

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

In the matter of the application of       )  
UtiliCorp United, Inc., d/b/a Missouri   )  
Public Service, for permission,       )  
approval, and a certificate of       )  
convenience and necessity authorizing   )  
it to construct, install, own, operate,)  
control, manage and maintain a gas     )  
distribution system for the public     )  
in the City of Rolla, Missouri and the   )  
surrounding unincorporated area located)  
in Phelps County, Missouri.       )

Case No. GA-94-325

**APPEARANCES:**     James C. Swearengen and Dean Cooper, Brydon, Swearengen  
                            & England, PC, P.O. Box 456, 312 East Capitol,  
                            Jefferson City, MO 65102, for UtiliCorp United  
                            Inc., d/b/a Missouri Public Service.  
                            John C. Landwehr, Cook, Vetter, Doerhoff & Landwehr,  
                            231 Madison Street, Jefferson City, MO 65101, for  
                            Conoco Inc.  
                            Susan A. Anderson, Assistant Public Counsel, Office of  
                            Public Counsel, P.O. Box 7800, Jefferson City, MO  
                            65102 for Office of Public Counsel and the public.  
                            Cherlyn D. McGowan and William M. Shansey, Assistants  
                            General Counsel, P.O. Box 360, Jefferson City, MO  
                            65102, for Staff of the Missouri Public Service  
                            Commission.

**HEARING**

**EXAMINER:**       Joseph A. Derque, III.

**REPORT AND ORDER**

**PROCEDURAL HISTORY**

On April 15, 1994, UtiliCorp United, Inc. (UtiliCorp) filed an application with the Commission for a certificate of convenience and necessity authorizing it to construct, install, own and operate a gas distribution system for the public in the City of Rolla, Missouri, and the surrounding unincorporated area, generally located in Phelps County, Missouri.

Together with that application, UtiliCorp filed a metes and bounds description and plat map of the proposed service area. In addition, a copy

of the franchise ordinance from the City of Rolla authorizing Missouri Public Service (MPS), UtiliCorp's operating company, to serve the city of Rolla and a feasibility study containing plans, specifications and estimated costs of the facilities to be constructed were also filed.

Participation without intervention was granted to Conoco, Inc. There were no other requests for intervention in this matter. At the request of UtiliCorp, this matter was placed on an expedited schedule. The matter was heard on August 11, 1994 and, after oral argument, was fully and finally submitted to the Commission for Decision.

#### FINDINGS OF FACT

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

The Commission states that it has reviewed and considered all of the evidence and argument presented by the various parties in this case. Due to the extreme time constraints in this matter and the volume of evidence submitted, some evidence and positions on certain matters 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 relevant or necessary to the resolution of the issue involved.

UtiliCorp is a Delaware corporation, with various utility holdings throughout the United States and abroad, including its Missouri operating company, Missouri Public Service. UtiliCorp is investor owned and has assets of approximately one billion dollars. Within the State of Missouri, UtiliCorp, through its operating company, MPS, provides natural gas service to approximately 42,000 customers in 28 communities.

In its application and testimony, MPS proposes to supply natural gas service to the City of Rolla, Missouri, and the surrounding unincorporated area of Phelps County, Missouri. Testimony indicates that the City of Rolla had a population of approximately 14,000 in 1990, with a total population in Phelps County of 35,000. This total translates into roughly 5200 households in Rolla itself. The city corporate limits cover approximately 8 square miles and the city is considering annexations on all sides. There are an additional approximate 2000 persons living within one mile of the current city limits.

Rolla currently has energy choices between electricity and propane. It is the official position, taken apparently after popular vote, that the City of Rolla is fully supportive of the application of UtiliCorp. It is the position of the city that the availability of natural gas would serve to help the current industry and promote commercial and industrial expansion in the area. The Rolla area currently has eight major employers, the largest category being governmental and educational agencies.

MPS states that the corridor extending from St. Louis southwest across the state, referred to as the I-44 corridor, has great potential for economic development. MPS agrees with the city in that they are of the opinion that development is hampered by the lack of a regulated natural gas supply. It is pointed out that the propane industry is unregulated. It was also noted that propane prices, as they are unregulated, may be unrealistically high.

MPS states that the construction of the system is scheduled to begin August 15, 1994, pending Commission approval. The system will be funded using internally-generated funds and will be completed over a period of three years. MPS estimates that the cost of the construction will be

approximately \$7.3 million, \$500,000 of that being the steel main connecting the system with the transportation pipeline.

The application of UtiliCorp, d/b/a MPS, is filed pursuant to Section 393.170, RSMo. 1986, and 4 CSR 240-2.060(2). The standards contained in the above-quoted statute state that the application may be granted when it is determined that such a franchise is "necessary or convenient for the public service." Inherently, the statute indicates that the proposed service should be an improvement justifying its cost. In addition, safety, adequacy of facilities, reliability and experience of the provider, and prevention of inefficient duplication of service should be considered. (*State ex rel. Intercon Gas v. PSC*, 848 S.W.2d 593, (Mo. App. WD 1993)).

In light of the above, the central issue raised in this matter in regard to the issuance of the certificate itself is one involving the economic feasibility of the proposed project. This issue has been raised and pursued assiduously by the Staff of the Commission and the OPC.

In its testimony, the Staff presents evidence that the feasibility studies submitted by MPS are misstated in regard to the ability of natural gas to compete with propane as an energy source, the potential anticipated load, the potential anticipated number of customers who will convert from propane, and the consideration of the expense necessary to complete and operate the proposed project.

MPS filed a feasibility study and later refiled an amended study. In its feasibility study, MPS reflects the use of information regarding construction costs, operational and maintenance expense, and assumptions regarding the cost of debt and return on equity, all for the purpose of determining the level of revenue required to cover all capital and operating costs of the project.

MPS admits that the critical assumptions used in making this determination involved estimates of construction costs and projected sales. MPS concludes that the proposed system should generate enough revenue based upon the rates it proposes to charge to cover operating and capital costs by the end of the conversion period (which MPS states as being three years).

In its testimony, the Staff maintains that the conversion rate of 70 to 90% as estimated by MPS is unrealistic. Staff also finds from evidence and experience with various other systems that the delivered cost of gas is underestimated by MPS, together with an overestimation of the price per gallon of propane. Taken together, the Staff states that the project as proposed by UtiliCorp is not economically feasible.

The Staff expresses concern that, to support this system with a lower conversion percentage than anticipated and stiff competition from the propane industry, subsidization will occur or rates will be raised to the point that the service is no longer in the public interest. This is also referred to by the Staff and the OPC as "bait-and-switch" ratemaking, as rates will be artificially low initially, only to become more realistic later to support the system.

The Commission has fully considered the evidence presented by the Staff and is fully aware of the import of that evidence, should the Staff's predictions prove accurate. Bearing the Staff's evidence in mind, the Commission will grant the requested certificate for the reasons set out hereafter and with the conditions set out later in this Report and Order, including a provision for customer-side-of-the-meter conversion in order to assist in facilitating a more rapid and higher percentage conversion rate.

UtiliCorp itself, an approximate billion dollar company, has operated as a regulated utility successfully in Missouri and other regulated venues, since the 1940s. In regard to its desire to serve the Rolla area and its attending feasibility estimates for doing so, some weight must be given to the size and experience of UtiliCorp and MPS. In addition, should the Staff's position prove to be more accurate and MPS be mistaken in its analysis of the economic viability of this project, the financial stability of UtiliCorp's operation in Missouri will not be jeopardized by the mistake. Both Staff and Company's positions on the feasibility of the project are based upon estimates. The Commission finds that Company's estimates are as reasonable as Staff's and, since MPS bears most of the risk if it has underestimated the economic feasibility of the project, the public benefit outweighs the potential for underestimating these costs.

It is clear that the citizens of the Rolla area want the availability of natural gas in their area. It appears to the Commission that this is not only for the purpose of serving the individual residential consumer, but also to serve various existing commercial, governmental, educational, and industrial concerns and for future development. The end benefit to the citizens of the Rolla area clearly appears to be resulting economic growth and employment opportunities. When supported by the record, the Commission has in past decisions, and would now, endorse natural gas service as an incentive to help promote this desired economic growth.

Finally, OPC states in the hearing memorandum that it is of the opinion that natural gas in this area would not be feasible if the annual cost of providing it is more than the annual cost of providing propane unless "it can be shown that customers will prefer natural gas over propane, even if natural gas costs more." It is the Commission's opinion that the primary benefit from the provision of service to the Rolla area

may be in terms of economic development. It is clear that the citizens of Rolla support such a concept.

The size and the financial strength of its parent company, when taken together with the anticipated benefits of providing natural gas to the I-44 corridor, outweigh the concerns of Staff in regard to feasibility. The Commission, therefore, finds that the proposed certificate of convenience and necessity to serve the Rolla franchise is necessary and convenient for the public service and will be granted with the conditions as set out hereafter in this Report and Order, and for the area as set out by legal description and plat, contained as a part of MPS's application in this case, incorporated herein by reference as if fully set out, and marked as Attachment A.

In regard to various conditions presented to the Commission and which may be imposed on MPS in the exercise of this certificate, the central issue surrounds the level of rates to be charged to the Rolla service area.

The Staff proposes that the Commission adopt rates specifically based on, and reflective of the cost to serve the Rolla area. The Staff refers to these as "cost-based" rates.

Further, the Staff has some objection to the potential surcharge proposed by MPS to support the system in Rolla should conversion rates fall short of UtiliCorp's estimates. The concern of the Staff is largely centered on the fact that levy of the surcharge would unduly accelerate excess plant recovery.

Finally, the Staff believes that UtiliCorp stockholders should bear the risk of under-recovery of excess costs associated with the project.

In its testimony, MPS states that it recommends the use of existing filed and approved gas rates for the Rolla service area. MPS unequivocally states that it believes these existing rates will support the system and

yield an adequate long-term return. As a fail-safe mechanism, MPS also proposed a potential surcharge be allowed should conversion not proceed at projected levels. MPS has since stated on the record that this surcharge provision is not essential to the success of the project.

Finally, OPC restates its concern that the existing rates will be found to be too low once the actual costs involved in the operation of the system are determined, thus causing a substantial raise in rates somewhere in the future.

As part of this issue, the Commission will also deal with the issue involving the potential for subsidization of the proposed Rolla system by the remainder of the ratepayers in the MPS service territory. This issue was presented by the Staff and supported by the OPC. It is argued that no detriment to the remainder of the MPS operating system should result should the Rolla system be unable to support itself or should feasibility estimates by MPS be grossly in error.

The Commission considers the size and diversity associated with UtiliCorp and MPS to be of substantial advantage in providing service to an area such as Rolla. It is clear that smaller, financially marginal companies would not propose nor would be necessarily given the opportunity to engage in a project such as this. To force MPS to create a separate set of cost-based rates on the Rolla service area alone would be forfeiting the advantage MPS has in terms of economies of both scale and scope. The Commission sees no advantage in setting rates specific to the Rolla area prior to completion of construction and will, therefore, authorize for service in the Rolla area the existing filed and approved gas rates for the northern and southern district of MPS, until such time as a general rate case is requested or a complaint filed.



Further, no surcharge will be authorized in this case. The Commission is of the opinion that, should a financial problem arise that would provoke the levy of such a surcharge, such a financial problem would more appropriately be dealt with in a general rate proceeding.

In regard to the potential subsidization, or cross subsidization, between the various areas in the state in which MPS operates, the Commission is aware of the concerns of the Staff. The Commission does not find it appropriate at this time to place various artificial constraints on MPS, as any advantage derived from economies of scope and scale would potentially be lost. The Commission will, however, order MPS to keep separate accounting records for the Rolla service area, to be examined at the time of the next general rate case, to determine if any detriment to the remainder of the system has or will occur.

UtiliCorp states that, at the time of its next general rate case, it will provide some evidence that no subsidization has occurred. In addition, should it become necessary, MPS states that rates based on its cost-of-service to Rolla may also be filed.

The Commission has determined, in conjunction with the approval of existing rates, that no general rate case will be required of MPS. MPS will be given the same option it now has of initiating a rate proceeding at its discretion. The Commission can see no real benefit to the ratepayers by requiring a rate filing within three years. Should MPS be suspected of overearning, procedures now exist for investigation and the filing of a complaint by the Staff. This should be sufficient to ensure that no gross overearning or other prohibited activity takes place.

MPS has requested a variance from the provisions of the Commission's promotional practice rules specifically for the purpose of providing free installation and recalibration of existing customer equipment to facilitate

and promote the conversion of the Rolla area from propane to natural gas. Testimony by MPS indicates an average of \$300.00 per customer, on the customer's side of the meter, for this conversion will be necessary to complete the system.

The Staff is opposed to this variance request for reason that it believes the cost of the prohibited practice should not be placed in the rate base. The OPC concurs in this position, stating that the costs of the prohibited practice should be borne by the shareholders. In addition, the OPC adds that MPS has not shown good cause why the variance should be granted. OPC points out that apparently no other plan was considered by MPS in determining how conversion cost to the consumer could be reduced. Finally, OPC recommends a limit be placed on the duration of any conversion incentive program.

The Commission has thoroughly considered all aspects of this most important issue. The Commission appreciates the candor of MPS in stressing the "make-it-or-break-it" nature of the treatment of the proposed conversion costs. In addition, the Commission clearly understands the reluctance expressed by the Staff and OPC in granting any type of variance allowing prohibited promotional costs to be placed in the rate base.

The Commission considers it an important part of its regulatory function to stand in the stead of competition in dealing with utility proposals such as this one. Because conversion rates are so vital to the success of this project, and because of the apparent competition from the unregulated propane industry faced by MPS, the Commission will grant a variance from the proposed prohibited promotional practice in these specifics: MPS will be allowed to provide a maximum of \$300.00 free conversion, installation and recalibration, per customer, on the customer's side of the meter only. Any remaining customer conversion costs paid by

the Company should be appropriately borne by the shareholders, and will be accounted for below the line.

This variance will be limited to a period of three years from the effective date of this order. As MPS proposes to complete the project in three years' time, this should be sufficient to ensure the necessary number of conversions. The Commission stresses that this variance is only for the proposed Rolla service area and will not be extended to any other UtiliCorp service area in Missouri.

#### 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 natural gas and electric service in the State of Missouri and, therefore, subject to the general jurisdiction of the Commission pursuant to Chapters 386 and 393, RSMo. (Cum. Supp. 1992).

The Commission has authority under Section 393.170, RSMo. (Cum. Supp. 1994) to grant permission and approval to construct and operate a franchised service area, should the Commission find, after hearing, that the franchise is necessary or convenient for the public service.

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 this regard, the Commission has considered all substantial, competent and relevant evidence in this matter and determines that the granting of the application, with the conditions as set out herein, is necessary and convenient for the public service and in the best interest of the public.

IT IS THEREFORE ORDERED:

1. That the application of UtiliCorp United Inc., d/b/a Missouri Public Service, for approval and a certificate of convenience and necessity to construct, install, own, operate, control, and manage a gas distribution system in the City of Rolla, Missouri and parts of unincorporated Phelps County, Missouri adjacent thereto, as set out in Attachment A to this order and incorporated herein as if fully set out, is hereby granted.

2. That, in the operation of the above-stated Rolla service area, UtiliCorp United Inc., d/b/a Missouri Public Service, will use those rates currently approved by this Commission and in use in the remainder of UtiliCorp's operating area in the State of Missouri.

3. That UtiliCorp's motion for a variance from the promotional practice rules of this Commission is hereby granted to the extent and limits as set out in this Report and Order.

4. That UtiliCorp, through its operating company, is authorized to account for the above-stated \$300.00 maximum per customer conversion costs above the line, and include those costs in rate base.

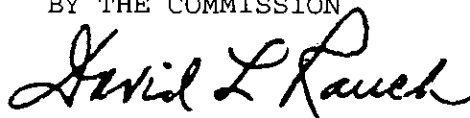
5. The Commission makes no finding as to the prudence or ratemaking treatment to be given any costs or expenses incurred as the result of the granting of this certificate to operate in the above-described service area, except those costs and expenses dealt with specifically in the body of this Report and Order, and reserves the right to make any disposition of the remainder of those costs and expenses in any future ratemaking proceeding which it deems reasonable.

6. That UtiliCorp Inc., d/b/a Missouri Public Service, will keep a separate and complete accounting of the Rolla service area and will provide that separate accounting to the Staff upon proper request in any future rate or complaint proceeding.

7. That UtiliCorp, by its operating division, MPS, will file tariffs in accordance with this Report and Order and to incorporate the service area herein approved, for service on or after September 1, 1994.

8. That this order shall become effective on September 1, 1994.

BY THE COMMISSION

A handwritten signature in black ink, reading "David L. Rauch". The signature is written in a cursive, flowing style.

David L. Rauch  
Executive Secretary

(S E A L)

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

Dated at Jefferson City, Missouri,  
on this 22nd day of August, 1994.

Description of the Proposed Area to be Certified:

Sections 23, 24, 25, 26, 27, 34, 35, and 36 of Township 38N; Range 8W, all in Phelps County, Missouri.

Sections 1, 2, 3, 9, 10, 11, 12, 13, 14, 15, 16, 22, 23, 24, 25, 26, and 27, of Township 37N; Range 8W, all in Phelps County, Missouri.

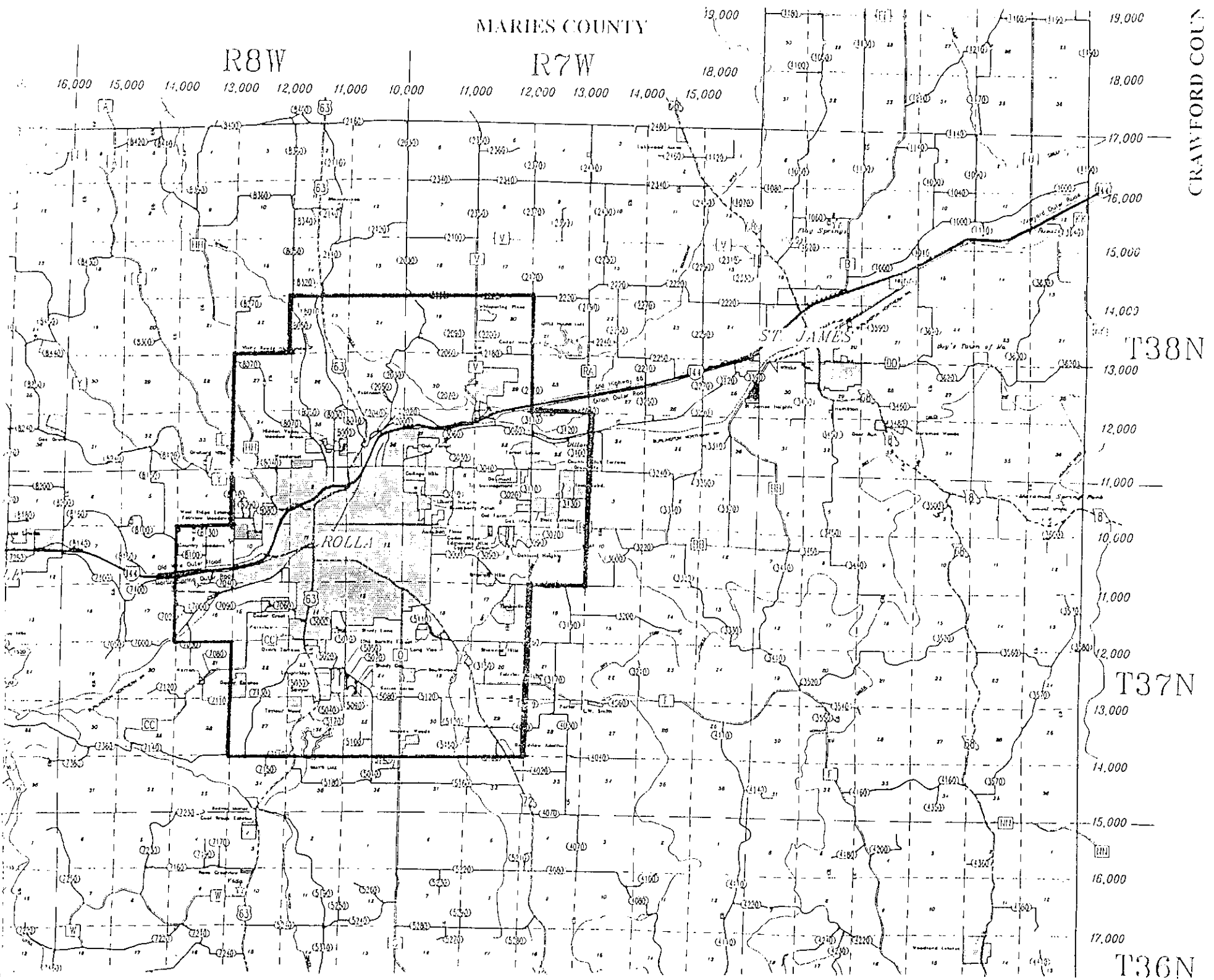
Sections 19, 20, 29, 30, 31, 32, and 33, of Township 38N; Range 7W, all in Phelps County, Missouri.

Sections 4, 5, 6, 7, 8, 9, 17, 18, 19, 20, 29, and 30 of Township 37N; Range 7W, all in Phelps County, Missouri.

# MARIES COUNTY

R8W

R7W



CRAWFORD COUNTY