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 public 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 Salem, Missouri and certain other unincorporated areas located in Phelps County and Dent County, Missouri.	)	Case No. GA-95-216

REPORT AND ORDER

Issue Date: August 8, 1995

Effective Date: August 18, 1995

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APPEARANCES:

James C. Swearengen, Attorney at Law, Brydon, Swearengen & England, P.C., 312 East Capitol Avenue, Jefferson City, MO 65101, for UtiliCorp United, Inc., d/b/a Missouri Public Service.

Lewis R. Mills, Jr., Deputy Public Counsel, P.O. Box 7800, Jefferson City, MO 65102, for Office of the Public Counsel and the Public.

Aisha Ginwalla, Assistant General Counsel, P.O. Box 360, Jefferson City, MO 65102, for Staff of the Missouri Public Service Commission.

ADMINISTRATIVE LAW JUDGE: Joseph A. Derque, III

REPORT AND ORDER

Procedural History

On January 23, 1995, 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 natural gas distribution system for the public in the City of Salem, Missouri, and the surrounding unincorporated area, generally located in Phelps and Dent Counties.

Together with that application, there is also on file with the Commission a map of the proposed service area and a franchise ordinance from the City of Salem, which resulted from a public ballot of the residents of the City of Salem. A feasibility study containing plans, specifications, and estimated costs of the facilities to be constructed were also filed.

There were no requests for intervention in this matter. The evidentiary hearing was held on June 30, 1995, and, after briefing, this case was finally submitted to the Commission for decision.

Findings of Fact

The Missouri Public Service Commission, having considered all competent and substantial evidence, on the record taken as a whole, 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 contesting this matter. Some evidence and positions taken by the parties may not be addressed by the Commission in this Report and Order. 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 case.

UtiliCorp is a Delaware corporation, with various utility holdings throughout the United States and abroad, including its Missouri operating company, Missouri Public Service. (The Commission may refer to either UtiliCorp or MPS in this decision interchangeably.) UtiliCorp is an investor-owned utility and has assets of approximately one billion dollars, and a capital structure in Missouri of approximately 55% debt and 45%

equity. Within the state, *MPS* provides natural gas service to approximately 42,000 customers in 28 communities.

In its application and testimony, UtiliCorp proposes to supply natural gas service to the City of Salem and surrounding area. The proposed service area extends, generally, from the current Rolla service area, southeasterly along the proposed route of the transportation pipeline to the corporate limits of the City of Salem, and includes the surrounding area in Dent and a portion of Phelps Counties. Testimony indicates that the Salem proposal includes an anticipated converted customer base of approximately 1200 conversions in the City of Salem, with 3500 persons located outside the city limits who can be considered potential customers, at an estimated capital investment of approximately $2.8 million of UtiliCorp's internally generated funds.

The Salem area currently has energy choices between electricity and propane gas. It is the position of the City of Salem, taken after popular vote, that the public is fully supportive of the application of UtiliCorp.

The application of UtiliCorp is filed pursuant to Section 393.170, RSMo. 1994, 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 and 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. W.D. 1993).

No substantial challenge exists on the record regarding the financial and operational capability of UtiliCorp to provide safe and adequate service to the Salem area, that the need for such service exists, or that the general public is desirous of such service. No question is raised challenging the ability of UtiliCorp to bear the financial risk of expansion into the Salem area without placing the remainder of UtiliCorp's ratepayers or the Missouri portion of the Company in jeopardy.

Evidence presented by UtiliCorp reflects feasibility projections, including information and assumptions regarding construction costs, operation and maintenance expense, and conversion rates, all for the purpose of determining the level of revenue required to cover all capital outlay and operating costs of the project. UtiliCorp maintains that the project is economically feasible as proposed, assuming the Commission grants a waiver of provisions of Chapter 14 of 4 CSR 240, permitting UtiliCorp to provide free conversion expense to customers.

The central, and for all intents and purposes, the only issue raised in this case, and pursued assiduously by the Staff and the OPC, is one challenging the economic feasibility of the proposed project. The Staff has stated various reasons why the project is not economically sound, and why the project will work to the detriment of the public interest. However, these sub-issues are more appropriately characterized as reasons why the proposal is not an economically sound one.

The Staff's central contention is that the proposed service to the Salem area is not economically feasible for two interconnected reasons. The Staff states that, should cost-based rates be set for the Salem area as a discrete entity, the cost of providing gas service will not be competitive with propane, its direct competitor. The Staff-calculated costs assume, initially, that the cost for providing service to Salem should be borne exclusively by the Salem consumers and should not become a part of the embedded costs for the remainder of the UtiliCorp service area. If this is the case, the Staff maintains that the UtiliCorp feasibility study is grossly understated as to the actual cost per unit of gas supplied to the Salem consumer.

The Staff states that, in addition to grossly undervaluing the cost per unit of gas, UtiliCorp overestimates the number of customer conversions that will take place once the service is offered. The Staff assumes in its estimate that no customer conversion waiver will be granted. In this case, UtiliCorp has also filed a request asking that the Commission grant it authority to provide free conversions to potential customers in the Salem area. Under the current Commission rules, contained in Chapter 14 of 4 CSR 240, providing such free service would be considered a prohibited promotional practice. The Staff is also opposed to granting the requested waiver.

The Staff maintains, in support of its position on feasibility, that the UtiliCorp feasibility study excludes administrative and general costs which should be allocated to the proposed Salem project. The Staff expresses the concern that the remainder of the MPS system will support, and therefore subsidize, the administration and operation of the proposed Salem system.

Finally, the Staff alleges that the anticipated cost of gas delivered to Salem (the transportation rate) is understated because it does not reflect the cost of the proposed Missouri Gas Company pipeline spur from Rolla to Salem and because the transportation rate agreed to by MGC is largely the result of an inappropriate affiliate transaction.

Although the Office of Public Counsel states it does not have the resources to independently evaluate the question of feasibility raised by the Staff, OPC states that it supports the Staff position. The OPC states that, if the full cost of all facilities including the cost of the pipeline spur are reflected in the cost of service for the Salem proposal, and those costs are assessed to the Salem area customers only, the resultant rates will not be competitive with propane. It is the principle concern of the OPC that the ratepayers in the Salem area will be required to absorb some potential operating loss at a later date, after conversion from propane to the UtiliCorp system. The OPC does not feel that this is, therefore, ultimately in the public interest.

The Commission has fully considered the evidence presented in this case by the parties. The Commission finds no significant challenge to the ability of UtiliCorp to operate a safe and efficient gas distribution service. It is equally clear that the provision of natural gas service to the Salem area will be in the public benefit, not only as a service to residential customers, but also as an incentive to help promote the economic growth of the community.

In determining the economic feasibility of the proposal, the Commission would first note the size and financial condition of UtiliCorp. There is little question that UtiliCorp can suffer a complete loss on this project without appreciable damage to its Missouri operation or harm to its ratepayers.

In this case, the Commission finds the expansion into the Salem area will be allowed, but solely at the risk of the shareholders of UtiliCorp. Should the proposed project fail or, for any reason, prove to be economically inefficient or unsound, the Commission will likely assess project costs and operational losses against UtiliCorp and its shareholders.

The Staff's arguments that the project is not economically feasible are based largely on cost allocation and ratemaking assumptions. The Staff's objection to the project hinges on the premise that Salem will be treated as a separate distribution area for purposes of cost allocation and rates. The Commission does not think it appropriate to engage in cost-allocation and rate design issues in a certification case. While the financial integrity of the applicant may be thoroughly examined in concert with the economic feasibility of the proposed project, the Commission finds revenue requirement and rate design issues are best left to general rate proceedings. The Commission sees no advantage in the balkanization of costs, and therefore rates, in an increasingly competitive environment. To do so would also be to force UtiliCorp to forfeit any benefits it may have to offer in terms of economies of scale.

Therefore, the Commission finds that the proposed project to provide natural gas service to the Salem area is necessary and convenient for the public service and is in the public interest. The Commission will issue the applicant a certificate of convenience and necessity to construct, install, own, operate, control, manage, and maintain a natural gas distribution facility, and to render natural gas distribution service in a certificated area as set out in Attachment A to this order and in the UtiliCorp application, incorporated herein by reference. The Commission will grant the above certificate subject to the conditions, as discussed below.

The Commission, as stated above, sees no advantage in setting rates specific to the Salem area at this time, and will, therefore, authorize the existing filed and approved gas rates for the northern and southern districts of MPS for service in the Salem area, until such time as a general rate case is requested or a complaint filed.

In addition, the Commission will order MPS to keep separate accounting records for the Salem service area, to be examined at the time of the next general rate case. The Commission also points out to

UtiliCorp that it makes no finding or determination as to the prudence or ratemaking treatment to be given to this project and its associated costs.

The Staff has requested a separate docket be opened for the purpose of investigation of inappropriate affiliate transactions by UtiliCorp among its operating divisions. This is largely the result of Staff's concern over the transportation contract between Missouri Gas Energy and MPS for the proposed Salem area. UtiliCorp states that it has no objection to the Staff proposal.

The Commission is of the opinion that the establishment of such a docket is not warranted.

Finally, UtiliCorp has filed a requested 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 Salem area from propane to natural gas. UtiliCorp requests an average of $300.00 per customer, on the customer's side of the meter.

The Commission would note the discussion of an identical variance request in the application of UtiliCorp to serve the Rolla area, Case No. GA-94-325. The Commission finds the requested activity to be a prohibited promotional practice requiring a variance. The Commission will grant a one-time variance in this case, identical to that granted in the above-cited Rolla case, with identical conditions, and for the same reasons.

The Commission will grant a one-time variance from the provisions of Chapter 14 of 4 CSR 240 to UtiliCorp to provide a maximum of $300.00 per customer, (not on an average) for conversion, installation, and recalibration, on the customer's side of the meter only, in the Salem service area as set out in Attachment A hereto. This variance will be limited to a period of three years from the effective date of this order. Any remaining customer conversion costs will be borne by the shareholders, and will be accounted for below the line.

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. 1994.

The Commission has authority under Section 393.170, RSMo. 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 Salem, Missouri, and other parts of Phelps and Dent

Counties, Missouri, as set out in Attachment A hereto and UtiliCorp's application, is hereby granted.

2. That, in the operation of the above-stated Salem service area, UtiliCorp United, Inc. will use those rates currently approved by this Commission and in use in the remainder of the UtiliCorp operating area in the State of Missouri.

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

4. That UtiliCorp United, through its operating division, Missouri Public Service, is authorized to account for the above-stated $300.00 maximum expenditure per customer (not on the average) above the line, and include those costs in rate base.

5. That 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, except those costs and expenses dealt with specifically in this Report and Order, and reserves the right to make any disposition of the remainder of those costs and expenses it deems reasonable, including charging those costs and expenses to the stockholders of UtiliCorp United, Inc., in any future ratemaking proceeding.

6. That UtiliCorp United, Inc., by its operating division, Missouri Public Service, will keep a separate and complete accounting of the Salem service area and will provide that separate accounting to the Staff upon proper request in any future rate or complaint proceeding.

7. That UtiliCorp United, Inc., by its operating company, Missouri Public Service, will file tariffs in accordance with this Report and Order,

prior to commencing construction or operations in the approved service area.

8. That this Report and Order shall be effective August 18, 1995.

BY THE COMMISSION

David L. Rauch

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. 1994.
Drainer, C., Not Participating.

Dated at Jefferson City, Missouri, this 8th day of August, 1995.

Attachment A