BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of Capital City Water Company for authority to file tariffs increasing rates for water service provided to customers in the company's Missouri service area.	))))	Case No. WR-90-118

APPEARANCES: **Kathy Lee Pape**, Attorney, General Waterworks Management Service Company, 950 Haverford Road, Bryn Mawr, Pennsylvania 19010-3879, for Capital City Water Company.

B. Allen Garner, City Counselor, 320 East McCarty Street, Jefferson City, Missouri, 65101,

and

James M. Fischer, Akre, Wendt & Fischer, 102 East High Street, Suite 200, Jefferson City, Missouri 65101, for City of Jefferson, Missouri.

Lewis R. Mills, Jr., First Assistant Public Counsel, Office of Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of Public Counsel and the public.

Robert J. Hack, Assistant General Counsel, and **William K. Haas**, Assistant General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

REPORT AND ORDER ON REHEARING

On October 31, 1990 the Commission issued a Report And Order rejecting tariffs filed by Capital City Water Company (CCWC) to increase rates for water service. On December 11, 1990 the Commission granted CCWC a rehearing of one issue from the October 31 Report And Order. The Commission granted rehearing of the issue of the proper adjustment to be made to CCWC's test year revenue requirement for the contract between CCWC and Public Water Supply District No. 2 of Cole County (District).

A hearing was held in this matter as scheduled on March 7, 1991. Parties filed briefs and the matter is now before the Commission on rehearing. Exhibit 56 was late-filed without objection and will be admitted into evidence in this Report And Order.

Findings of Fact

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

The Commission in its October 31 Report And Order found that CCWC's decision to execute the contract with District was imprudent. Specifically, the Commission found:

> In 1977, the Company needed more water storage facilities and reviewed its only two options: building its own tanks or leasing them from the District. Company experts recommended leasing facilities if the lease agreement contained an annual cap of 182.5 million gallons. In August, 1977, the Company entered a lease agreement for the use of three of District's tanks with a total capacity of 1.3 MG and three adjacent wells. In exchange for the use of these facilities, the Company agreed to: (1) pay the District $2,000 a month rent; (2) pay the District a monthly sum equal to the cost of water sold to the District the previous month; (2) [sic] pay for the variable costs of the water sold to the District (treatment, electricity, etc.); and (3) [sic] pay for the operational and maintenance expenses of District's tanks and wells. It does not contain any cap. The 182.5 MG recommended cap was exceeded by the District in 1979. Because of the unexpected growth of the District, the Company's costs under the contract have been rapidly escalating.

(Report And Order, pp. 2-3).

> The Commission is greatly concerned with Company's escalating costs under the contract. This concern is heightened by Company's failure to decrease its costs under the addendum and its agreement to incur additional costs. Thus, the Commission believes it is appropriate to examine the reasonableness of Company's rental expense by examining the contract terms which gave rise to the expense. One of the components of Company's rental expense is the amount of water used by the District. According to the terms of the contract, this is an unlimited amount. The record shows that it is an unlimited amount because Company ignored advice it received to include a 182.5 MG cap as one of the terms of the contract. The Commission finds the Company agreement to the contract without a cap against the recommendation of one of its own experts is unreasonable.
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> The contract had terms which exacerbate the absence of a cap because it required the Company to return the District's water payment. The Company argued that this exchange of checks is a "wash" and has zero impact on the ratepayer. This Commission has rejected that argument. In the Commission's opinion, the Company's return of the District's water payment is, in effect, its provision of free water. This, combined with the absence of a

> cap, means Company agreed to provide an unlimited amount of free water in exchange for a fixed amount of storage.
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> For a fixed amount of storage, the Company agreed to provide unlimited free water and pay a $2000 a month rental fee and pay for the maintenance of the leased facilities. In the Commission's opinion, this is excessive compensation. That Company would agree to such unequal and burdensome terms is not the concern of this Commission if its shareholders bear the costs but when the costs of such terms fall upon the ratepayers, it is incumbent upon the Commission to act. The Commission finds it would be totally inappropriate to allow the Company to fully recover the expense associated with the execution of this contract.

(Report And Order, pp. 7-8).

By its December 11 order the Commission determined it should rehear the issue of the proper adjustment to CCWC's proposed rates associated with the decision of CCWC to enter into the imprudent contract with District. The Commission indicated that the parties should adduce evidence showing a comparison of the effect on revenue requirement of the contract and the revenue requirement which would have resulted if CCWC had constructed its own storage facilities.

The four parties to the case presented evidence concerning the cost to CCWC of the contract and the hypothetical storage facility. The parties presented evidence of the cost of both a ground storage facility and an elevated storage facility. A 1.0 million gallon (MG) elevated tank was the storage option considered by CCWC in 1977 and the evidence is that an elevated tank is the preferable storage facility when factors other than cost are considered. Elevated storage facilities are more reliable; they provide enhanced fire protection, are more capable of meeting high instantaneous flow demands, have lower operating expenses, and are easier to operate. The evidence indicates that CCWC would have chosen to build an elevated storage tank if it had built its own facilities in 1977, and the costs associated with an elevated tank will be considered in this case to determine the adjustment to revenue requirement. The costs as calculated by the parties for elevated storage and related facilities are:

CCWC	1989 test year	$118,004
Staff	1989 test year	$138,558
	50 year average (ROR* 9.23%)	$101,474
	50 year average (ROR 7.29%)	$100,359
City	1989 test year	$148,160
Public Counsel	20 year average	$160,350
	1989 test year	$143,448

*ROR = rate of return

Staff and Public Counsel, although calculating a test year revenue requirement, have proposed that an average revenue requirement is more reasonable to use to compare costs. Staff calculated three revenue requirements: (1) a 1989 test year revenue requirement; (2) a 50-year average using 1977 rate of return and tax factors; and (3) a 50-year average using 1989 rate of return and tax factors. Staff supports using the 50-year average using 1977 rate of return and tax factors.

Public Counsel calculated a 1989 test year revenue requirement and a 20-year average revenue requirement. Public Counsel supports the 20-year average as a more conservative cost to use to compare to the contract costs.

The Commission does not believe it is appropriate to determine the hypothetical costs of elevated storage to be used for an adjustment in this case based upon an average of estimated or projected future costs. If CCWC had built 1 MG elevated storage facilities in 1977-1978, the costs associated with those facilities in this rate case would have been calculated applying 1989 test year factors.

The hypothetical 1989 revenue requirements of Public Counsel, Staff and City are consistent. CCWC's is significantly lower even though its witness, Joe A. Dysard II, testified he performed traditional revenue requirement calculations from 1978 through 1989 to arrive at the amount. Dysard's initial calculation was $162,951 but this was reduced in his rebuttal testimony to $118,004 because he had included costs already being recovered by CCWC in rate base. Staff's initial calculation was a hypothetical revenue requirement of $118,493,

but this was increased to $138,558 to account for a necessary extension to the Southwest Boulevard interconnection and boring of U.S. Highway 54. City's calculations are based upon CCWC responses to data requests as adjusted for facilities already included in rate base. Public Counsel used the calculations from its testimony in the initial phase of this proceeding as adjusted for certain errors.

Since all of the calculations of the cost of elevated storage in 1977-1978 are hypothetical, the Commission must decide which of the calculations is most reasonable based upon assumptions in each calculation and the costs included. City's witness Steven C. Carver has presented what the Commission considers the most reasonable approach to the issue. Carver reviewed three different studies provided by CCWC through data request responses and chose an updated 1991 study as corrected for facilities already in rate base. The 1991 study was prepared by CCWC and Carver's adjustments are similar to those made by the other parties. Carver's additional calculations for the tax factors and rate of return appear reasonable. The Commission therefore finds that the hypothetical cost in this case to CCWC if it had built a 1 MG elevated storage facility in 1977-1978 is $148,160.

The four parties presented two basic positions concerning the cost of the contract with District. Although the actual calculations differ, both CCWC and Staff maintain that the cost of the contract is the incremental cost of annual power, chemicals, rent and maintenance expenses. City and Public Counsel maintain that test year contract expense should be the payment to CCWC for water provided to District. City in addition adds the monthly lease payment into its calculation. The four calculations are:

CCWC	--	$110,585
Staff	--	135,267
City	--	438,169
Public Counsel	--	414,171

Approximately 13.57 percent of the total water provided by CCWC is provided to District customers and approximately one-half of that water comes from CCWC's treatment plant. The use of CCWC's system and employees to provide this amount of water to District customers should be recovered by CCWC through rates. As the Commission found, CCWC's current practice of refunding all payments below the cap in the contract is unreasonable because it means District is receiving free water.

Because of the contract CCWC has made no attempt in the past to quantify the costs associated with providing service to District's customers and establish tariffs for that service, except that CCWC charges District the rates in Rate E for water provided which exceeds the cap in the contract. The cap requires District to pay for water used by its customers in excess of a percentage of growth factor as applied against the highest monthly sales volume during the preceding year. The evidence showed that little revenue was generated under this liberal cap. During the 1989 test year there was no revenue generated. From 1978 to 1989 $24,369.49 has been paid by District to CCWC for water used in excess of the cap.

CCWC now argues that the only costs of providing water to District are the incremental costs and that all fixed costs are recovered through other rates. CCWC would have the Commission decide that District customers should not be responsible for any capital costs, depreciation expense, or overhead costs; that because of the District's unique character, its use of CCWC's water system causes no fixed costs. Staff supports CCWC's basic position.

The Commission cannot adopt CCWC's position on this issue. Providing water to District customers causes some costs, both directly assignable and allocated as well as fixed and variable, to CCWC. Those costs should be reflected in rates. The rates would include the cost of the contract, which should have been a certain amount rather than an undetermined, escalating amount based upon District's water usage. The only rate available in CCWC's tariffs and the one

used to monitor District's water usage is Rate E. This is also the rate used to recover the costs of water used by District above the contract cap. These rates recover a portion of the cost of service of CCWC and have been found to be just and reasonable by the Commission.

Without other evidence of what would be a reasonable rate for water service to District, both for CCWC water and for District water, the Commission must utilize the rate charged. The Commission will use as the cost of the contract the $414,169 as proposed by City without the additional $2,000 a month rent. The monthly rent is an expense which should be recovered in the rates charged by CCWC. This is also the almost identical amount supported by Public Counsel originally and which the Commission found reasonable in the initial phase of this case.

There was evidence that if there had been no contract, then District would not have been a customer of CCWC and so there would be no revenue from District's use under Rate E. Even if this were true, the Commission has not found that there should have been no contract but only that CCWC should have negotiated a definite cost for leasing District facilities and should have charged District for water usage. The Commission finds there was sufficient benefit to District from a contract that a contract with reasonable terms would probably have been negotiated and District would have become a customer of CCWC. In addition, the Commission must look at test year costs as they were incurred. District was provided water by CCWC and there are costs associated with that usage in the test year. The Commission is using the costs of the hypothetical storage facility to determine a reasonable adjustment to CCWC's revenue requirement, not to change the circumstances that existed in the test year.

The Commission ordered rehearing to receive additional evidence on the proper calculation of the costs associated with the contract. No party presented a cost of service study or other calculation of the fixed costs that should be allocated to District. Adoption of incremental costs as the proper method of

establishing costs for use of CCWC's system is not consistent with ratemaking principles nor is it reasonable. Rate E is used to charge District for excess water and was used to calculate the water used by District. Without another rate upon which to determine the cost of providing water to District, the use of Rate E is the most reasonable approach presented in this case.

Comparing the costs of the hypothetical elevated storage facility and the amount paid under Rate E by District, the Commission finds that CCWC's revenue requirement shall be adjusted $266,009. Based upon this adjustment, which is larger than the adjustment found to be reasonable in the initial phase of this case, the Commission finds that there shall be no rate increase for CCWC customers as the result of the tariff filed by CCWC in this case.

Conclusions of Law

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

The Commission granted rehearing in this case on the limited issue of the proper adjustment to revenue requirement associated with the contract between CCWC and District. The Commission in its initial Report And Order found the contract to be imprudent and the Commission has not addressed that issue in this rehearing. In any hearing regarding a proposal to increase rates the burden of proof to show the new rates are justified is on the utility. Section 393.150(2), R.S.Mo. 1986. The Commission, in the Callaway Nuclear Plant rate case, stated that the utility has the burden of reasonableness of costs it seeks to recover and that reasonableness should be judged using the standard of prudence. *RE: Union Electric Company*, 27 Mo. P.S.C. (N.S.) 183, 192 (1985). After finding the contract to be imprudent, the Commission ordered a rehearing to allow the parties to adduce additional evidence concerning the proper adjustment to revenue requirement which should result from the imprudent contract. Based upon the evidence presented and the findings made in this Report And Order On Rehearing, the

Commission concludes that CCWC has failed to meet its burden that the proposed rates are just and reasonable.

IT IS THEREFORE ORDERED:

1. That the proper adjustment associated with the contract between Capital City Water Company and Public Water Supply District No. 2 of Cole County is $266,009.

2. That late-filed Exhibit 56 be hereby admitted into evidence.

2. That this Report And Order On Rehearing shall become effective on the 2nd day of July, 1991.

BY THE COMMISSION

Brent Stewart

Brent Stewart
Executive Secretary

(S E A L)

Steinmeier, Chm., Mueller and
McClure, CC., concur;
Rauch, C., dissents, with opinion;
all certify compliance with the
provisions of Section 536.080,
R.S.Mo. 1986.
Perkins, C., not participating.

Dated at Jefferson City, Missouri,
on this 19th day of June, 1991.

DISSENTING OPINION OF COMMISSIONER DAVID L. RAUCH
Case No. WR-90-118 (Rehearing)
Capital City Water Company

I respectfully dissent from the Report and Order adopted by a majority of the Commissioners in this case. Although I agree with the conclusion of the majority on several points, including the hypothetical revenue requirement for the construction of company-owned storage facilities and the treatment of the monthly rent of $2000, I cannot agree with the majority's conclusion regarding the cost of the contract.

The majority has concluded that the cost of the contract equals the value of the water provided the District by the Company. The adjustment sought in this rehearing is calculated by subtracting from this figure the revenue requirement assigned the projected storage facilities. I agree with the methodology for calculating the adjustment; however, I disagree with the value assigned the water delivered to the District, and, consequently, I disagree with both the calculation of the Company's cost of the contract and the amount of the adjustment to the Company's revenue requirement.

The City of Jefferson and the Public Counsel both contend, and the majority agrees, that all the water provided the District per the contract should be valued based on the tariffed Rate E. After all, they argue, this is the only tariff available and it is the rate the exchange of checks is based upon. The Company and the Staff contend, on the other hand, that Rate E is not truly applicable in determining the real value of the water provided the District by the Company and its use was never intended to do this. No cost of service was ever performed and, moreover, the District is not a typical Rate E customer because no other Rate E customer provides a substantial amount of the water it uses from its own sources.

The City and Public Counsel contend that all the water provided the District should be valued equally based on Rate E and thereby should reflect the fully distributed costs of the Company's treatment plant and distribution system. The Staff and Company contend that essentially only the incremental cost of producing the water provided the District should be used in establishing its value.

It is my conclusion that the District is, in part, a typical customer of the Company and, in part, it is not. The District receives water from the Company which is, in fact, acquired from two different sources. One source is the Company's treatment plant and the other is the District's wells. I believe the water provided the District need not be and should not be valued as if the District were a typical Rate E customer. The water provided the District should be valued differently based on its source and related costs.

A substantial amount of the water provided the District is produced by the Company's treatment plant and delivered to the District through the Company's distribution system. This water should be valued the same as the water provided other similar water customers. This water should not be valued on an incremental cost basis for this particular customer and valued on a fully distributed cost basis for other customers. However, I contend that the water provided the District which comes from the District's own wells can, and should, be valued differently. This water is correctly valued equal to the additional

costs incurred by the Company to pump it, treat it and maintain the District's equipment, as stipulated in the contract.

Although the Company has not yet sought separate rates for valuing the two sources of water provided the District, I believe that evidence presented in this rehearing provides a basis for assigning different values to the different sources of water, and, thereby, provides a basis for a different calculation for determining the cost of the contract and the amount of the adjustment than the specific calculations offered by any of the four parties to this case.

As noted on Sankpill Revised Schedule 8, page 12, a total of 380,228,000 gallons of water was provided the District by the Company during the test year. Of that amount, 204,901,000 gallons came from the Company's treatment plant. This amount accounted for 8% of all the water produced by the treatment plant, a facility which the Company alone owns, equips, operates and maintains.

The balance of the water provided the District, 175,327,000 gallons, came from the District's own wells which the District itself owns and equips but which the Company operates and maintains per the contract. The Company incurs no major capital costs or other significant fixed costs in regard to the District wells. It merely maintains the District's wells and facilities, pays for the power used to operate the pumps and provides chemical treatment to the water before it is provided to the District. Three specific directly assigned costs incurred in production of water from the District's wells by the Company are clearly identified and quantified in Sankpill's revised Schedule 8: maintenance of the wells and springs, $8,918; fuel or power purchased for pumping, $33,720; and chemicals $1,195. The total of these three expenses, $43,833, reflects the incremental costs of the water derived by the Company from the District's wells and sold back to the District.

To the figure of $43,833 should be added the value of the Company produced water from its treatment plant based on all the Company's fully distributed costs as reflected in Rate E. Here the District is treated and should be treated like other large volume customers. 204,901,000 gallons valued, based on Rate E, would be $223,192. The sum of $267,025, I would contend, represents a more reasonable value for the water provided the District and, therefore, a more reasonable figure by which to conclude the cost of the contract. Accepting the majority's projected revenue requirement for the hypothetical storage facility of $148,160, and subtracting this amount from the contract cost of $267,025, the excessive cost of the contract would equal $118,865. This amount is also the amount I believe reflects a more reasonable adjustment to the Company's revenue requirement to account for the imprudence of contract the Company chose to enter into with the Water District.

My contention, admittedly, would be more easily argued had the Company sought approval of distinctive rates for these two different sources of water. I realize that there are many reasons why this approach was never pursued, not the least of which is that this Commission, nor any of the parties to this case, until recently, ever questioned how the water provided the District was valued. Had separate rates been sought for the separate sources of water used to provide water to the District, it could be speculated that some of the controversy of this case would have been resolved much earlier. In fact, I would suggest that if the Company had established separate rates and could provide most of the

District's water needs directly from the wells rather than from the Company-owned treatment plant, the contract signed with the District could, even without a reasonable cap, appear much more reasonable than it currently does.

Respectfully submitted,

David L. Rauch, Commissioner