UtiliCorp initiated a program partly involving the retirement of its then current computer system, referred to in testimony as the "vintage" or "legacy" system, and installation of a new, centralized computer system. This caused the test year expense for systems maintenance to be abnormally low as maintenance on the vintage system was suspended, and some employees were transferred to the new system. Testimony shows that a number of employees were transferred from vintage system maintenance to functions involving the new system and that a portion of the payroll expense was capitalized. The expense for those employees therefore is not reflected in the systems maintenance expense category.

The Staff proposes a total systems maintenance expense credit which results in an adjustment of approximately $628,000. UtiliCorp alleges that a normal level of expense should reflect the adjusted historical levels. It is UtiliCorp's intent to return the transferred employees back to their original functions and, in fact, hire additional employees because the new server/client computer system is more maintenance intensive than the vintage system.

The Staff states that it was unable to determine an accurate level of systems maintenance expense for the test year. The Staff witness states that the proper Federal Energy Regulatory Commission (FERC) account in which to record systems maintenance expense is account No. 935, "maintenance of general plant." The witness states that the Staff was unable to ascertain an accurate level of maintenance expense because that expense had been recorded in various other accounts in addition to account 935 and, apparently, UtiliCorp was unable to produce sufficient accurate, historical data to track these costs.

The Staff continues that it was then impossible to identify total systems maintenance expense for the test year and compare it to levels incurred in previous years to obtain an accurate, normalized level. Nonetheless, the Staff based its recommendation on an analysis of account 935 for years 1992 through 1996. The Staff found that, for years 1992 through 1994, prior to the transfer of personnel, the annual average expense was approximately $1.79 million. However, the Staff is recommending a total expense level of approximately $1.26 million. The Staff states that the adjustment amount represents 50 percent of the difference between the $1.79 million average and the test year level of $769,000.

Both the OPC and Jackson County support the position of the Staff.

The Commission finds the Staff position, based on historical data, is a reasonable estimation of the ongoing expense in this category which should properly be charged to the ratepayer. The Commission agrees with the Staff that, as UtiliCorp was unable to produce sufficient evidence to support its position, the weight of the evidence supports the Staff position.

The Commission adopts the adjustment to revenue requirement proposed by the Staff.

Depreciation Expense Issues - D -2

Change in Service Lives

Depreciation is a system of accounting that aims to distribute the cost or other basic value of tangible capital assets, less salvage, over the estimated useful life of the unit (which may be a group of assets). UtiliCorp states depreciation expense should, to the extent possible, match either the consumption of the facilities or the revenues generated by the facilities. The matching concept is also an essential element of the basic regulatory philosophy of intergenerational customer equity.

For the purpose of setting depreciation rates and determining the useful service lives of facilities, both UtiliCorp and the Staff have characterized MPS's production facilities as life span accounts, and its transmission, distribution and general plant facilities as mass asset accounts. The change in service lives proposed by these parties results in a Staff adjustment of approximately $5.9 million.

The estimated retirement date for production plant units is one of the required parameters used in the calculation of depreciation rates for these assets. A summary of the UtiliCorp and Staff positions on these dates for MPS's generation facilities is given below:

Generating Unit	MPS Retirement Date	Staff Retirement Date
Sibley Units 1, 2 and 3	2010	2020
Jeffrey Units 1, 2 and 3	2013, 2015 and 2018	2020
*Nevada C.T.	1999	2020
KCI Units 1 and 2	2000	2020
*Greenwood Units 1-4	2004	2020
*Ralph Green C.T.	2014	2020

*Leased Units

The UtiliCorp witness states that the retirement dates for the MPS production units, which were supplied by MPS planning personnel, were, in his experience, consistent and reasonable and reflected the current best estimate of when the generating units would retire, giving due consideration to each unit's age, location, operating characteristics and expected future usage. In its calculation of retirement dates, UtiliCorp includes its estimation of time over which investor-related costs should be recovered. In particular, with respect to Nevada CT and Greenwood units which are leased, UtiliCorp states that the retirement dates used for the depreciation calculations correspond to the lease termination dates for those facilities. UtiliCorp maintains that the Staff proposal has ignored the relation between investment and retirement dates.

Also, UtiliCorp states that the retirement date of 2020 proposed by the Staff for all generating facilities is not appropriate for the determination rates. This date ignores the Company's plans, gives no recognition to the type of asset placement activity necessary to achieve the longer life, and results in inadequate levels of depreciation.

The Staff bases its use of the 2020 retirement date for generation facilities on the fact that it appears, from the Staff's information, that 2020 is an appropriate planning horizon. However, the Staff does not maintain that all units should be retired on that date.

The Staff supports its position by explaining that UtiliCorp documentation demonstrates that the useful lives of MPS's generation assets can reasonably be expected to extend beyond the dates assigned them by UtiliCorp. The evidence that the Staff uses includes the following: (1) MPS's 1995 Integrated Resource Plan which has a planning horizon to the year 2013; (2) current MPS coal contracts, which, for the Jeffrey units, expire in 2020; (3) MPS capital and construction budgets (two-year document); (4) MPS operation and maintenance budgets (five-year document); (5) MPS Replacement Power Plans as revealed in the depositions of MPS electric production employees; and (6) MPS reports contained within the most recent Southwest Power Pool Coordinated Regional Bulk Power Supply Program (ten-year document).

However, with the exception of the Jeffrey coal contracts, which expire in 2020, the Staff was unable to demonstrate from the documents listed above any estimated retirement dates beyond the year 2013. In addition, the Staff states that:

> ". . .It [retirement date] is something determined by its owner where they state at this point in time [it] is [no] longer in service . . .
>
> and
>
> ". . .Under a life span account, the average service life is of only nominal importance in the computation for depreciation, because you have this date certain out there that is really irrelevant to any actuarial analysis that you may have undertaken.
>
> "Q. How do you arrive at that date certain?
>
> "A. That is arrived at by the owner's statement."

With respect to the transmission, distribution and general plant accounts (mass asset accounts), the Missouri Public Service Commission recommended changes to almost every average service life proposed by UtiliCorp, some as small as a fraction of a year. UtiliCorp feels that the changes are inappropriate for three reasons. First, Staff conducted no evaluation of the historical experience and its applicability to the future. Second, Staff modified average lives in tenths of a year implying a precision far beyond the bounds of achievability. Third, Staff provides no details regarding how the depreciation rates were calculated.

The OPC testimony generally supports the Staff's position with one additional argument. The OPC points out that in this "competitive" rate filing by UtiliCorp, it seems to be the intent of UtiliCorp to accelerate the rate of depreciation, and thus increase rates, in order to enter an apparent competitive environment with little or no sunk costs or stranded investment, while other utilities in the state are still maintaining standard depreciation rates. UtiliCorp alleges that this simply levels the potential competitive playing field level. The OPC regards this UtiliCorp proposal as providing a clear competitive advantage to UtiliCorp.

The Commission does not find competent and substantial evidence to adopt the position of the Staff. The Commission finds that the Staff has failed to prove that its proposed retirement dates are reliable.

The Commission finds that the service lives for the above-stated generation facilities are established as proposed by UtiliCorp.

Terminal Net Salvage

UtiliCorp has proposed the inclusion in current rates of the estimates of net costs of end-of-life dismantlement in the calculation of the above-stated production unit depreciation rates. Both the Staff and OPC disagree, and the Staff proposes an adjustment of approximately $1.8 million.

UtiliCorp states that terminal net salvage refers to the net demolition cost of a plant or unit at final retirement. UtiliCorp maintains that these costs will be incurred and should be recognized in current rates. UtiliCorp points out the difference between interim net salvage (removal and salvage associated with interim retirements) and terminal net salvage (relating to ultimate retirement) and notes that the Staff has already recognized, to some extent, interim net salvage as being properly included in depreciation rates. UtiliCorp notes several other states in which similar approaches have been used.

Both the Staff and OPC point out that this Commission has rejected the inclusion of terminal net salvage in rates in past cases based on the fact that terminal costs of removal are speculative and not known and measurable. The Commission has also found interim costs to be sufficient for purposes of recovery. The Staff adds that the timing of the ultimate decommissioning and removal of a generation unit would, in today's changing electric environment, be highly speculative.

The Commission finds that terminal net salvage costs are speculative and not known and measurable and therefore may not be included in current rates. The Commission adopts the proposed Staff adjustment.

Elimination of Interim Additions

UtiliCorp proposes the inclusion of the costs of interim future additions in the calculation of production unit depreciation rates. Both the Staff and OPC disagree, with the Staff proposing an adjustment of approximately $1.5 million.

UtiliCorp defines interim additions as the replacement of retired plant components or the addition of new plant components between the date of original installation and the date of final retirement of the plant or unit. UtiliCorp employs a method to determine the ongoing amount to be included in annual depreciation. This amount seems to be based on a historic analysis of interim additions over the life of the plant or unit and extrapolation of that amount over the remaining life of the plant or unit.

The Staff and OPC state that the Commission has held in previous cases that inclusion in current rates of future additions violates Section 393.135, RSMo 1994, the statutory prohibition against inclusion in rates of costs for property which is not fully used and useful. The Staff and OPC cite the following cases: In re Union Electric Company, 27 Mo.P.S.C. (N.S.) 183, (1985); In re Kansas City Power & Light Company, 28 Mo.P.S.C. (N.S.) 228, (1986); and Case No. ER-90-101, In re Missouri Public Service, 30 Mo.P.S.C. (N.S.) 320, (1990).

The Commission agrees that inclusion in current rates of future additions violates the provisions of Section 393.135, RSMo 1994. The Commission adopts the proposed adjustment of the Staff.

Change in Procedure

This issue deals with the MPS proposal to change from the current method of depreciation, the average life group method (ALG) to the equal life group (ELG) method. The Staff has proposed an adjustment of approximately $1.2 million as a result of UtiliCorp's adoption of the ELG method in its original filing.

UtiliCorp is proposing the equal life group (ELG) method in order to meet the competitive challenge faced by MPS, presumably in a deregulated electric utility industry of the future. UtiliCorp states that the equal life group method gives recognition to the fact that assets retire at different ages and thus the method provides a better matching of depreciation expense with asset consumption. UtiliCorp adds that this method more closely emulates the method used by competitive industries. UtiliCorp notes that several state commissions have adopted this method for telecommunications companies.

Both the Staff and OPC are opposed to the adoption of the ELG method. The Staff notes several serious objections to the adoption of the ELG method. The Staff witness points out that the ELG method results in uneven depreciation over the course of several years, accelerating depreciation early in the time period. The ELG method does not result in straight line depreciation rates but in rates which decline over time. The Staff takes the position that this would necessitate an annual examination of depreciation rates.

Secondly, the Staff points out that application of the ELG method is extremely burdensome because of the detailed records needed to make reasonably accurate future estimates of mortality dispersion.

Finally, it is the Staff's position that the adoption of the ELG method is an attempt by UtiliCorp to "optimize accruals to the reserve at the expense of the current ratepayers" and to actually enhance UtiliCorp's competitive advantage in the marketplace. The Staff witness testified that, far from creating a level playing field, the adoption of such a method of accelerating depreciation could allow UtiliCorp the opportunity to actually undercut competition as "they would have the opportunity to write assets down when the others don't."

The Commission does not find sufficient evidence to alter its long-standing policy regarding the method used to calculate depreciation. Furthermore, the Commission finds the method proposed by UtiliCorp is unduly burdensome. The Commission will adopt the Staff-proposed adjustment.

Change in Technique

This issue is the result of a UtiliCorp proposal to alter Commission policy by allowing MPS to adopt the remaining life technique.

The Staff proposes an adjustment of $2.3 million, applying instead the traditional whole life technique.

The remaining life technique, according to UtiliCorp, allows a company to recover any reserve imbalance over the remaining life of the account. UtiliCorp states that this technique gives recognition to past accumulations of depreciation and limits the amount of depreciation to the total net investment. UtiliCorp claims the technique allows for automatic adjustment to the rate of depreciation for the inevitable differences between actual asset activity and estimated mortality patterns.

The Staff offers several criticisms of the remaining life technique. As all electric utilities in the state use the whole life technique, the Staff is opposed to adopting a different technique on an ad hoc basis. Rather than alter the regulated environment on a piecemeal basis, the Staff recommends such issues be addressed by the electric restructuring task force.

Secondly, because the remaining life technique deals with the recovery of a theoretical reserve imbalance, the Staff submits that this technique is appropriate only if and when it is shown that an alleged reserve deficiency is material.

Lastly, the Staff suggests in its brief that the remaining life technique is inappropriate when an over-earnings situation exists.

The OPC supports the position of the Staff and adds that UtiliCorp has failed to demonstrate any shortcomings of the current method in Missouri, that is, the whole life technique. OPC maintains that, as UtiliCorp is the party wishing to alter the Commission's long-standing policy, it is incumbent on UtiliCorp to prove by substantial and convincing evidence that such a change is desirable and of benefit to the ratepayers.

The OPC is of the opinion that UtiliCorp has not proffered sufficient evidence to warrant such a change in Commission policy.

The Commission agrees with the points made by the Staff and OPC. The Commission does not find sufficient evidence to warrant alteration of its long-standing use of the whole-life technique. Therefore, the Commission will adopt the Staff-recommended adjustment.

General Plant Amortization

UtiliCorp proposes to amortize seven general plant accounts over the associated tax lives of the accounts rather than depreciate these assets. The accounts involved are: (1) Account 391.0, Office Furniture and Equipment; (2) Account 391.1, Computer Equipment; (3) Account 393, Stores Equipment; (4) Account 394, Tools, Shop and Garage Equipment; (5) Account 395, Laboratory Equipment; (6) Account 397, Communication Equipment and (7) Account 398, Miscellaneous Equipment. This is an effort by UtiliCorp to streamline its method of accounting for various minor items. UtiliCorp maintains that tracking these minor items individually for depreciation purposes is not cost-justified and proposes to amortize these items over the tax life of the account. This would accelerate the return on the investment. There is an approximate $3.7 million difference between the UtiliCorp filing and the Staff adjustment as a result.

The Staff and OPC support an adjustment of $3.7 million and state that the tax life of an item generally does not reflect the item's useful life for depreciation purposes. The Staff notes in testimony that tax lives are shorter than, and unrelated to, useful lives and, thus, the amortization of the general plant account is an attempt by UtiliCorp to accelerate the recovery of its assets prior to the anticipated advent of competition.

Further, the Staff offers the argument that the amortization of these assets over the tax life, as opposed to the useful life, of the item, violates the concept of intergenerational equity. The principle of intergenerational equity states that the costs of providing the service should be borne by the generation of ratepayers that caused the costs to be incurred, not by an earlier or later generation. The Staff testimony reveals that the average useful life, or service life, of the accounts in question is ten years or more. Use of tax life will therefore cause current ratepayers to pay for items which will remain useful far into the future.

The Staff notes that the UtiliCorp proposal does not meet the criteria of FERC Accounting Release AR-15. The Staff reasons that UtiliCorp will have to continue its current cumbersome tracking of these assets for purposes of the FERC anyway and that, therefore, the benefits of streamlining its accounts, claimed by UtiliCorp, will not be realized.

Lastly, the Staff has proposed that MPS capitalize its general plant accounts at $1,000, rather than the current $500, in an effort to accomplish the savings and administrative efficiencies desired by UtiliCorp without the attendant increase in rates. The Staff maintains that increasing capitalization to $1,000 will allow MPS to avoid cumbersome bookkeeping on 87 percent of the assets in the general plant accounts.

The Commission finds the Staff arguments regarding the deficiencies of the tax life approach to be convincing. It would be ill-advised to adopt the tax life approach because it does not reflect the item's useful life and violates the concept of intergenerational equity. The Commission will adopt the Staff's proposed adjustment.

The Commission will also order MPS to capitalize its general plant accounts at $1,000 in order to accomplish additional savings and administrative efficiencies.

Computer Equipment Depreciation

As a sub-issue of general plant amortization, UtiliCorp proposes to establish a depreciation rate for its computer equipment account based on that account's five-year tax life. The Staff alleges that this account is over-accrued in the amount of approximately 125 percent and that the depreciation rate for this account should be set at zero.

Alternatively, the Staff suggests an average service life of 13 years for this account and a net salvage value of 25 percent. With this in mind, the Staff proposes that the Commission adopt a depreciation rate of 5.77 percent as an alternative to its zero percent recommendation. The Staff points out that the account in question is not totally made up of personal computers but also contains main frame and other equipment which makes up approximately 43 percent of the account balance. The Staff states that the mix of equipment in the account dictates an average service life of 13 years and the Staff's 5.77 percent depreciation rate.

The Commission finds the evidence of over-accrual supports adoption of a depreciation rate of zero percent.

Depreciation Summary

The Staff, OPC and UtiliCorp are instructed to recalculate depreciation rates based on the Commission's decisions on the depreciation issues and to file recalculated depreciation rates along with the ordered tariff filing.

Amortization of Regulatory Assets - D-3

Regulatory assets are defined as those prudently incurred costs booked as assets by the utility based on action by the regulator to allow future recovery of the capitalized costs in rates. UtiliCorp testimony indicates that these costs are generally regarded as "above-market" costs in a competitive environment and therefore as costs which are likely to be "stranded." In a competitive market in which prices for service are based on the market and not as the result of regulation, it is thought that above-market costs may not be recoverable.

The Staff has proposed an adjustment of approximately $4.5 million in response to a UtiliCorp proposal to accelerate recovery through amortization of its currently booked regulatory assets over a period of four years. UtiliCorp refers to this proposal as an attempt to recover "transition" costs prior to restructuring in the electric industry. The Staff characterizes the UtiliCorp proposal as an attempt to recover stranded costs prematurely.

The UtiliCorp witness testifies that the electric utility industry is in the process of significant change revolving around the advent of competition. UtiliCorp believes there is now an opportunity, prior to the onset of deregulation, to prepare costs and balance sheets for a competitive market. UtiliCorp states that, when prices are set by the competitive market, it will be difficult if not impossible to recover prudently incurred regulatory costs. If allowed to remain on the books, UtiliCorp states that regulatory assets will not be recoverable with the onset of a competitive market. UtiliCorp wishes to recover these regulatory assets over a four-year period by application of a customer surcharge.

The Staff views the UtiliCorp proposal as an attempt to recover potential stranded costs prior to potential restructuring. The Staff is not in favor of the UtiliCorp proposal and hence the approximate $4.5 million adjustment. The Staff gives several reasons for its opposition to the recovery of transition costs.

The Staff states that, in the event of competition, not all electric utilities will have "positive" stranded costs. If the utility's generating assets have an overall market value greater than current book value, stranded costs would be "negative." The Staff continues that, if a utility's negative stranded costs are greater than its positive stranded costs, the utility may be able to actually raise its electric prices rather than be forced to lower them. No evidence has been presented that UtiliCorp will incur a "positive" stranded cost position in the event of deregulation.

The Staff also points out that the electric restructuring task force, with which the Staff is participating, is only now considering many of the issues surrounding electric restructuring, including treatment of stranded costs. The Staff has not taken a position on any electric restructuring issues beyond the current efforts of the Commission to study the matter. The Staff thinks it is premature for the Commission to make piecemeal decisions regarding the treatment of various matters which may result from potential deregulation.

The Staff states that no evidence is present to indicate that the regulatory assets involved in the UtiliCorp proposal are or will be truly stranded and unrecoverable. Whether assets will be stranded, and if and from whom the funds will be recovered, are issues not yet decided in Missouri.

The OPC and Jackson County generally agree with the position of the Staff on this issue. In addition, OPC emphasizes the point that UtiliCorp is asking the ratepayers to assume the entire burden of paying for the alleged stranded costs when, ultimately, this may not accurately reflect the eventual statewide policy.

The Commission finds that approval of transition costs is premature. Additionally, there is insufficient evidence as to what assets will be stranded, if any, and as to what costs may be recovered, and from whom.

The Commission adopts the proposed adjustment of the Staff.

FAS 87 vs. ERISA Minimum Contribution - Pension Expense - D-4

Pension expense represents a future obligation to the employee, which accrues to the employee's benefit over a term of service with the utility. In its original filing, UtiliCorp proposed to recover a level of pension expense based on its contribution to its employee pension plan required by the Employee Retirement Income Security Act of 1974 (ERISA). The amount for the test year is zero, based on ERISA mandated funding levels.

The Staff is recommending that the correct amount of pension expense should be based on application of Financial Accounting Standard No. 87 (FAS 87). The Staff bases its position on the fact that the Commission is currently required by state law to calculate post-retirement benefits other than pension in accordance with FAS 106 and to allow recovery of those benefits. As the FAS calculation of benefits for 87 and 106 are identical, the Staff is of the opinion that the method for recovery of benefits should be identical also.

There are two differences between the methods used by UtiliCorp and the Staff. First, UtiliCorp prefers to use a 15-year amortization period to reflect gains and losses, while the Staff recommends a five-year period. Secondly, UtiliCorp proposes to recognize gains and losses by using what is generally known as the "corridor" approach.

UtiliCorp maintains that its corridor approach causes less expense volatility because it tends to levelize market fluctuations and differences between actuarial assumptions and real life experience.

The Staff argues that amortization of gains and losses over a lengthy period of time can result in rates which are increasingly inaccurate and reflect intergenerational inequity. The Staff prefers a five-year amortization period for recognition of all losses or gains as a reasonable amount of time.

The Staff notes that the Commission has specifically rejected use of the corridor approach and approved the use of a five-year amortization period for FAS 87 in several previous cases.

The OPC and Jackson County both support the position of the Staff.

The Commission concurs with the Staff in regard to adopting accrual accounting for pension benefits, per Financial Accounting Standard No. 87, and authorizes the use of the accrual method.

The Commission rejects the corridor approach and adopts the Staff's suggested five-year amortization period. The Commission finds it preferable to recognize gains or losses in pension expense in current rates as closely as possible. The Commission adopts the Staff-proposed adjustment.

FAS 106, Other Post-Retirement Employee Benefits Expense - D-5

Other post-retirement employee benefits (OPEBs) refers to certain benefits paid to retired employees that are non-pension related. OPEB expense is mainly considered to be expense from the provision of post-retirement medical benefits by the company to former employees.

Both parties agree that OPEB expense should be determined using the requirements of FAS 106. Those requirements include accrual accounting. Accrual accounting, as opposed to the pay-as-you-go method, attempts to approximate the post-retirement compensation cost of an employee over the life of that employee's service. The pay-as-you-go method merely reflects the actual annual cash outlay for benefits.

The Staff has proposed an approximate $350,000 adjustment to the FAS 106 account based on the Staff's proposed five-year amortization of unrecognized gains and losses. UtiliCorp is proposing a corridor approach as set out in the FAS 87 issue above.

In addition, UtiliCorp seeks to recover the unfunded balance of OPEB benefits expense incurred in 1993 through 1996. MPS proposes to recover these funds through a surcharge mechanism over a four-year period. Testimony reflects that the amount of adjustment is $239,721 per year. UtiliCorp explains that pay-as-you-go levels were maintained in the account after the 1993 MPS rate case (ER-93-37) because UtiliCorp interpreted the original decision as making a determination that the pay-as-you-go status would be maintained.

The Staff disagrees, stating that the remand order in Case No. ER-93-37, dated April 4, 1997, holds that MPS has recovered FAS 106 expense through its current rates, which went into effect in 1993.

Both Jackson County and the OPC support the position of the Staff.

The Commission agrees with the Staff in regard to recovery of the unfunded OPEB balances from 1993-96. The Commission finds that MPS has already recovered FAS 106 expense in its current rates.

The Commission finds substantial evidence that FAS 106 expense should be amortized over a five-year period, as the Commission has done for FAS 87 expense. The Commission rejects the corridor approach for FAS 106 for the same reasons as it rejected that approach for FAS 87.

The Commission adopts the Staff adjustment.

Maintenance Expense Normalization - D-6

The Staff proposes an adjustment of approximately $1.1 million to the total non-payroll maintenance expense account. The Staff states that it found the test year maintenance expense to be abnormally high and therefore used a five-year normalized expense process to more accurately represent the ongoing level of maintenance expense.

The Staff gives two reasons for its use of the five-year normalization rather than the one-year normalized method supported by UtiliCorp. The Staff first points out that UtiliCorp has substantial discretion over the budgeting and prioritizing of maintenance projects, and this has resulted in an abnormally high test year amount as compared with previous years. Secondly, the Staff testifies that it had great difficulty obtaining information necessary to ascertain the normal amount of maintenance expense. Staff states that, to the best of its knowledge, UtiliCorp has no specific budget guidelines which specify a normal amount of maintenance expense and could provide no information as to what projects are undertaken on a recurring basis. Further, UtiliCorp did not furnish the Staff with its maintenance policies or changes for the 1994-96 time period.

The Staff, therefore, used the normalization method, which is a type of averaging, to obtain its normalized expense figure. The following table shows Staff's comparison of actual maintenance figures for the five-year period with the normalized amount applied to this rate proceeding.

MISSOURI PUBLIC SERVICE
CASE NO. ER-97-394
Comparison of Normalized Maintenance with Actual
Source: Shaw Direct, Schedule 2

Maintenance Area	1992	1993	1994	1995	1996
Production	$ 5,695,403	$ 7,828,917	$ 5,850,114	$5,336,900	$ 6,964,823
Norm. Ovhl	500,000	500,000	500,000	500,000	500,000
Transmission	728,809	680,561	798,063	776,051	904,434
Distribution	4,773,419	4,805,958	4,856,674	3,265.837	5,366,599
Total	$11,697,631	$13,815,436	$12,004,851	$9,878.788	$13,735.856

Staff's "Total" Normalized Maintenance Expense $12,226,512

UtiliCorp states that the most common approach to normalizing costs is to adjust the test year for any abnormalities, as in this case the 1996 ice storm, and to use the adjusted amount to project ongoing expense. UtiliCorp points out that this method has been used by the Staff and UtiliCorp for the majority of the adjustments in this case. The UtiliCorp witness points out that the Staff failed to adjust all five years in its calculation for abnormalities. The UtiliCorp witness, Gary L. Clemens, uses distribution maintenance expense as an example and gives the following figures in rebuttal.

Mr. Shaw's Normalized Level of Distribution Maintenance Expense	**$4,613,697**

Actual Distribution Maintenance Expense

1992	Higher than Mr. Shaw's Normalized Level	$4,773,419
1993	Higher than Mr. Shaw's Normalized Level	$4,805,958
1994	Higher than Mr. Shaw's Normalized Level	$4,856,674
1995	Lower than Mr. Shaw's Normalized Level	$3,265,837
1996	Higher than Mr. Shaw's Normalized Level	$5,366,599

The average would be closer to the expected level of normalized expense. See the following table . . . .:

1992	$4,773,419	
1993	$4,805,958	
1994	$4,856,674	
1995	$4,900,000	(estimated increase)
1996	$5,017,607	(decreased for ice storm)
New 5-Year Average	$4,870,732	
Mr. Shaw's Average	$4,613,697	

The Commission finds the weight of evidence to favor UtiliCorp on this issue and will deny the proposed $1.1 million adjustment. However, the Commission is disturbed by the apparent lack of policy, program and budget information from UtiliCorp regarding its ongoing maintenance program in its MPS service area. The Commission advises UtiliCorp to formulate specific plans and budget goals for its ongoing maintenance program for the MPS service territory. It is hoped that proper ongoing maintenance will mitigate or totally avoid a future situation as serious as that caused by the most recent ice storm.

Economic Development Costs - D-8

The Staff has proposed an approximate $90,000 adjustment, representing 50 percent of the jurisdictional amount allocated for economic development costs. Evidence reveals that these costs were incurred by UtiliCorp employees engaged in maintaining relations with economic development councils from various municipalities. This apparently includes meetings and other assistance to municipalities in obtaining federal and state funding for growth and expansion in conjunction with the promotion of "Energyone" sales activities. It is agreed that "Energyone" activities are a non-regulated function of UtiliCorp.

The Staff has characterized these economic development activities as being promotional and, as such, properly chargeable to the shareholders of UtiliCorp and not to the MPS ratepayers. The Staff's proposed adjustment covers salaries, personal and administrative expenses (including meals and golf), and promotional items such as "Energyone" advertising material; $1,300 worth of golf balls; and $12,000 paid to assist building development in Nevada, Missouri.

The Staff states that, while a greater disallowance could be justified, the 50 percent disallowance was selected as being conservative. The Staff also noted that while there may be some benefit to the ratepayers from economic development activities, UtiliCorp was unable to quantify this benefit. The Staff pointed out that some costs were clearly of no benefit to the ratepayers, such as the meals and golf expenses.

Both the OPC and Jackson County support the position of the Staff, although the OPC recommends a disallowance of 100 percent based on the promotional practices rules and the fact that it is OPC's opinion that the ratepayers receive no benefit whatsoever from the economic development activities.

UtiliCorp cites the value of creating jobs to the community, the benefit of economic growth, attracting private investment, and stimulating tax revenue, all as being of benefit to the individual communities, the state of Missouri and the ratepayers of MPS. No quantification of these benefits has been offered by MPS save documentation of the creation of jobs in the test year of 1996 through successful economic development programs.

The Commission finds the Staff-recommended adjustment to be reasonable and supported by the evidence of record. The Commission will adopt the Staff-proposed adjustment.

Corporate Allocations - D-9 (Sub-issues A through G, I and J)

In order to understand the allocation issues, it is necessary to review the UtiliCorp accounting procedures.

Prior to 1995, MPS operated largely as an independent company with dedicated accounting, risk management and human resources departments. Beginning in 1995, however, UtiliCorp significantly reorganized its operation and centralized a number of functions, including its accounting function. UtiliCorp states that the reorganization was an effort to streamline its diverse businesses, make its operations more efficient and cost effective, and prepare for the advent of a competitive electric industry.

As a result, MPS no longer operates as an autonomous unit but as a division of UtiliCorp, sharing common services, such as accounting, human resources, information technology and risk management with the remainder of the UtiliCorp domestic divisions. Each specific function, according to Witness Dittmer, was centralized beginning in 1995 and continuing through the test year. These are referred to as Enterprise Support Functions (ESFs). During 1996, UtiliCorp had approximately 20 ESFs. Dittmer further testifies that most of the 20 or so ESFs provided services to regulated and non-regulated divisions alike throughout 1996.

The effect of the 1995 reorganization was that fewer costs were incurred directly by and exclusively for the MPS division and that many more costs were incurred on a UtiliCorp corporate-wide basis.

In some instances the corporate-wide costs were allocated on the basis of a general allocator, commonly referred to as the Massachusetts formula. The Massachusetts formula is described as a formula used to allocate costs when no better cost causative factors can be identified. The components used in developing the formula include revenue margins, payroll expense, and investment in plant and non-utility property.

A. Governmental Affairs

UtiliCorp proposes to allocate, by use of the Massachusetts formula, a portion of the costs in its governmental affairs ESF, which includes charges for the UtiliCorp federal and state "governmental support" and "legislative" programs. The Staff has proposed a disallowance for all of the costs incurred for representation in Washington, D.C. by the firm of Wiley, Rein, and Fielding, and 50 percent of the remaining costs, before jurisdictional allocation. This results in a total proposed Staff disallowance of approximately $400,000.

Based on its understanding that the Commission routinely treats lobbying activities as a below-the-line expense, the Staff concluded from work product evidence offered by UtiliCorp that the Washington, D.C. firm was engaged primarily in lobbying and legislative monitoring activities. The material is highly confidential. UtiliCorp has outsourced its federal legislative program to the Washington, D.C. firm. That firm provides UtiliCorp with periodic updates on pending legislation and various other federal legislative activities. The Staff alleges that no substantial proof of the firm's total activities was forthcoming from UtiliCorp.

The Staff maintains that all of the Washington, D.C. costs and 50 percent of the other pre-jurisdictional allocation costs were incurred solely to benefit UtiliCorp shareholders. The Staff is willing only to concede that the Missouri ratepayers might share the costs of "properly recoverable communication expenditures" at a local level.

UtiliCorp states, through testimony, that its governmental affairs ESF includes the following functions:

(1) Monitoring introductions to federal and state legislatures;
(2) Identifying issues that impact UtiliCorp operations;
(3) Communicating information back to affected groups;
(4) Determining appropriate actions, such as educating legislators about impact on the company, working with other companies, etc.; and
(5) Informing affected parties on passed legislation to comply with new rules or requirements.

UtiliCorp argues that many of the legislative monitoring functions are a normal and legitimate business expense. In addition, UtiliCorp takes issue with the Staff's characterization of legislative expenses as being a "below-the-line" activity and therefore synonymous with being not includable in rates. The UtiliCorp witness is of the opinion that 95 percent of the expense charged as state legislative monitoring is a legitimate business expense and does not constitute lobbying activity.

The OPC and Jackson County support the position of the Staff.

The Commission finds the Staff position to be reasonable and supported by the evidence of record. As in the remainder of the cost allocation items where it is employed, the Commission finds the evidence indicates that the 50/50 split of costs is fair both to the ratepayer and the shareholders of UtiliCorp. This is due in part to the substantial lack of evidence and specific documentation provided by UtiliCorp and in part to the evidence provided by the Staff. In this particular instance, the Commission finds the Staff's evidence to be persuasive in that a substantial amount of the costs involved in this issue were used for lobbying purposes. The Commission's policy has been to charge lobbying costs to the shareholders, and the Commission finds nothing in the record to convince it to alter that policy.

The Commission adopts the adjustment proposed by the Staff.

B. Public Affairs

The Staff proposes a disallowance from the public affairs ESF in the amount of approximately $250,000. In the test year, testimony reveals the public affairs ESF included the corporate responsibility program, corporate contributions, the UtiliCorp United Foundation Fund, corporate sponsored events, civic and community involvement, and industry associations. The Staff noted that while the charitable gifts and contributions themselves were recorded below-the-line, the administrative costs were not. The Staff maintains that this Commission routinely disallows all charitable contributions.

UtiliCorp's testimony and argument for the inclusion of the proposed disallowance in rates is basically the same as put forth for the inclusion of dues and donations. UtiliCorp restates its argument that causing an item to be recorded "below-the-line" does not preclude the Commission from including it in rates. Additionally, UtiliCorp states that benefit to all, including the ratepayers, is incurred as the result of the UtiliCorp corporate responsibility program and UtiliCorp's support for local non-profit organizations. At the least, UtiliCorp supports a reasonable sharing of the costs from the public affairs ESF, and the dues and donations ESF.

The OPC and Jackson County support the Staff's position.

The Commission has routinely disallowed costs for charitable gifts and contributions. The Commission finds that, while the UtiliCorp corporate responsibility program is commendable, the ratepayers cannot be held liable for contributions to charities not of their own choosing. In addition, the Commission is not convinced by the evidence that it is just and reasonable to include these costs in rates.

The disallowance proposed by the Staff is adopted.

C. Trans UCU ESF (Corporate Travel)

During the test year this ESF was responsible for arranging and providing for corporate travel. Part of the ESF costs incurred were related to the leasing, operation and maintenance of several corporate aircraft. The Staff proposes a disallowance related to leasing and operating costs of these aircraft. Some details regarding the use and accounting procedures used for these corporate aircraft remain highly confidential and will not appear in this report and order.

According to the Staff this issue arose as the result of approximately $2.9 million in overall residual aircraft costs at the end of the test year which were unassigned to any business unit, division or ESF. UtiliCorp proposes to allocate these residual costs to its business units on the basis of the Massachusetts formula. The evidence on this issue relates largely to comparisons by both parties to the relative costs, advantages and disadvantages of these aircraft in relation to the use of commercial travel.

The Staff initially points out that, up to this time, UtiliCorp has not included its residual aircraft costs in rates. The Staff has also been unable to identify any other utility in the state which is operating a business aircraft and which has included such costs in the development of jurisdictional retail rates.

The Staff witness bases his analysis partly on information furnished by UtiliCorp in an attempt to justify the inclusion of the residual costs in rates. The Staff witness analyzed information furnished by UtiliCorp regarding variable corporate aircraft operating costs assigned to business units and ESFs. The witness made comparisons between the variable cost per flight and the cost of alternative commercial airlines on a cost-per-passenger basis. The Staff witness has broken down the cost per business unit figures to reflect cost-per-passenger being assigned to the given ESF or business unit in comparison to cost-per-passenger of alternative commercial transportation.

The Staff witness concludes that he has reviewed information furnished by UtiliCorp regarding the operation of one aircraft used to shuttle employees between Omaha and Kansas City. The Staff witness notes that no date for the information, referred to as the "PRC Aviation Study," could be found but states that the date of the most recent source of information cited in the study is October 1987. The witness continues that the study was prepared for the General Aviation Manufacturers Association and the National Business Aircraft Association and was apparently designed to "convince stockholders and other parties" of the financial soundness of operating corporate aircraft. The Staff witness doubts that this constitutes an "independent" study. The witness concludes that the study does not provide key sources of information, calculations and the assumptions used in arriving at the results of the study and that the study was provided to the Staff at such a late date that complete analysis was impossible.

In the hearing of this case, the Staff testified to receiving an additional cost analysis provided by UtiliCorp. Mr. Dittmer testified that the shuttle analysis performed by UtiliCorp was flawed in many respects, including the apparent elevation of comparable costs and comparison of 5,500 commercial flights with 4,500 private shuttle flights.

UtiliCorp supports its operation of the shuttle, and the comparison analysis of its costs, by stating that the analysis demonstrates that the operation of the shuttle is "within three percent of the cost of commercial flights and related costs." UtiliCorp maintains that the total costs of the shuttle are reasonable when compared with similar commercial travel, and therefore some $679,537 should be recovered in rates.

UtiliCorp also maintains that the PRC study quantified the benefits of the use of the corporate jet aircraft, including enhanced productivity, reduced total travel time, personal security and safety and reduced stress for employees and families. UtiliCorp concludes that the costs of the company's jet (the non-shuttle aircraft) are also justified when all costs related to employee travel are considered.

The Commission finds the UtiliCorp evidence to be insufficient to support the inclusion of the questioned costs in rates. The Commission also finds the Staff evidence in support of its disallowance to be substantial and competent. The weight of the evidence therefore causes the Commission to find that the Staff proposed disallowance will be adopted.

D. Severance Costs

The Staff has proposed an approximate $142,600 disallowance for test year severance costs. The Staff witness states that such costs are largely non-recurring and are quickly offset by savings in payroll expense. The typical severance pay is six months salary.

UtiliCorp disagrees with the Staff's position. UtiliCorp states that payroll savings are achieved, to the benefit of the ratepayers, by severing employees. UtiliCorp believes that the concurrent severance costs, therefore, should also be borne by the ratepayers.

UtiliCorp also points out that it regards severance pay as a management tool and therefore seeks inclusion of what it considers an ongoing amount of severance costs in rates. The test year severance expense was a result of the UtiliCorp reorganization program, referred to as "Building Tomorrow's UtiliCorp," or BTU. The UtiliCorp witness explains that the BTU program is ongoing, along with a certain level of severance costs. UtiliCorp maintains that these costs should properly be reflected in rates.

The Commission finds the weight of evidence in this issue indicates that the severance costs in question were a one-time occurrence and not an ongoing expense. In addition, while some benefit to the ratepayer may accrue, the evidence is insufficient on that point.

Therefore, the Commission will adopt the proposed adjustment of the Staff.

E. Common Plant Allocation Factor

This issue revolves around the allocation of costs for one of the "responsibility centers" (RC) in the Operations Support ESF, namely, the facilities support RC. This RC includes rent and other office-related costs for office buildings located company-wide which housed ESF personnel during the test year.

Initially, according to the Staff witness, both UtiliCorp and the Staff used the same allocation method to determine the portion of these consolidated costs which should be included in local rates. That method is described as the "head count" method. Subsequently, in August 1997, and after the filing of UtiliCorp direct testimony, UtiliCorp revealed a proposal to allocate facilities support costs on the basis of an overall common plant ESF allocation factor rather than the head count factor. This caused an increase in the common plant expense in the amount of approximately $567,000, the proposed amount of the Staff adjustment. The common plant allocation rate is reported to be 24.98 percent. The head count factor used by the Staff is 18.35 percent.

The UtiliCorp witness states that the common plant allocation factor is more precise, follows previous regulatory treatment, and is reasonable. UtiliCorp adds that the head count factor fails to allow for the movement of employees during the year and is inconsistent with the allocation factor used in the remainder of the ESF.

The Staff bases its objection on the fact that UtiliCorp has failed to document the reasonableness of either allocation factor. Although the Staff objected to UtiliCorp's original head count allocator, the Staff offered no alternative. After the late change in allocation factor by UtiliCorp, Staff still maintains that adequate documentation is lacking and the UtiliCorp position is unsupported. The Staff urges the Commission to hold UtiliCorp to its original position.

The Commission finds the evidence presented by UtiliCorp to be reasonable and sufficient to support its position. The Commission will deny the proposed Staff adjustment.

F. Mergers and Acquisitions (M&A), International and New Product Development

The Staff proposes an adjustment of approximately $726,000, alleging that UtiliCorp failed to adequately capture and assign costs to three major non-regulated activities. Those activities are mergers and acquisitions, international operations and new product development. The Staff states that, "based on Missouri policy and practice, merger company records and the extensive experience of its auditors," the above adjustment was the result of the Staff directly assigning 25 percent of the finance ESF costs and 50 percent of the executive, operations, CFO and external communications ESF costs to M&A, international and new product development.

The Staff characterizes the UtiliCorp policy as one of growth by acquisition. The Staff points to the acquisition or startup of a number of companies and the aggressive acquisition strategy of UtiliCorp, both domestically and internationally. The Staff also notes the UtiliCorp effort beginning in 1995 to launch a proprietary national brand for its energy services called "Energyone." Finally, the Staff lists the unsuccessful merger attempt with Kansas City Power & Light Company (KCPL) which took place during the test year, all as examples of the amount of time UtiliCorp's management and staff personnel have given to unregulated activities.

Specifically, in the executive ESF, the Staff testifies that, of a total cost incurred of $1.5 million, only $200,000 was charged to foreign operations. The Staff witness states that, of the eight senior management officers, several were either partly or wholly responsible for international operations, mergers and acquisitions or other non-regulated activities. The Staff witness states that, other than the $200,000 charge for international operations, no charges were made to this ESF for any other unregulated activities such as mergers and acquisitions.

In the operations ESF, the Staff states that the individual responsible for operations, Mr. Robert Green, charged only 14 percent of the total ESF costs to international operations. There were, according to Staff, no M&A or corporate development charges to this ESF from Mr. Green.

In the financial ESF, the Staff recommends a 25 percent disallowance. The Staff notes the various functions contained in the description of the finance ESF, including external financing of both domestic and international ventures, daily cash management, lock box interface, cash collections, pension management, check signing, financial community relations and administration of the customer finance program. The Staff originally requested a 50 percent disallowance of the costs attributed to this ESF minus those costs incurred for bank service fees and collection agency fees. That adjustment was later changed to 25 percent. The Staff is of the opinion that the excluded fees were incurred for regulated activities.

For the Chief Financial Officer (CFO) ESF, the Staff first points out that there is a substantial lack of documentation of the CFO's time. It adds that given a description of the responsibilities and duties of that position by UtiliCorp, it was the position of the Staff that unregulated activities made up a large portion of those duties, including international operations and merger activity. Time charged to those activities was not reported at all, and later under-reported. The Staff is also critical of the "exception" timekeeping used by the CFO and described below. The Staff proposes a 50 percent disallowance of the costs charged to this ESF.

For the external communications ESF, the Staff maintains that this position exists chiefly to facilitate external financial requirements related to UtiliCorp's non-regulated and international activities. The Staff adjusted these costs to exclude costs associated with the UtiliCorp annual report and shareholders meeting and then proposed 50 percent, the remainder, be allocated to M&A activities, international and new product development.

The Staff bases this proposed disallowance on a comparison of the job accountability of the senior vice president-corporate communications, with the UtiliCorp proposed allocations themselves. It should be pointed out that, as in all of the five ESFs, the Staff substantiates its proposed disallowances partly on the poor timekeeping of various senior executives. The Staff explains that UtiliCorp executives, and all ESF personnel, use "exception" time sheet reporting to track the ultimate assignment of costs to an ESF. The employee's own ESF is charged with the costs unless the time sheet reflects an "exception." No time is reported or assigned to a task unless there is an exception. The Staff considers exception timekeeping to be a very inadequate method of tracking costs for purposes of accurately determining the amount of time and expense devoted to regulated, as opposed to non-regulated, activity in a diverse company such as UtiliCorp. The Commission agrees.

As a result of inadequate timekeeping and lack of other documentation, the Staff was forced to use its own estimation of time spent in various activities in conjunction with the various job descriptions furnished it, to allocate an appropriate level of funds which should reasonably be included in rates.

UtiliCorp states, generally, that its senior management is not heavily involved in foreign operations and that each of the international companies is managed relatively autonomously. In this regard, UtiliCorp points out that substantial time differences exist between its corporate headquarters in the Midwest and its companies in Australia and New Zealand which makes lengthy contact during reasonable working hours very difficult. UtiliCorp also states that it does not have controlling interest in its New Zealand and Australian operations.

UtiliCorp also argues that the Staff disallowances of 50 percent, and 25 percent of the finance ESF, were arbitrary, without basis in evidence, and unrealistically low. UtiliCorp adds that after some direct assignment of costs to non-regulated activities, the Massachusetts formula was used to assign costs. UtiliCorp argues that, as a result of the application of direct assignment and use of the Massachusetts formula, the assigned costs accurately reflect the time and expense dedicated to various business units and activities.

The Commission finds substantial evidence supports the position of the Staff. The Commission finds the proposed adjustment to be reasonable in light of the poor timekeeping and inadequate records offered by UtiliCorp. The Commission will adopt the Staff adjustment.

G. Discretionary Bonus/Employee Recognition

The Staff has proposed an adjustment of approximately $148,000 for certain discretionary employee bonuses and merchandise distributed to employees, allegedly related to the "Energyone" activity.

The Staff witness states that the employee bonuses in question are not predicated on any achievement of goals or targets and seem to be an after-the-fact reward. The witness continues that in his experience such after-the-fact rewards are not common in the utility industry. Further, the Staff witness states that he finds it difficult to believe that ratepayers benefit from the employee bonuses.

The Staff continues that UtiliCorp awarded certain merchandise displaying the "Energyone" brand to its employees during the test year. The cost of the merchandise was included as an operating expense in certain ESFs. The Staff takes the position that all costs of promoting the Energyone brand name should be borne by the UtiliCorp shareholders.

UtiliCorp states that both the merchandise and bonus plans are part of a UtiliCorp program to retain its employees. UtiliCorp notes substantial turnover in its industry and a desire on the part of its employees to obtain recognition from the company for the contribution they are making. The bonuses are intended to recognize and reward exceptional performance. In addition, UtiliCorp maintains that the program is, in effect, "self-funding" because the expense to replace experienced employees is greater than the expenditure of salary and benefits combined.

The Commission finds the discretionary bonus plan to be as the Staff describes it, an after-the-fact reward plan not predicated on any achievements or goals. The Commission typically does not award costs to the ratepayers for programs of this nature without a substantial showing of direct ratepayer benefit. *The Commission finds the Staff proposed* adjustment to be just and reasonable.

The Commission will adopt the proposed Staff adjustment.

I. ESF Time Reporting

While this issue does not contain a monetary adjustment, the Staff particularly has requested the Commission issue, as a part of its report and order, a direction to UtiliCorp requiring positive time reporting. As has been noted above, UtiliCorp currently uses "exception" reporting. The Staff testifies repeatedly that this type of time reporting creates a major impediment to auditing the accuracy and fairness of the charges to regulated and non-regulated functions and particularly to the various ESFs. It is also the opinion of the Staff that UtiliCorp employees, under the exception system, are neglecting to report time spent in non-regulated functions and are therefore, by default, causing that time to be charged to the ratepayers of MPS.

UtiliCorp responds that "contemporary management theory holds that the traditional organizational chart does not provide the necessary flexibility" for the efficient operation of current and future utility businesses. UtiliCorp, as has been set out above, disputes the Staff assertion that, for one reason or another, UtiliCorp employees are not reporting their time accurately.

The Staff has also recommended that UtiliCorp be required to maintain current organizational charts and job descriptions which clearly delineate responsibility and reporting requirements. The Staff notes that the Commission has the statutory authority to specify the nature of the accounting records of regulated entities.

UtiliCorp states that its current cost assignment procedure, described as direct assignment based upon requirements, allocation based upon cost causative factors, and application of the Massachusetts formula, is a reasonable approach for assigning costs associated with time reporting.

As this issue bears no monetary amount, the Commission will make no ordered finding. The Commission will, however, strongly suggest to UtiliCorp that it adopt positive timekeeping, as recommended by the Staff, and accounting procedures which adequately separate and track costs associated with the operation of the MPS regulated service area.

J. The Ernst and Young Synergy Study

During the test year, UtiliCorp commissioned the firm of Ernst and Young to study and report on possible synergies which could be expected from the proposed merger of KCPL into UtiliCorp. The Staff has proposed an adjustment of approximately $280,000, which reflects all costs of this study.

The Staff states that this item is a non-recurring expense and therefore should not properly be considered inside the test year for ratemaking purposes. The Staff also states that no evidence was offered by UtiliCorp that the ratepayers have received any "stand-alone" or "non-merger" benefit from the study.

UtiliCorp witness Robert Green stated that the Ernst and Young study was a detailed internal analysis which helped management identify many cost-saving programs as part of its ongoing re-engineering. Some examples are the centralization of operating functions, new computer software, new control systems, improved training and ways to handle environmental issues. UtiliCorp states that its ratepayers are, and will continue, to benefit from the knowledge gained from a third-party review of the UtiliCorp procedures and operating practices.

The Commission finds that the record does not adequately support a finding that the study in question produced any real benefit to the ratepayers. The Commission also finds the Staff case to be sufficient on the record to support its proposed adjustment.

The Commission will adopt the Staff-proposed adjustment.

Dues and Donations - D-10

The Staff has proposed an adjustment of approximately $42,600 in the cost of dues and donations to various organizations on the basis that membership in these organizations is not necessary for the provision of safe and adequate service and that donations to charitable organizations, while perhaps worthwhile and well-intentioned, should be rejected as not necessary for the provision of safe and adequate service. The Staff maintains that these costs should be regarded as a gift from the company and its stockholders, not as an involuntary gift from the ratepayers. Testimony reveals these organizations include various country clubs, rotary clubs and a host of charities.

UtiliCorp states that it has regularly obtained above-the-line treatment of its charitable donations and dues in other jurisdictions. These recoveries have been based on the premise that the cost of meeting civic responsibility benefits everyone, including the ratepayers. UtiliCorp demonstrates its corporate responsibility by supporting the various worthwhile organizations in the community and would recommend a reasonable approach to sharing this responsibility with the ratepayers.

The Commission has traditionally disallowed donations such as these. The Commission finds nothing in the record to indicate any discernible ratepayer benefit results from the payment of these donations.

The Commission agrees with the Staff in that membership in the various organizations involved in this issue is not necessary for the provision of safe and adequate service to the MPS ratepayers.

The Commission will adopt the proposed adjustment of the Staff.

Tariff Issues

In Case No. ET-98-103, consolidated with the rate filing and Staff complaint, UtiliCorp filed three proposed tariffs. The three tariffs were suspended to the operation of law date of March 18, 1998, to coincide with the suspension of proposed tariffs in the rate filing. The three tariffs propose the initiation of real-time pricing, the modification of the line extension policy and the institution of flexible rates and special contract service. The Commission will deal with each tariff separately and with the alternative rate proposal later in this report and order.

Real-Time Pricing Tariff

UtiliCorp has proposed a real-time pricing tariff (RTP) to allow MPS to reconfigure its rates to better conform to the emerging competitive electricity environment. By way of summary of the proposed tariff, UtiliCorp describes the tariff as having a two-part structure. The first part comprises the customer baseline load, which is a calculation of the customer's usage absent an RTP program. This baseline load is calculated on the customer's historical usage. The second part of the RTP proposal covers the difference between actual and baseline usage in each hour. This usage is priced at the marginal cost-based real time price, allowing the customer the option of purchasing additional load above the baseline or selling back excess load at the real-time price.

A description of the proposed RTP tariff is contained in the direct testimony of SIEUA witness Donald E. Johnstone. Mr. Johnstone states:

> "The Company's proposal calls for a Customer Base Bill to be established which reflects a pre-determined level of usage at a pre-determined price. The Base Bill seeks to be revenue neutral to the utility and customer, assuming the customer were to use exactly the Customer Baseline Load (CBL) amount of energy under the program. The CBL may or may not change over the term of the RTP agreement.
>
> Hourly real time electricity prices (P_{rtp}) will be established and communicated by the utility to the customer one day ahead. These prices will apply to usage above or below the CBL. Incremental usage is billed at P_{rtp}. Similarly, decreases in usage are credited at P_{rtp}.
>
> In establishing the price P_{rtp}, MPS proposes to add a combination of fixed and variable adders to the estimate of marginal cost, as shown in the tariff and in the testimony of Company witness Chapman at Pages 14 and 15. This hybrid approach of fixed and variable adders appears to be unique among utilities. Further, it contains variables that are not spelled out in the tariff, but rather are set on an individual basis by the Company.
>
> These adders have the effect of causing a greater markup at times when marginal cost is lower, and a lower markup at times when marginal cost is high. I would note that such a phenomenon is in direct contrast to what is usually observed in a competitive market, as margins are trimmed when market prices are low and expanded at times of high demand and high market price. I have prepared Schedule 5 which shows how the variable adder affects the markup under two different marginal cost situations. This schedule also shows the scale of percent markups that could be expected under the various scenarios.
>
> There are additional noteworthy features in the tariff. These include 'Price Quotes for Fixed Quantities' and 'Bill Aggregation Service.' The first allows customers to contract with MPS for short-term power contracts (one week to six months) for agreed increments of usage, under mutually agreeable terms. The second, Bill Aggregation Service, allows customers with multiple accounts, that are financially or legally related to one another, to aggregate bills for the purpose of the incremental energy charge.
>
> Finally, the Company wishes to offer a 'Premium RTP Service,' which is similar to Basic RTP Service, except that a reduced markup on the marginal cost is accepted in return for an additional fixed payment, Base Bill Premium

(*B*), by the customer. The reduced markup is accomplished by using a relatively higher alpha and/or a relatively lower gamma in the pricing equation."

UtiliCorp argues that the utility, the customer, and the remainder of the ratepayers will all benefit from this program. UtiliCorp states that the proposed tariff allows customers to use energy in a more economically efficient manner because use can be planned and adjusted based on the current price. For the energy supplier, the proposed tariff allows incremental sales of excess capacity. For the service provider, UtiliCorp points out an opportunity to encourage customer growth in a manner that promotes system reliability and economic efficiency.

The Staff prefers and recommends an alternative RTP tariff, substantially the same as the tariff approved by the Commission in Case No. ET-97-113, In re Kansas City Power & Light Company. The staff witness points out the differences between the UtiliCorp proposal and the Staff-recommended KCPL tariff.

In regard to availability, the Staff states that self-generating customers are suited for real-time pricing and the proposed tariff should be available for services used by self-generators, including standby, back-up and supplemental. Further, curtailable customers should be allowed to take service under the RTP tariff. Finally, it is the Staff's opinion that customers without hourly recording devices should be required to pay the installation cost of such devices.

In regard to monthly rates, the Staff states that the proposed tariff rates have variable pricing components which are to be negotiated individually with each customer. The Staff takes the position that a negotiated rate is a special contract rate and should be entered into under the special contract tariff. The Staff states that the variables in the pricing component should be fixed within the RTP tariff. The Staff also states that no provision has been made for the adjustment of transmission charges. The Staff is of the opinion that embedded-cost transmission charges should be a component of the hourly real-time price so that the amount of use of the transmission system is the same for customers with the same use.

The Staff states that the customer baseline load, once established, should only be adjusted by mutual agreement, and then only under special circumstances. The Staff is in favor of the two-part structure of the proposed tariff and the KCPL tariff and does not appear to favor the alternative, one-part SIEUA proposal.

Finally, the Staff seeks to eliminate the section of the proposed tariff which provides for price quotes for fixed quantities, stating that offering individual customers separately negotiated prices, structures and quantities will likely result in undue discrimination.

The Staff supports approval of a real-time tariff similar to the tariff adopted in the Kansas City Power & Light case.

The SIEUA recommends a one-part real-time pricing approach. The SIEUA states that the one-part approach would better reflect costs and will not discriminate between new and existing loads. SIEUA adds that the one-part tariff would be a better model for the future competitive retail sector.

The SIEUA agrees with the Staff regarding the price quote section and availability to curtailable and self-generating customers. Finally, the SIEUA states that it has identified many terms in the proposed MPS tariff that it states are ill-defined and unauditable. The SIEUA recommends that no tariff should be approved until the rates, terms and conditions of service are clearly defined.

The Commission has approved tariffs of this general type in previous cases, as pointed out by the parties. While the Commission is not opposed to tariffs of this nature, the Commission agrees with the preferences and recommendations of the Staff and, partly, with the SIEUA. The Commission finds that the Staff has provided sufficient evidence that the proposed tariff is not just and reasonable.

Therefore, the Commission will reject the proposed tariff.

Flexible Pricing/Special Contract Tariff

UtiliCorp has requested authority to implement a tariff that supports special contract service to large customers that has the following provisions regarding availability, rates and conditions.

With regard to availability, MPS, in instances where it faces competition from alternate energy suppliers, may enter into special rate contracts with Large Power Service customers. The rates agreed upon by MPS and customers will not exceed the rates available under the Large Power Service tariff or be less than rates that, in the aggregate, exceed MPS's incremental costs making a contribution to fixed costs. All contracts entered into under the tariff would be provided to the Commission Staff and the OPC and would be subject to the Commission's jurisdiction.

UtiliCorp states that this is an effort to retain large customers and to retain as much contribution to fixed cost recovery as possible. UtiliCorp has filed a proposed tariff detailing its proposal for a special contract tariff with a flexible rate feature.

The Staff recommends an alternative tariff with substantially the same provisions as the tariff approved by the Commission in Case No. ET-97-113. The Staff contrasts the UtiliCorp proposal with the KCPL tariff in three general categories.

In the first category, availability, the Staff recommends the Commission set a minimum monthly billing demand to qualify for the special contract rate. This monthly demand is specified in minimum kWs used per month. This would have the effect of limiting the special contract rates to those customers who would be large enough users to have an adverse impact on the remainder of the ratepayers on the system were they to leave.

In the second category, rates, the Staff suggests that a proper tariff should make it clear that the rates negotiated for each customer will exceed the incremental cost of serving that customer and that MPS will seek to maximize each customer's contribution to margin without undue discrimination. The Staff suggests the following language:

> The rates agreed upon by Missouri Public Service and each customer shall reasonably exceed Missouri Public Service's incremental cost of serving that customer. Missouri Public Service will endeavor to maximize each customer's contribution to margin without the exercise of undue discrimination.

In the third category, conditions, the Staff recommends that MPS should be required to provide not only the special contracts themselves, but sufficient documentation to allow adequate review by the Staff. A contract documentation section was incorporated into the KCPL tariff and the Staff recommends its use.

The OPC does not support the UtiliCorp proposal and does not agree entirely with the Staff's alternative. The OPC notes the following deficiencies in the Staff proposal, and contained in the KCPL tariff:

> KCPL was allowed to use its discretion in applying the tariff to customers with special needs and receiving a smaller contribution to margin from these customers when there is no rationale for lessening the margin. This discretion was allowed despite the fact that the utility is likely to have an incentive to offer smaller margins in situations where it helps its competitive position.
>
> KCPL is allowed to enter into contracts that do not contain "market out" clauses which would allow customers to be free

> to choose the services of an alternative supplier once direct retail access becomes available.
>
> KCPL was granted discretion to enter into special contracts of unlimited length even though the Commission's order in Case No. EO-95-181 stated that it was "concerned with the length of contracts."

The SIEUA points out two fundamental problems with the UtiliCorp-proposed tariff. First, the SIEUA witness notes that the downward flexibility removes the incentive for the company to have its product priced properly for all classes of customers. The second SIEUA criticism is that the proposed tariff provides different prices for different customers who would otherwise be similarly situated.

SIEUA recommends cost-of-service based rates in lieu of the downward flexibility portion of the proposed tariff. Also, the SIEUA proposes that all price reductions be posted so that all similarly-situated customers will be aware of prices offered to others.

In surrebuttal, after review of the Staff alternative proposal, the SIEUA witness states that the SIEUA has a concern in regard to the suggested Staff language regarding expanding the availability of the special contract rate to special needs customers. The SIEUA explains that there needs to be some qualification that it would only be appropriate to maximize margin in regard to special contracts that are in response to viable competitive alternatives. Special needs contracts should reflect rates that are cost-based, and those rates should not maximize the contribution to margin.

Finally, the SIEUA suggests a modification to the incremental cost language proposed by the Staff:

> In situations where contract rates under this rate schedule are in response to viable competitive alternatives, and represent reductions from the otherwise applicable rate, such contract rate shall be designed to produce revenues that exceed Missouri Public Service Company's incremental

> cost of serving the customer, and Missouri Public Service Company shall endeavor to maximize the contribution to its margin from such customers without the exercise of undue discrimination and up to the level of the otherwise applicable rate.

Again, the Commission is not opposed to special contract tariffs and has approved such tariffs for use by several electric utilities in this state. However, the Commission agrees with the comments of the Staff in regard to availability, rates and various conditions. The Commission suggests that UtiliCorp refile a tariff similar in nature to the special contract tariffs the Commission has already approved.

The Commission finds that the Staff has provided sufficient evidence that the tariff as proposed is not just and reasonable.

The Commission will reject the proposed tariff.

Line Extension Policy

UtiliCorp has proposed a tariff regarding its line extension policy, also referred to as facilities extension policy. UtiliCorp proposes to revise its current facilities extension policy to reflect that the recovery of costs for facilities extensions will take into consideration the potential revenue associated with each class of customer.

Briefly described, the UtiliCorp proposal provides for a construction allowance from MPS that is based upon an analysis of the revenue provided from the extension during the first five years of its use.

An additional purpose of the proposed tariff is to reflect the unbundling of generation, transmission and distribution costs. This proposal would restrict the MPS investment in facilities to an amount that can reasonably be recovered from the distribution portion of its network.

UtiliCorp is also proposing that applicants for service provide the conduit and other materials at their cost in areas requiring underground service.

The Staff states that residential extensions and proposed allowances fall into the following four categories and amounts:

I.	Electric Cooling, Gas Space & Water Heating	$1,371
II.	Electric Cooling & Water Heating, Gas Space	$2,020
III.	Dual Fueled Heat Pump	$2,820
IV.	All Electric	$2,220

The Staff's analysis of the proposal indicates that category I customers would suffer the most impact while category IV customers would suffer the least impact.

The Staff generally supports the proposed tariff revision as an effort to properly allocate costs to those customers who cause the costs. The Staff would recommend that the proposed tariffs be altered to incorporate the two-year transition period proposed by MPS but not reflected in the actual tariff. The Staff would also recommend that the proposed tariffs be modified to describe the characteristics of each of the four categories of residential customers. Finally, as the proposed tariff makes reference to the electric services standards handbook, the Staff suggests that the Commission instruct MPS to furnish the Staff with an updated handbook whenever substantive changes occur.

Intervenor Missouri Gas Energy (MGE) is opposed to the proposed MPS tariff revision because, as stated by the MGE witness, the proposed tariff unfairly burdens the customer who chooses gas space and water heating by deducting a higher allocated percentage. MGE argues that gas space and water heating customers get less credit for the revenues they produce than customers with electric water heating or space heating. MGE continues that the result is that gas water and space heating customers are required to pay an electric facility's extension charge while electric water and space heating customers are not required to do so. MGE offers the following chart as an example:

Type	Description	Allocated Piece to Infrastructure Percentage	Construction Cost	Annual Distribution Gross Margin	Customer Payment
I.	Gas Space & Water Heat, Electric Cool	33%	$2,020	$379	$539
II.	Electric Water, Electric Cool, Gas Space Heat	20%	$2,020	$470	$0
III.	Electric Heat Pump, Gas Back up Heating	20%	$2,020	$417	$0
IV.	All Electric	20%	$2,220	$526	$0

MGE maintains that a more equitable approach would be to use the same allocated percentage for all customers regardless of equipment in the structure. MGE also notes the lack of a category for natural gas-fired cooling. Finally, MGE states that the proposed tariff language is confusing.

Jackson County supports the Staff position on this issue while the OPC takes no position.

The Commission concurs with MGE that a proper line extension policy should employ the same allocated percentage to all residential customers regardless of the equipment installed in the structure.

The Commission finds there is sufficient evidence that the proposed tariff is not just and reasonable.

The Commission will reject this tariff.

Incentive Regulation

UtiliCorp is proposing an incentive regulation plan, called an Efficiency Earnings Model (EEM). An incentive regulation plan generally is described as a method for setting rates to allow the opportunity for the utility to obtain a higher return for assuming higher risk.

In traditional regulation, once the utility's rates are set in a general rate proceeding, the utility assumes the risk of any revenue requirement increases and, conversely, receives the benefit of any revenue requirement decreases, until such time as another general rate proceeding takes place and imbalances are adjusted. The UtiliCorp proposal is referred to by the Staff as a sliding scale sharing grid-type plan, called Performance Based Regulation (PBR). The utility would be allowed to retain a portion of its earnings above its authorized return on equity depending on a comparison of achieved earnings with a pre-established sharing grid. Depending on the comparison of the actual return of the company with the sharing scale in the grid, the utility might retain all or some of its earnings above its authorized rate of return.

The sliding scale mechanism is the only type of incentive plan that has been approved by this Commission. It is currently being used on an experimental basis by UE, as the result of Case No. ER-95-411, and was used by Southwestern Bell Telephone Company from 1990-1993 as the result of Case No. TC-89-14, et al. UtiliCorp also sets out the following purposes for such a plan:

1. Provide adequate incentives for the company to cut costs and increase efficiency and productivity.

2. Prevent any cost reduction action that might degrade performance measurements of safety, reliability and customer service quality.

3. Remove the over-emphasis on capital investments.

4. Reduce the high cost and time consumption of the traditional regulation model.

5. Continue to provide a reasonable regulatory review of the profit levels of a monopoly enterprise.

6. Remove the "profit envy" or "profits are bad" concept of current regulation.

7. Establish a regulatory model that looks at "price" instead of "cost."

8. Address the need for "price stability."

On an annual calendar basis, the MPS proposed sharing grid is as follows:

13.5% to 14.5%	25% to customer/75% to shareholder
14.5% to 15.5%	50% to customer/50% to shareholder
15.5% to 16.5%	75% to customer/25% to shareholder
16.5% and above	100% to customer/0% to shareholder

The mechanics of the UtiliCorp proposal are for the company to issue a report detailing its annual calendar year earnings by April 15 of the following year. The Staff, Office of Public Counsel and other involved parties would then review the report and bring their recommendations and any points of disagreement forward to the Commission. By July 1 of that year, the Commission would issue its order containing its findings as to the company's earnings for the previous year, and order rate credits to be issued, as appropriate, if MPS's earnings are within the sharing portion of the grid.

Initially, the Staff states that, under certain circumstances, it is not opposed to implementation of a well-designed experimental incentive regulation plan. The Staff notes that a well-designed and managed plan requires the following: up-front agreement on how earnings should be calculated for purposes of determining whether customer sharing is called for; and a high degree of cooperation on discovery so that the Staff and other parties can make their recommendations to the Commission within the truncated time period called for in the past sliding-scale plans now used in Missouri and in UtiliCorp's proposal.

Those matters being necessary to the proper administration of this type of plan, the Staff states that it does not favor allowing MPS to implement such a plan at this time for three reasons. The Staff has serious concerns regarding (1) the MPS cost allocation procedures; (2) an MPS propensity for earnings manipulation; and (3) the discovery problems regarding MPS encountered by the Staff in this and previous rate proceedings.

Finally, the Staff objects to the details of the MPS proposed sharing grid as being slanted in favor of the shareholders and against the ratepayers. The Staff notes that every aspect of the sliding scale is less favorable to the ratepayer than the plan currently in effect for UE.

The OPC also does not believe that MPS should be authorized to engage in an incentive plan for three general reasons. First, as did the Staff, the OPC cites UtiliCorp's recent, consistent, non-cooperation with the discovery process in this case. In that regard, the OPC witness states:

> "Alternative Regulatory Plans require a greater degree of cooperation between a utility, the Commission, the Staff, the Public Counsel, and other intervening parties. An ARP does not mean a decrease in regulatory oversight, but a change in focus. This change in focus involves: the production of reports on a timely basis, access to company planning documents on a regular basis, interaction between the parties to address unanticipated changes in operations or other factors, customer service measures, and other possible goals such as increases in productivity or efficiencies. The difficulty Public Counsel and other parties in this case have had getting timely and actually responsive responses to discovery indicated that an ARP, with its required high degree of cooperation, would be a disaster." (Exhibit 11, Trippensee Direct, pp. 15-16).

The OPC cites UtiliCorp's consistent disregard of, and failure to fulfill, previous commitments to the Commission. The OPC notes particularly Case No. EO-95-187 in which it alleges MPS failed to submit required documents.

The OPC reiterates the Staff contention that UtiliCorp has a propensity, in fact a corporate policy, to "manage" corporate earnings.

The OPC also notes its objection to the propriety of the benchmarks on the sharing grid as favoring the shareholders and the company, and the UtiliCorp proposal to use year-end rate base and capital structure.

Jackson County supports the position of the Staff and also points out that the current State statute governing the setting of rates, Section 393.270, RSMo 1994, requires the Commission to consider all relevant factors when setting the rates of a public utility. As the proposed incentive plan does not, by design, allow consideration of all relevant factors, Jackson County maintains that the proposal is unlawful.

The Commission is aware that it has currently approved several experimental incentive regulation plans of one type or another. However, the Commission has weighed the evidence in this record carefully and finds several matters of concern.

First, the Commission finds that the sharing grid, as proposed by UtiliCorp, is not in the interest of the MPS ratepayers and is neither fair nor reasonable.

Second, the Commission notes the concerns of both the Staff and OPC in regard to the long-term problems encountered in this litigation in regard to discovery and cooperation between the parties. The Commission will not assign fault in this matter but states that a successful incentive regulation plan requires proper and accurate accounting and other record keeping, and substantial cooperation between the parties.

Third, the Commission agrees with Jackson County to the extent that the approved Incentive Plans to date have all been experimental and have had a fixed expiration date.

Therefore, for the above reasons, the Commission will reject the proposed incentive regulation plan.

Stipulation and Agreement

On February 27, 1998, the Staff, OPC and UtiliCorp filed a proposed stipulation and agreement, requesting Commission approval of the resolution of three issues. Those issues are a customer deposit interest proposal, an energy audit tariff, and a low-income weatherization program. The parties have failed to reach an agreement on a low-income weatherization program and have, therefore, requested the removal of an additional $150,000 from the MPS revenue requirement. The proposed stipulation and agreement is appended to this report and order as Attachment B.

In regard to the customer deposit matter, the parties have agreed that MPS will calculate and pay interest on customer deposits at a rate of one percent over prime lending rate, or 9.5 percent. The parties state that this is consistent with the Commission's Report and Order in Case No. GR-97-272, in re Associated Natural Gas Company.

The energy audit tariff was originally filed in Case No. ET-98-103, later consolidated into this proceeding. Generally, the proposed tariff provides for residential mail-in audits, large commercial and class A industrial audits, and small commercial and class B industrial audits.

The residential audits will focus on advising residential customers as to energy usage by appliance and end-use as well as furnishing a list and description of energy efficiency measures relevant to the customer's home.

The large commercial and class A industrial audits will consist of providing the customer with a detailed report designed to identify areas of greatest opportunity for improvement in energy efficiency. This will include a prioritized list of recommendations, relevant options, and an explanation of potential savings, costs, benefits, and overall value.

The small commercial and class B industrial audits will focus on customer energy consumption and operations, and will provide the customer with recommendations for improvement in energy efficiency. The customer will be provided with a report setting out the results of a walk-through audit and containing recommendations for improvement.

As the proposed stipulation and agreement is non-unanimous, rule 4 CSR 240-2.115 must be applied. Pursuant to this rule, the parties were notified by the General Counsel's office of their right to request a hearing. None of the non-signatory parties requested a hearing within the five-day time period specified in the rule. Furthermore, the Chief Deputy General Counsel indicated in his letter filed March 4, 1998, that no party has indicated that it will request a hearing. The Commission has complied with the provisions of 4 CSR 240-2.115 and, therefore, finds the proposed stipulation to be unanimous by operation of that rule.

The Commission has reviewed the terms of the proposed stipulation and agreement and finds that competent and substantial evidence exists on the record to support all three provisions of the proposed stipulation. The Commission finds the energy audit proposal to be reasonable and in the public interest and will approve that proposal. The Commission also finds the energy audit tariff to be reasonable and will order a tariff to be filed by UtiliCorp in compliance. The Commission finds the agreement between the parties regarding the proposed $150,000 debit to the MPS revenue requirement to be reasonable and has reflected that debit in the revenue summary and revenue requirement in this report and order.

The Commission finds the proposed stipulation and agreement to be just, reasonable, and in the public interest and will approve the stipulation and agreement and order UtiliCorp to comply with its terms and conditions.

Revenue Summary

C = Company
S = Staff
O = Office of the Public Counsel

	Revenue Requirement
Company's Revised Recommendation - January 8, 1998 Reconciliation	$14,941,360
Changes to reflect final Cash Working Capital, Interest on Customer Deposits and Staff Correction	450,757
Final Company Recommendation	15,392,117

Hearing Memo Ref	Issue	Decision	
E-1	Capital Structure	S	4,128,835
E-2	Return on Equity	S	5,968,700
E-3	Cost of Long-Term Debt	S	570,133
C-1	Weather Normalization - Net of Fuel Expense	S	1,244,372
C-2	Economic Development Rider Revenue	C	
C-3	Off-System Sales Revenue - Net of Fuel Expense	S	1,325,968
D-1	Systems Maintenance	S	628,745
D-2	Depreciation Issues:		
	Change in Service Lives	S	-0-
	Terminal Net Salvage	S	1,794,954
	Elimination of Interim Additions	S	1,538,532
	Change in Procedure	S	1,282,110
	Change in Technique	S	2,307,797
	General Plant Amortization	S	3,720,415
D-3	Amortization of Regulatory Assets - Transition Costs	S	4,565,995
D-4	FAS 87 vs ERIS Minimum Contribution - Pension Expense	S	262,628
D-5	FAS 106 - Post-Retirement Benefits Expense	S	357,023
D-6	Maintenance Normalization	C	
D-8	Economic Development Costs	S	90,308
D-9	UCU Corporate Allocation Issues:		
	A. Governmental Affairs	S	399,794
	B. Public Affairs	S	249,444
	C. Trans UCU	S	515,922
	D. Severance Costs	S	142,662
	E. Common Plant Allocation Factor	C	
	F. Mergers & Acquisitions, International & New Products	S	726,122
	G. Discretionary Bonus/Employee Recognition	S	147,787
	J. Ernest & Young Synergy Study	S	279,343
D-10	Dues & Donations	S	42,627
	Revenue Requirement		(16,898,098)

Rate Design

This issue involves the method of applying any resultant increase or decrease in rates to the rate structure of MPS. The Staff supports the position of applying decreases or increases in equal percentages across all rates and rate classes. The Staff states that reducing all rates by the same percentage will preserve the current revenue distribution among customer classes, maintain the current rate continuity between general service tariffs and result in the same percentage impact to all customers. The Staff cites a current class-cost-of-service study performed for this case which indicates that preserving the current revenue distribution among customer classes is reasonable and appropriate and accurately reflects the fact that the revenues generated by the various classes are reasonably identical to the relative costs to serve those classes.

SIEUA proposes that the Commission authorize a sub-class of the large power service class, called "network system direct," and create a reduced rate for that class. These customers apparently take service at the primary voltage. It is the position of the SIEUA that the network direct customer group is less costly to serve than the remainder of the large power service class and should receive an additional five percent reduction in rates.

The Commission declines to adopt the suggestion of the SIEUA based on the Staff's evidence that no inequities exist among customer classes at this time.

The Commission finds substantial evidence to adopt the Staff position that any rate increase or decrease as a result of this case will be assigned in an equal percentage manner, across all rates and rate classes.

Pending Motions

During the course of the briefing period in this case, several motions were filed which are still pending. The Commission will dispose of those pending motions at this time.

On January 23, 1998, the Staff filed a motion to extend the page limit of the initial briefs, set at 150 pages, as its brief was filed at 152 pages long, and to accept its brief for filing. Only UtiliCorp objected, by response of January 26, 1998, stating that, if properly formatted, the Staff's brief would have actually been some 227 pages in length. UtiliCorp stated as its requested remedy that it "may find it necessary to request an extension of the page limitation for its reply brief in order to fully respond." On February 4, 1998, MPS filed its reply brief consisting of 102 pages and appendices. The Commission accepts both the Staff initial brief and the MPS reply brief for filing.

On January 27, 1998, the Staff filed a motion to strike a portion of the initial brief of UtiliCorp. In its motion the Staff states that, beginning on page 48 and continuing to page 49 of the initial brief, UtiliCorp cites Exhibit No. 68 in support of its case. Exhibit No. 68 is generally referred to as the "ice storm memo." The Staff points out that, upon Staff objection, Exhibit No. 68 was ruled inadmissible in the evidentiary hearing of this case, by ruling of the presiding officer, (referred to as the "regulatory law judge"). The Staff seeks an order of the Commission striking those portions of the UtiliCorp initial brief which refer to Exhibit 68.

On January 28, 1998, UtiliCorp filed its response to the Staff's motion and a motion to reconsider the evidentiary ruling referred to above. As its basis for reconsideration, UtiliCorp states that Section 536.070, RSMo 1994, does not prohibit reference to an excluded document in a brief. UtiliCorp adds that the Staff has not cited, nor is there a Commission rule, which allows a motion to strike as a remedy for reference to such a document in a brief. Further, UtiliCorp states that there is no authority under the Missouri Rules of Civil Procedure for the Staff's motion.

UtiliCorp also pleads that the ruling, made by the presiding officer, be reviewed by the Commission as the ruling was erroneous. UtiliCorp states that it has the "right" to bring such a ruling to the attention of the Commission for reconsideration. UtiliCorp prays the Commission deny the Staff's motion to strike, reverse the ruling of the presiding officer and maintain the overall level for maintenance expense.

Rule 4 CSR 240-2.130 (3) states "the presiding officer shall rule on the admissibility of all evidence." The rule continues that evidence to which an objection is sustained shall be preserved for the record. No mention is made, nor authority given, for any party to request reconsideration of an evidentiary ruling by the Commission. For purposes of conduct of evidentiary hearings, the presiding officer has the exclusive authority to make evidentiary rulings (4 CSR 240-2.130(4)). The Commission finds, therefore, that the UtiliCorp request for reconsideration by the Commission of the evidentiary ruling of the presiding officer regarding the exclusion from evidence of Exhibit No. 68 must be denied.

In regard to the Staff's motion to strike, findings made by the Commission must be based on substantial and competent evidence, taken on the record as a whole. In making its findings, the Commission may not take into consideration any matter not on the record and may not base a finding of fact on any matter not in evidence. UtiliCorp, by making an inappropriate reference to the excluded document in its brief, is asking the Commission to make a finding of fact based on a document not in evidence. The Commission finds this to be improper. As the excluded document is not a part of the record that the Commission may consider in making its decision, the Commission finds that the Staff's motion to strike references to the document from the UtiliCorp brief is reasonable.

The Commission will grant the Staff motion to strike and exclude from the UtiliCorp initial brief the last paragraph on page 48, beginning with the word "finally" and continuing on to page 49 and ending with the word "added," and, on page 49, the first full paragraph beginning with the word "so" and ending with the word "issue."

Twice in its reply brief, on pages 25 and 88, UtiliCorp requests the Commission to take official notice of various documents pursuant to Section 536.070, RSMo. 1994, and 4 CSR 240-2.130. On February 13, 1998, the Staff filed a response in opposition to the UtiliCorp requests and moving the Commission to strike reference by UtiliCorp to the documents in question. On February 18, 1998, UtiliCorp filed a response to the Staff's objection, restating its request for the Commission to take official notice of the various documents.

The Commission has considered the various arguments of the Staff and finds them compelling. However, the Commission has reached a threshold determination in this matter. The Commission finds that all parties had fair opportunity to exercise their due process rights prior to and during the evidentiary hearing, including offering testimony, proffering evidence for consideration and admission and cross-examination of adverse parties. At the conclusion of the on-the-record portion of the evidentiary hearing, the Commission considered the record closed. The Commission will not accept the offer of evidence subsequent to the conclusion of the evidentiary hearing unless by consent of the parties. To do so would be violative of the due process rights of the remainder of the parties and would be fundamentally unfair.

The requests of UtiliCorp for the Commission to take judicial notice of various documents, found on pages 25 and 88 of its reply brief, are denied for the reasons as set out above. In addition, the Staff motion to strike is granted. The Commission will exclude the following portions of the UtiliCorp reply brief: (1) page 25, the last paragraph beginning with the word "Moreover" and including footnote 13, through page 26, the first three lines through the word "positions"; and (2) page 88, the paragraph beginning with the word "After" through the rest of the page including footnote 20, through page 89, the entire first paragraph through the word "Commission."

Conclusions of Law

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

UtiliCorp United Inc. d/b/a Missouri Public Service is a public utility engaged in the provision of electric service to the general public in the state of Missouri and, as such, is subject to the general jurisdiction of the Missouri Public Service Commission pursuant to Chapters 386 and 393, RSMo 1994.

The Commission has authority under Chapter 393, RSMo 1994, to set just and reasonable rates for the provision of service by regulated electric utilities.

Inclusion of future additions in current rates is contrary to the provisions of Section 393.135, RSMo 1994.

The orders of the Commission must be based on substantial and competent evidence, taken on the record as a whole, and must be reasonable and not arbitrary, capricious, or contrary to law. In that regard, and in setting rates which are just and reasonable, the Commission has considered all relevant evidence and determines, as set out in the findings of fact, that Missouri Public Service's revenue requirement will be decreased in the amount of $16,898,098 as set out in this report and order and as reflected in the Revenue Summary.

The proposed stipulation and agreement is treated as unanimous by operation of rule 4 CSR 240-2.115, is in the public interest, and is approved.

IT IS THEREFORE ORDERED:

1. That the Commission's scenario I of February 19, 1998, and the response of the parties filed March 2, 1998, is made a part of the record and entered into evidence as Exhibit No. 161.

2. That the proposed tariff sheets submitted by UtiliCorp United Inc. d/b/a Missouri Public Service on April 18, 1997, are hereby rejected.

3. That UtiliCorp United Inc. d/b/a Missouri Public Service is hereby directed to file, not later than March 18, 1998, revised tariff sheets with a thirty day effective date in accordance with the findings in this report and order, to implement the rate decrease of $16,898,098.

4. That the above-ordered decrease in rates will be applied as an equal percentage across all rates and rate classes.

5. That UtiliCorp United Inc. d/b/a Missouri Public Service, the Office of the Public Counsel, and the Staff of the Commission are ordered to recalculate and file depreciation rates in accordance with the findings in this report and order not later than March 18, 1998.

6. That the various motions, as set out in the body of this report and order, are hereby granted and denied as detailed herein and those portions of the initial and reply briefs of UtiliCorp are stricken from the

record as detailed herein. Any objection not specifically addressed is overruled and any motion not specifically addressed is denied.

7. That UtiliCorp United Inc., d/b/a Missouri Public Service, is hereby ordered to comply with the terms and conditions of the stipulation and agreement, filed February 27, 1998, and to file an energy audit tariff for Commission approval in compliance therewith in conjunction with the remainder of the tariff filings ordered herein.

8. That the proposed real-time pricing tariff, the line extension policy tariff, and the flexible rate and special contract tariff, originally filed in Case No. ET-98-103, are hereby rejected for the reasons as set out in this report and order.

9. That this report and order shall become effective on March 18, 1998.

BY THE COMMISSION

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Crumpton, Murray, and Drainer, CC.,
concur and certify compliance with
the provisions of Section 536.080,
RSMo 1994
Lumpe, Ch., absent.

Dated at Jefferson City, Missouri,
on this 6th day of March, 1998.

CASE NO. ER-97-394, ET AL

SECOND REVISED REVENEUE REQUIREMENT SCENARIO I

C = Company
S = Staff
O = Office of the Public Counsel

	Revenue Requirement
Company's Revised Recommendation - January 8, 1998 Reconciliation	14,941,360
Changes to reflect final Cash Working Capital, Interest on Customer Deposits, & Staff Correction	450,757
Final Company Rcommendation	15,392,117

Hearing Memo Ref.		Issue	Decision	
E-1		Capital Structure	S	4,128,835
E-2		Return on Equity	S	5,968,700
E-3		Cost of Long Term Debt	S	570,133
C-1		Weather Normalization - net of Fuel Expense	S	1,244,372
C-2		Economic Development Rider Revenue	C	
C-3		Off System Sales Revenue - net of Fuel Expense	S	1,325,968
D-1		Systems Maintenance	S	628,745
D-2		Depreciation Issues :		
		Change in Service Lives	S	5,897,705
		Terminal Net Salvage	S	1,794,954
		Elimination of Interim Additions	S	1,538,532
		Change in Procedure	S	1,282,110
		Change in Technique	S	2,307,797
		General Plant Amortization	S	3,720,415
D-3		Amortization of Regulatory Assets - Transition Costs	S	4,565,995
D-4		FAS 87 vs ERISA Minimum Contribution - Pension Expense	S	262,628
D-5		FAS 106 - Post Retirement Benefits Expense	S	357,023
D-6		Maintenance Normalization	C	
D-8		Economic Development Costs	S	90,308
D-9		UCU Corporate Allocation Issues :		
	A	Governmental Affairs	S	399,794
	B	Public Affairs	S	249,444
	C	Trans UCU	S	515,922
	D	Severance Costs	S	142,662
	E	Common Plant Allocation Factor	C	
	F	Mergers & Acquisitions, International & New Products	S	726,122
	G	Discretionary Bonus / Employee Recognition	S	147,787
	J	Ernst & Young Synergy Study	S	279,343
D-10		Dues & Donations	S	42,627
		Revenue Requirement		(22,795,803)

ATTACHMENT A

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Public Service, a Division of UtiliCorp United, Inc.'s Tariff Designed to Increase Rates for Electric Service to Customers in the Missouri Service Area of the Company.	)	Case No. ER-97-394

and

In the Matter of the Filing of Tariff Sheets by Missouri Public Service, a Division of UtiliCorp United, Inc., Relating to Real-Time Pricing, Flexible Rates / Special Contract, Line Extension Policy and Energy Audit Program.	)	Case No. ET-98-103

and

The Staff of the Missouri Public Service Commission,	)	
Complainant,	)	
v.	)	Case No. EC-98-126
UtiliCorp United, Inc., d/b/a Missouri Public Service,	)	
Respondent.	)	

STIPULATION AND AGREEMENT AND
REVISED RESPONSE TO REVENUE REQUIREMENT SCENARIOS

COMES NOW the Staff of the Missouri Public Service Commission (Staff), the Office of the Public Counsel (OPC) and Missouri Public Service (MPS), a division of UtiliCorp United, Inc. and in support of this Stipulation And Agreement And Revised Response To Revenue Requirement Scenarios state as follows:

1. On March 21, 1997, MPS filed revised electric rate schedules designed to increase

ATTACHMENT B

MPS' gross annual electric revenues by $13,213,002, exclusive of any franchise or occupational taxes. The schedules also were designed to collect a Transition Charge of $11,420,543, exclusive of any franchise or occupational taxes. The combined change reflected in the revised electric rate schedules is an increase of $24,633,546, or 9.3%. These rate schedules carried an effective date of May 21, 1997 and are designated as Case No. ER-97-394.

2. During the course of the prehearing conference as well as subsequent conversations between the signatory parties, certain agreements were reached which require Commission attention and approval. Specifically, the signatory parties request that the Commission approve the resolution of the following three issues:

A. Customer Deposit Interest: The signatory parties agree that MPS will calculate and pay interest on customer deposits at a rate consistent with that ordered by the Commission in the recently litigated Associated Natural Gas rate proceeding, Case No. GR-97-272. Consistent with the Report And Order issued in that case on December 3, 1997, MPS agrees to calculate and pay interest on customer deposits at a rate of 1% over prime lending rate or 9.5%.

B. Energy Audit Tariff: The signatory parties agree that MPS' Tariff implementing an Energy Audit Program, filed August 18, 1997, in Case No. ET-98-103, is reasonable and should be approved by the Commission. In the Direct Testimony of Lena M. Mantle (Exhibit 20, pp. 13-16), the Staff recommended that MPS be authorized to implement its Energy Audit Program proposed in Case No. ET-98-103.

C. Low Income Weatherization: In the Direct Testimony of Ryan Kind (Exhibit 19), Public Counsel proposed that MPS implement a low income weatherization program. At the prehearing conference, the Staff and MPS agreed that such a program would be worthwhile. The details of the program were not worked out at that time, however, and after numerous discussions concerning those details, the signatory parties have been unable to come to an agreement on how such a program should be implemented. Accordingly, the question of whether MPS should conduct a low income weatherization program is no longer at issue in this case. Revised Responses to Revenue Requirement Scenarios attached hereto reflect removal of $150,000 from MPS's revenue requirement, i.e., the "Final Company Recommendation" for each scenario decreases by $150,000 and the "Revenue Requirement" goes further negative by $150,000.

WHEREFORE, the signatory parties, Missouri Public Service, the Staff and the Office of the Public Counsel respectfully request that the Commission in its Report And Order in these consolidated cases approve this Stipulation And Agreement and the resolution of the three issues identified above. The signatories apologize for any inconvenience to the Commission or the other parties caused by the instant Stipulation And Agreement And Revised Response To Revenue Requirement Scenarios.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered or sent by facsimile transmission to all counsel of record as shown on the attached service list this 27th day of February, 1998.

Steven Dottheim