BEFORE THE PUBLIC SERVICE COMMISION

OF THE STATE OF MISSOURI

CASE NO. ER-82-52

In the matter of Union Electric Company of St. Louis, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the Company.

APPEARANCES: Paul Agathen, Attorney at Law, and William E. Jaudes, Attorney at Law, Union Electric Company, P. O. Box 149, St. Louis, Missouri 63166, for Union Electric Company.

Robert C. McNicholas, Associate City Counselor, 314 City Hall, St. Louis, Missouri 63103, for the City of St. Louis and Joseph R. Niemann.

Robert M. Lee, Attorney at Law, 720 Olive Street, St. Louis, Missouri 63101, for Laclede Gas Company.

George J. Bude, Attorney at Law, 130 South Bemiston, Clayton, Missouri 63105, for Consolidated School District No. 6, Jefferson County.

Robert C. Johnson, Attorney at Law, 314 North Broadway, St. Louis, Missouri 63102, for Industrial Intervenors, Monsanto, et al.

Gary Mayes, Attorney at Law, One Mercantile Center, St. Louis, Missouri 63101, for Metropolitan Sewer District.

Herman Barken, Attorney at Law, and Susan Pippe Attorney at Law, 41 South Central, Clayton, Missouri 63105, for St. Louis County, Missouri.

George Weible, Attorney at Law, City Hall, 200 North Second Street, St. Charles, Missouri 63301, for the City of St. Charles, Missouri.

Daniel S. Ochstein, Attorney at Law, P. O. Box 300, Holts Summit, Missouri 65043, for Missouri Public Interest Research Group.

Michael C. Pendergast, Assistant Public Counsel and Richard W. French, Assistant Public Counsel, 1014 Northeast Drive, Jefferson City, Missouri 65101, for the Office of the Public Counsel and the Public.

55

William C. Harrelson, Assistant General Counsel, and Eric K. Banks, Assistant General Counsel, P. O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REPORT AND ORDER

Introduction

On August 17, 1981, Union Electric Company (hereinafter Company) filed with the Missouri Public Service Commission (hereinafter Commission) revised tariffs reflecting increased rates for electric service provided to customers in the Missouri service area of the Company. The revised tariffs bear a requested effective date of September 16, 1981, and are designed to increase the Company's jurisdictional gross annual revenues by approximately $128,000,000, exclusive of gross receipts taxes.

By Order dated August 26, 1981, the Commission suspended the proposed tariffs and by Order dated September 21, 1981, the Commission further suspended the proposed tariffs for a period of six months beyond January 14, 1982 to July 14, 1982. Those Orders also established a schedule of proceedings for the time of the filing of the Company's evidence, the date by which applications to intervene were to be filed, the date by which the Staff and all other parties were to file evidence and, finally, dates for prehearing conference and hearing.

A number of parties were given permission to intervene. Some of the parties' interest was very limited in nature and only the Company, Public Counsel (hereinafter PC) and the Commission Staff (hereinafter Staff), participated generally throughout the entire proceedings.

To permit the Company's customers an opportunity to testify concerning the proposed increase, afternoon and evening hearings were held in the St. Louis area.

The prehearing conference in this matter began on March 15, 1982, and was attended by all parties except Consolidated School District No. 6 of Jefferson County (the School District), and the Metropolitan St. Louis Sewer District (Sewer District).

On March 18, 1982, the Company filed its Motion to Place Partial Increase in Effect Subject to Refund. Company sought to place into effect immediately an increase of $23,067,000. Oral argument was heard on the Motion on April 5, 1982, and briefs were thereafter filed by the Company, the Staff and the PC. The Motion was denied by the Commission's Order issued May 28, 1982.

At the outset of the hearing on March 29, 1982, the parties submitted a Hearing Memorandum containing an agreement for a true-up hearing for the purpose of establishing those prices, quantities and levels available at April 30, 1982. The true-up hearing was held on June 28, 1982, and the evidence offered has been used in the preparation of this Report and Order.

All parties have been afforded an opportunity to file briefs and reply briefs and those documents have been considered in the deliberations in this matter.

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 COMPANY

Company is a public utility corporation duly organized and existing under the laws of the State of Missouri. It is an electric corporation as defined in Chapters 386 and 393, RSMo. 1978, with its principal office and place of business at 1901 Gratiot Street, St. Louis, Missouri 63166. The Company is engaged principally in the generation, transmission, distribution and sale of electric energy at retail in the States of Missouri, Illinois, and Iowa. The Company also sells electricity at wholesale to 15 customers subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC). In addition, the Company operates a steam heating business in downtown St. Louis, and distributes natural gas in a small area of Illinois.

ELEMENTS OF COST OF SERVICE

The Company's authorized rates are generally based on its cost of service or its revenue requirements. As elements of its revenue requirements, the Company is authorized to recover all of its reasonable and necessary operating expenses and, in addition, a reasonable rate of return on the value of its property used in public service. It is necessary, therefore, to establish the value of the Company's property and to establish a reasonable return to be applied to the value of its property or rate base which, when added to the allowable operating expenses, results in the total revenue requirements of the Company. By calculating the Company's reasonable level of earnings, it is possible to mathematically calculate the existence and extent of any deficiency between the present earnings and any additional revenue requirement to be allowed in any rate proceeding.

THE TEST YEAR

The purpose of using a test year is to create or construct a reasonably expected level of revenues, expenses and investment during the future period during which the rates, to be determined herein, will be in effect. All of the aspects of the test year operations may be adjusted upward or downward to exclude unusual or unreasonable items or to include unusual items, by amortization or otherwise, in order to arrive at a proper allowable level of all of the elements of the Company's operations.

The Company's original filing of August 17, 1981, as well as its testimony and exhibits, were based on a forecast test year using budgeted data for the 12 months ending June 30, 1982. All parties have agreed to use the test year ending October 31, 1981, utilized in the Staff's cost of service, including known and measurable changes at April 30, 1982, subject to the true-up hearing.

TRUE UP

In addition to the agreement concerning the April 30, 1982, true up date, the Company proposes to include in rate base, with corresponding adjustments to depreciation reserve, depreciation expense, and property taxes, additions which it contends would be in service between April 30, 1982 and the operation of law date of this case.

The Commission Staff opposes the inclusion of any additional items in rate base unless at the time of the true up audit the Company certifies and the Staff verifies that the specific items are fully operational and used for service and the cost of such items can be identified. At the true up hearing held on June 28, 1982, the Company and Staff presented their areas of remaining disagreement in this regard.

A Staff engineer performed inspections of various projects on the 7th and 8th of June, 1982. If the inspection revealed that a new addition was properly in service that item was audited by a Staff accountant, who performed a review of the Company property records concluding on June 10, 1982, for the purpose of verifying the cost of those properties. The Staff has verified the operation and value of the expansion of the permanent coal pile base at the Company's Sioux plant and the replaced circuit breakers at the Mason substation. The Staff recommends inclusion in rate base of the respective costs of $514,000 and $155,000 and also recommends the attending adjustments to expenses and net operating income.

Still at issue are a number of additions including the replacement of the Cyclone Boiler of Unit No. 1 the Sioux plant. On the date of the Staff's inspection the installation was complete but the boiler had not been placed in service. The Staff does not recommend placing the boiler in the Company's rate base. A Company witness testified that the boiler was placed in service on June 20, 1982, in the generation of electricity.

The rate base reconciliation by the parties offered as Exhibit 148 at the true up hearing establishes the applicable cost to be $9,694,000.

Two new transformers at the Festus substation were not energized on the date of the Staff's inspection and the cost of these units are not recommended for inclusion. The Company's testimony establishes that transformer W was energized and released for operation on June 14, 1982, with a cost of $455,000. The Company expects transformer D, at a cost of $230,000, to be released and in service during the week of July 4, 1982.

Company originally proposed to include three circuit breakers at the

Roxford substation. At the time of the Staff's inspection none of the circuit breakers were in service and are not recommended for inclusion. The Company witness stated that one unit was placed in service on June 18, 1982, and the placing in service of the other two units will be deferred until later. The Company seeks inclusion in the rate base of the cost of the one circuit breaker in the amount of $85,000.

The Staff has verified the operation of the demineralizer at the Labadie plant but only proposes to include the Missouri portion of the expenditures verified through April 30, 1982, in the amount of $1,731,000. The Company witness testified that an additional amount of $160,000, applicable to Missouri, was expended in May but not completely recorded in the Company's books at the time of the true up audit.

Neither the Staff nor any other party offered evidence to dispute the Company's contention; in fact, the Staff testified that there are no reasons to disbelieve the Company's evidence. Staff also indicates that the Company's proposal does not differ greatly from the method frequently used to update the Company's rate base in the past. In the current case the Staff had a desire to use only audited or verified data and felt it must use an April 30, 1982 termination date because of the proximity of the operation of law date on the suspended tariffs.

The Commission is of the opinion that the inclusion of the items included in the Company's evidence as being in service would more nearly and accurately maintain the proper relationship between revenues, plant, and expenses for the period the rates will be in effect as a result of this case. A discussion to follow will reflect adjustments in that respect. The increases should include the total costs at Sioux and Labadie and the contested plant actually in service at the Festus and Roxford substations.

A portion of the Staff's dilemma may be resolved by an early determination of the method of the true up audit and the establishment of a cutoff date for the determination of plant in service and its cost. The parties should seek a Commission determination of these matters, as early as possible, in any subsequent proceeding, and in no event later than the commencement of the evidentiary hearing.

MISSOURI NET OPERATING INCOME

Company portrays its net operating income available to be $119,922,000. Other parties to the proceeding have proposed adjustments which would establish a higher net operating income available to the Company.

A. Employee Recreational Facility

The Company proposes to include in its revenue requirements the cost of owning and operating an employee recreational area.

The facility includes a square dance pavilion, a dining area, a meeting room, a softball diamond, a picnic area, a barbeque pavilion and outdoor movie screen, and living quarters for the caretaker.

The Staff proposes to deduct from the Company's rate base the net original cost of $207,000. Staff also proposes to disallow, as a reasonable necessary operating expense, the $34,000 associated with the operation of the facility. The PC and Missouri Public Interest Research Group (MoPIRG) propose to deduct the current market value of the facility from the Company's rate base.

The Company justifies the operation of the facility with the contention that it helps create a favorable employee attitude that carries over to the work place in the form of greater productivity and better job performance. To a lesser extent the operation of the facility is justified since various business-related activities are conducted there and it is also used by community and civic groups. The Company also points out that the Commission Staff has known about the facility for a number of years and has never proposed to disallow its operation in previous cases.

In the Commission's opinion the record is inadequate to establish that the facility is a reasonable and necessary cost of rendering service, or is a benefit to the Company's ratepayers. The Company's evidence concerning improved productivity and job performance was inadequate to prove to the Commission that the employee recreation facility is a reasonable or necessary operating expense. The facility's role as a site of the Company functions appears to be of a very secondary nature and the evidence in that regard is inadequate to justify inclusion.

In the Commission's opinion the Staff's proposed adjustment to both the operating expenses and rate base should be allowed. Evidence concerning the contention of PC and MoPIRG that the facility should be disallowed at its current market value is without merit. The evidence does not rise to the level necessary in this case to persuade the Commission that their approach should be adopted.

B. Advertising

The Company's jurisdictional advertising expense for the test year equalled $258,713. The Staff has proposed to disallow a portion of that amount as not being a reasonable and necessary operating expense.

All parties are essentially in agreement that under the Commission's application of the "New York Rule" in other recent cases, all of the Company's test year advertising expenses would be allowable. As applied by this Commission, the rule first excludes all political and promotional advertising and then allows all other advertising, including goodwill advertising, up to an amount equal to one-tenth of one percent of the utility's revenues.

The Staff's proposed adjustment is based on two recommended modifications of the Commission's present policy. The Staff proposes that Companies with jurisdictional revenues above $300,000,000 should be allowed only one twenty-fifth of one percent of revenues for advertising, while all other utilities should be allowed one-tenth of one percent. The Staff also proposes to commence disallowance of all goodwill advertising.

The Staff is of the opinion that the Commission's version of the "New York Rule" should be modified since it has not reduced the amount of litigation associated with advertising issues, nor has it reduced the amount of time the Staff must spend examining the ads.

Staff contends that except for the categories of advertising which it recommends the Commission continue to deem acceptable, most advertising engaged in by the Company is unnecessary. The Company, however, maintains that it is a metropolitan utility which competes with other utility companies for the same customer. With the exception of the areas of heating and cooling, the Company effectively has no competition.

The Commission is of the opinion that it may be prope·· to revise its position concerning the acceptability of goodwill advertising. However, the instant record provides no guidance for the determination of what portion of the Company's advertising is goodwill in nature. The Staff's adjustment is based on a percentage of total advertising only. Also, the Company has relied on the purpose of a stated percentage allowance as a vehicle by which the Company can accurately and adequately budget its expenditures.

While some, or all, of the Company's goodwill advertising may be unnecessary and objectionable, exclusion of the cost of such advertising must await the time when this has been established and those costs are definable. For the purposes of this case the Staff's proposal cannot be accepted.

To justify inclusion as an expense in future proceedings, advertising expenses, particularly for goodwill advertising, should be the subject of expert testimony concerning its effect and its benefit to the ratepayers. The burden shall be on the Company to identify, for audit purposes, the category into which the advertising falls and the criteria used to classify it. Other parties may then have an opportunity to challenge the reasonableness and use of the criteria in Company's classification.

C. Uncollectibles

The Company proposes to increase its test year losses due to uncollectible accounts by $255,700. The Staff recommends a reduction from the test year uncollectible losses in an amount of $35,000.

The Staff has used a four-year average of the losses in the amounts of $1,728,300, $2,022,256, $2,172,739 and $2,442,783 for the years 1978 through 1981 respectively. The Staff has also taken into consideration the ratio of the uncollectibles to the Company's total revenues for the corresponding years and the absence of any discernible pattern to that relationship. Company's uncollectibles, as a fraction of revenues, appears to be unusually high for 1981.

The Company contends that the increase in the level of uncollectibles is justified because the amount has steadily increased and the Company's credit and collections section has arrived at its proposed level of uncollectibles by the use of 1982 budget data.

The Commission has been willing to move in the direction of the use of budgeted or forecasted data only when the methods appear to be reasonably calculated to insure accuracy. Such assurance is not present in the instant controversy.

On the other hand, the Commission has frequently accepted the use of an average to establish a level of expenses when there appears to be little or no pattern to the fluctuation. It is recognized that there is a pattern to the increase in the amount of uncollectibles, that there is no pattern to the level of uncollectibles when compared to overall revenues. In the Commission's opinion the unusually high amount of uncollectibles in the Company's test year should be reduced by $35,000.

D. Customer Deposits

The Staff proposes to reduce the Company's calculated rate base by the $4,394,000 representing customer deposits. The Staff also proposes to allow, as operating expenses, approximately $264,000 required to pay interest on the deposits at the rate of six percent provided in the Company's tariff. The Company opposes the deduction from rate base and also proposes to eliminate the interest allowance from its operating expenses. This issue bears on both the Company's rate base and its level of expenses.

It is a generally accepted rate-making principal that customer-supplied funds should be considered cost-free capital on which the shareholders of the Company should not earn a rate of return since the shareholders are not the source of the funds. The Company contends that the characterization of the deposits in this manner is inappropriate because the six percent interest rate removes the deposits from the cost-free category.

The Company portrays its weighted cost of capital as 12.34 percent. The Staff's mid-point recommendation is approximately 11.69 percent. If the ratepayer receives a lower rate of interest on his deposits and is required to pay, in rates, a higher amount to provide a reasonable rate of return, the Company's cost of service has been artifically inflated. In effect, the customer is being asked to accept a relatively low rate of interest on his involuntary investment and at the same time furnish a higher rate of return to the custodian of the involuntary investment. Since the customers' deposits are at least partially cost free and customer supplied, the deduction from rate base is proper and the inclusion of the supporting interest to the customers should be allowed as a reasonable and necessary operating expense. This combination of treatments will compensate the Company for the actual cost of using the funds which are not supplied by the shareholders.

The Company contends that the customer deposits are analogous to borrowed funds. In the Commission's opinion this is not true. Shareholders exercise a choice in investing in the Company. Lenders exercise a choice in becoming creditors in the Company. Although deposits are in many cases justified, the provider of that deposit has not done so voluntarily and should not be further penalized by providing both the principal and a rate of return.

E. <u>Interest on Customer Deposits</u>

Public Counsel and MoPIRG advocate the increase of interest rate on customer deposits to nine percent. The Company opposes the request and the Staff took no position.

Company's objection is based on the assumption that six percent is similar to the return available on passbook savings, which the Company contends is the only generally available investment of an amount equal to the average customer deposit of $82. The request to increase the rate of interest is based on the contention that six percent is simply not a realistic rate of interest in today's economy.

In the Commission's opinion there are several distinctions, as demonstrated by the evidence, between the customer deposit and a passbook savings account. Passbook savings are not involuntary investments and can be recovered on short notice at the option of the depositor. Customer deposits are involuntary investments and ordinarily must be left with the Company for a stated period of time, up to one year.

In the Commission's opinion the tariffs to be filed as a result of this case shall provide for a payment of nine percent interest on customer deposits. The funds to support those payments shall be included in the Company's reasonable and necessary operating expenses.

F. Rush Island and Sioux Amortization

In the Company's Case No. ER-77-154, the Commission allowed a five-year amortization of the cancellation costs associated with Rush Island units three and four. The Commission also authorized a five-year amortization of the maintenance expense associated with replacement of the Sioux unit No. 2 boiler floor. The five-year period authorized was to commence in January of 1978. The Commission did not permit unamortized balances to go into the Company's rate base and allowed the Company to recover the costs in their entirety through its rates.

The Staff proposes to allow five and one-half months amortization of the costs in question in the expenses for the purpose of this case. The Company contends that a full-year's amortization of both expenses should be included. Company's criticism is based on the claimed inconsistency of using a projected test year for only one purpose while retaining a historical test year for all others. Company contends that the Staff's test year ending October 31, 1981 and the true-up year ending April 30, 1982, both include a full-year's amortization which should be allowed as operating expenses.

The Staff's position is correct and is not the use of a projected test year for an isolated purpose. The end of the amortization period on January 1, 1983 will be approximately five and one-half months after the rates will go into effect as authorized by this Report and Order. At that time the balance in the applicable accounts will reach zero. The amortization has been authorized for a specific purpose for a specific period and the rates previously authorized included that recovery.

Since the rates to be authorized herein are for the future, it is improper to provide for costs beyond their termination date of January 1, 1983. Such an inclusion would amount to an over-recovery.

The Commission finds that Staff's inclusion of five and one-half months of the Rush Island and the Sioux amortization is proper.

G. Bank Service Charges

The Company proposes to include in Administrative and General expenses an amount to reflect the estimated value of bank service charges avoided as a result of the Company maintaining a minimum cash balances. The proposed inclusion would reduce the Company's operating net income by $135,000. It is the Staff's opinion that the inclusion is improper because the Company has historically never paid transaction fees and its current policy reflects the Company's ability to maintain average bank balances to avoid transaction fees. The Company's data to show avoided bank service charges is for calendar year 1981 and does not coincide with either the Company's or the Staff's test year in this matter.

The Company maintains bank balances for two reasons. Arrangements for lines of short term credit require compensating balances to support those lines of credit. Balances are also maintained to avoid bank service charges. The balance required to avoid bank service charges is smaller than the balance required to support the Company's lines of credit. The Company presently has $8 million of balances required to support the lines of credit, however, there is no stated or required balance for the avoidance of bank service charges. As a result of a long term working relationship with the banks, the Company is informed if its bank balances are not high enough to avoid charges prior to those charges being levied. As stated by one of the Company's witnesses, the Company has become more scientific in its approach to the banks and has realized that in the past bank balances may have been artifically high. By the use of sound money management policies the Company has been able to reduce those hard balances to as low a level as possible and still meet the requirements of the banks in order to maximize the use of the cash in their account.

In the Commission's opinion the Staff's position of ignoring the costs of the Company maintaining bank balances is correct since there are no identifiable costs associated with maintaining minimum balances.

There should be no inclusion of avoided bank service charges since it appears that there is no genuine exposure of the Company to incurring those charges.

H. Corporate Franchise Tax

The Staff and Company disagree on the appropriate treatment of the Company's corporate franchise tax. Staff proposes to transfer a portion of the test year franchise tax in the amount of $436,000 to construction work in progress. It is the Staff's contention that the tax is an expense, a portion of which can be identified as being incurred due to the ownership of assets which are CWIP. The Staff also contends that its position is in accordance with the Uniform System of Accounts, Construction Three, paragraph 16, which states:

> "Taxes includes taxes on physical property (including land), during the period of construction and other taxes properly excludable in construction costs before the facilities become available for service."

The Staff is not contending that the tax is imposed upon the physical assets themselves, although it is clearly and directly measured by the cost of physical assets. The Staff contends that the instruction in the Uniform System of Accounts clearly contemplates capitalization of taxes other than taxes on physical property.

The Company is of the opinion that the taxes are imposed by state taxing authorities for the right to operate a business in the state and that these taxes are based on capitalization and not property. Since the taxes are an annual recurring cost of doing business the Company contends that they should be reflected currently in the Company's rates.

In the Commission's opinion the Company's position is sound because the tax is not imposed on the physical assets themselves, and the proposed transfer of a portion of the corporate franchise tax should not be adopted.

I. Residential Insulation Program

As a part of the settlement agreement in Case No. ER-81-180, the Company modified its existing Residential Insulation Program. The modifications included the reduction of the interest rate on money loaned under the program from 14 percent to 5 percent and up to a total amount of $2.5 million in outstanding loans at any time. As a part of the settlement agreement, an additional $225,000 was included in the cost of service. This amount represented the difference between five percent and the 14 percent interest then charged, applied to the total balance of $2.5 million.

The Company in this case proposes to continue the same provisions agreed upon and approved by the Commission in the last case.

The Staff proposes to continue the program as agreed to in Case No. ER-81-180 with one exception. The Staff has proposed to reduce the amount included in the Company's cost of service to $143,000. Staff's proposal is based on the fact that the balance of the five percent loans was $1.1 million as of March 3, 1982. However, as the Company's witness testified, the balance had increased the next month by about $300,000, to $1,409,000. Assuming the same trend will continue, the balance would be at the $2.5 million limit for almost the entire 12-month period after the rates take effect that are to be set herein. The original $225,000 figure was based on the rate of nine percent as the difference between the five percent and the then current interest rate of 14 percent. According to the Staff this differential is now up to 12.69 percent.

The Company's proposal to continue the original agreement with respect to the residential insulation program should be approved. The Company indicates the funds will soon be fully committed. The Commission expects this goal to be fulfilled and authorizes the inclusion of the applicable costs because of the importance of the program.

The Public Counsel did not take a position on the amount to be allowed to cover the cost of the service item, however, in its Reply Brief requested that the cost of the program be borne by all ratepayers of the Company equally rather than just by the residential customers under the present arrangement. By raising this contention in the Reply Brief the Public Counsel has effectively denied other parties an opportunity to respond and the Public Counsel's request should be disallowed.

The Staff has recommended that the Commission institute a docket to investigate the progress of the program to determine who is benefitting and whether those benefits outweigh the cost to the supporting ratepayer. In the Commission's opinion that portion of the Staff's position is sound and a docket shall be instituted for the purpose of investigating all aspects of the conduct of the residential insulation program, to include whether or not to continue or discontinue the program. Public Counsel's position may be explored in that proceeding.

J. Edison Electric Institute Contributions

The Company proposes to include most of the test year dues paid to the Edison Electric Institute (EEI) and an additional amount for a specific EEI project. The Company proposes an exclusion of two percent of the EEI dues which are conceded to be in support of political and lobbying activities. The Company, in its brief, claimed support by the Commission Staff. This contention is in error since the Staff disclaims any position in the matter; somewhat inconsistent with its frequent recent recommendations to disallow EEI dues in rate proceedings.

Public Counsel recommends disallowance of the EEI dues and contributions because the organization devotes a larger and unquantifiable portion of its budget to lobbying, than the two percent conceded by the Company. Public Counsel recommends the disallowance of the entire Missouri jurisdictional amount of $319,000. Company contends that the Public Counsel's position should be rejected because the proposed disallowance is not supported by competent and substantial evidence.

The Edison Electric Institute is a voluntary organization whose membership is made up of electric utilities throughout the United States. EEI studies and develops information concerning all aspects of the electric utility industry, including accounting, energy analysis, engineering and operation, environmental, finances and general industry relations. Most of EEI's work is done by numerous EEI committees. Several employees of the Company are members of EEI committees. The Company alleges that information brought to the Company's attention through EEI committee meetings and publications aid the Company in its operations and result in operational and financial benefit to the Company and its ratepayers.

Public Counsel proposes the disallowance of EEI payments as an operating expense in this case on the basis that EEI engages in considerable lobbying activities and public relations efforts on behalf of the electric utility industry. Company contends that the true lobbying efforts of EEI represent less than two percent of the EEI budget, and are therefore so significant that they should not have an effect upon the allowance or disallowance of EEI dues as an expense in this case. The two percent figure, however, is based solely on the amount reported by EEI pursuant to the Federal Registration of Lobbying Act, 2 U.S.C. Section 267(a). That federal statute requires any person engaged for pay in attempting to influence the passage or defeat of any legislation by the United States Congress to register with the Clerk of Congress and to file a quarterly verified report of all money received and expended by such person during the previous calendar quarter in carrying on his work. By its own terms, the Act does not apply to any person who "merely appears before a committee of the Congress of the United States in support of or in opposition to legislation." Nor does the Federal Registration of Lobbying Act require EEI to report expenditures related to its efforts to influence the Executive Branch of the federal government, regulatory commissions and Presidential task forces, or its efforts related to its support of witnesses testifying before Congressional committees.

This Commission has defined lobbying as "an attempt to influence the decisions of regulators and legislators in general." Re: Kansas City Power & Light Company, P.S.C. Case No. ER-81-42. page 23 (June 17, 1981). The evidence in this case makes it clear that substantially more than two percent of EEI's expenditures and efforts are directed toward influencing the decisions of regulators and legislators in general. The Commission has heard this two percent argument concerning EEI's lobbying activities on numerous occasions in the past, and has uniformly rejected that argument. The Commission holds that the fact that EEI reports two percent of its expenditures as lobbying expenses under the Federal Regulation of Lobbying Act is irrelevant to the Commission's consideration of this issue.

The fact that EEI applies a substantial portion of its expenditures and efforts toward lobbying is not necessarily, however, determinative of this issue either. If testimony was adduced, for example, that showed that EEI represents the interests of electric utility ratepayers and that those acts of representation were beneficial to ratepayers, it is possible that EEI dues, or a portion thereof, could be allowed as expenses in the Company's cost of service. In Re: Kansas City Power & Light Company, P.S.C. Case No. ER-81-42, page 24 (June 17, 1981), the Commission stated the following:

> The rule has always been that dues to organizations may be allowed as operating expenses where a direct benefit can be shown to accrue to the ratepayers of the Company. Conversely, where that sort of benefit does not appear, disallowance of the dues is required. It follows that the mere fact that an activity might fall within the very broad general definition of lobbying as used by Public Counsel should not necessarily mean that it is an improper expense for ratemaking purposes. The question is one of benefit or lack of benefit to the ratepayers.

In Re: Kansas City Power & Light Company, id., the Commission found that the record was silent as to the relative benefit of EEI activities. As a result, the EEI dues of that company were not allowed in the Company's cost of service. Likewise, in the instant case, benefits to the Company's customers of participation in EEI, if any, have not been quantified. As a result, the Company's EEI dues cannot be allowed in the Company's cost of service in this case. See Re: Missouri Public Service Company, Case No. ER-82-39.

K. Electric Power Research Institute (EPRI) Dues

The Company proposes to include the assessment from EPRI as a current expense and the cost of service. The Staff contends that 24 percent of the EPRI dues are nuclear-related and should be transferred to construction work in progress (CWIP). Staff proposes to amortize the remaining 76 percent over a 10-year period, with the unamortized portion included in rate base. Public Counsel proposes that the entire EPRI assessment be amortized over a 20-year period, with the unamortized portion excluded from rate base.

The Company's witness testified that capitalizing R and D as a part of the nuclear plant is improper because R and D does not constitute an asset which can be capitalized and depreciated. Instead, a technology or procedure is developed which can be used to improve service or reduce cost. As such, good accounting practice requires that the expense be recognized in the year incurred.

The Commission has since agreed with that analysis in Cases ER-81-42 and ER-80-48. The Commission reiterates its opinion that capitalization would treat as an asset something which may not be accurately measured, since its economic benefits cannot always be assured or identified.

General capitalization of research and development expenses would raise the dilemma of the proper treatment of research and development that bore no fruits. Such a position would place the Company in an unusual position of immediately recovering the cost of its failures whereas recovery of the cost of its successes would be deferred until sometime in the future. The Commission also sees no benefit in identifying the projects directly affecting a utility, and disallowing the portion of the assessment related to all other projects.

All the parties agree that EPRI's research is on the whole worthwhile, and the Commission therefore will not require that various portions of the assessment be segregated for special treatment in individual rate cases in an absence of a showing that certain projects are devoid of merit. The decision in this case should not be interpreted by the parties as a signal to terminate inquiry into the merit of research and development payments.

In the Commission's opinion the Company's position is entirely consistent with financial accounting standards. Although the Commission is not bound by financial accounting standards, that fact alone does not justify a departure from sound principals of accounting. A utility's accounting should depart from accepted accounting practices only in cases where some accepted rate-making principal takes precedence.

The Commission also notes that one inherent problem of the amortization theory is deciding upon the appropriate period of amortization. As an example of that problem, the Staff claims that EPRI benefits will accrue in 10 years while Public Counsel advocates a period of 20 years.

The Commission finds that it is reasonable to expense the test year EPRI assessment, and the Company's proposal is adopted. The Commission therefore need not address Public Counsel's proposal to exclude unamortized payments from rate base.

L. Kiln Gas

The Commission Staff has proposed that the Company's contribution to a kiln gas project be disallowed.

Kiln gas is a process of converting coal, including high sulphur Illinois and Missouri coal, into environmentally clean, low BTU gas. The technology was developed in 1970 by Allis-Chalmers, which in 1976 was joined in the project by Union Electric and 10 other utilities.

The position of the Staff and Public Counsel is based on two primary grounds. First it is questioned whether or not the kiln gas project will ever be of benefit to the Company's ratepayers. While it is true that the Company witnesses could not offer any guarantees of success, the Commission has recognized in the past that there is no guarantee of success of any research project. To require a guarantee of success would virtually eliminate all research and development.

The Staff proposes a disallowance partially on the basis that no electric power will be generated by a kiln gas plant. The project is also criticized on the ground that very little of the Company's total generation is fueled by gas. The Company does not consider the kiln gas project as a substitute for gas but as a substitute for the high sulphur coals found in nearby Illinois and Missouri. The Company's contribution to the kiln gas project is reasonable and should be approved for the purposes of this case.

M. Unemployment Compensation Taxes

Between the time the Staff prepared and filed its original cost of service study in early March and the time of hearing in this case, House Bill No. 1521 was signed and became effective on April 1, 1982. Under the old law, the tax rate for 1982 was .5 percent. The new law increases that tax rate to 2.6 percent. Under the new tax rate, the Company's unemployment compensation tax will be approximately $940,000 on an annual basis.

The Commission Staff concurred in the proposed adjustment and increased its proposed annualization to reflect the current charges. No other party addressed the matter in briefs, and the Commission adopts the position advanced by the Company, and agreed to by the Staff.

N. Reconnection Charge

Under the Company's existing tariffs, a customer whose service must be disconnected is charged $10 at the time such service is reconnected by the Company. In this case the Company proposes to increase the charge to $25. Staff proposes an increase to $15, while PC proposes that no increase be authorized.

The existing level of the charge was established in 1978, and the Company's witness testified that the actual cost of the reconnection and disconnection is now in excess of the Company's $25 proposal. Neither Staff nor Public Counsel challenge the level of cost. Instead, they advocate that their suggestions be adopted to mitigate a proposed 150 percent increase.

In the Commission's opinion it is a desirable goal to move in the direction of assessing utility costs against those causing those costs. In the instant case, however, the harshness of the proposed increase should be tempered and the move toward recovery of cost should be less abrupt. For those reasons, the Commission is of the opinion that the tariffs to be filed in this matter should authorize a reconnection charge in the amount of $20.

O. Fuel Costs

The disagreement as to fuel costs is whether fuel prices should be based on historical or on projected costs. The Staff originally proposed to calculate coal costs using a blend at the Labadie Plant of 77.5 percent high sulphur coal and 22.5 percent low sulphur coal. The Company proposed a blend of 65 percent high sulphur and 35 percent low sulphur coal. As a result of evidentiary presentation the Company and Staff have agreed to use a mix of 71.2 percent high sulphur coal and 28.8 percent low sulphur coal.

Fuel is the largest single item of expense in the Company's cost of providing service and has been consistently rising in recent years.

Generally the Commission only has been willing to use budgeted figures or allowances when not too distant from the test year for reasons of reliability. The Commission has been using budgeted fuel costs, when there has been an adequate refund provision, in recent cases. Under the Staff's proposal any overpayment of budgeted fuel costs will be refunded. Any under recovery of fuel costs will still be absorbed by the Company. Since it assumes the risk absorbing any fuel costs above budget, the Company still has the incentive to keep its fuel costs at a level as reasonable as possible. In the Commission's opinion the refund provision is adequate protection against the Public Counsel's criticism that the forecast may not be precise.

The Public Counsel also argues that the refund provision advocated is inadequate because the October invoices are not necessarily representive of the costs for the 12 months ending July 1, 1983. While it may not prove to be 100 percent accurate, absolute precision is not attainable in a cost of service, and in the case of the fuel refund the Commission is of the opinion that the use of October invoices is reasonable.

The Public Counsel also argues that the Staff's proposal is in conflict with the decision in State ex rel. Utility Consumer Counsel of Missouri v Public Service Commission, 585 SW2d 41 (Mo banc 1979). The Commission has considered the Public Counsel's contention and finds it without merit.

The Public Counsel offered no evidence but questioned the validity of the proposal in other respects. The Commission has established a trend of allowing forecasted fuel costs in proper cases, ER-80-286, ER-81-42 and ER-80-48, and by merely questioning the reasonableness of a proposal, the parties should not be permitted to change a generally accepted practice. In the Commission's opinion the Staff's proposal should be adopted since it contains both a recognition of probable increased costs during the period the rates in this matter will be in effect, and an adequate method of monitoring and refunding overcharges, if any.

At the true up hearing the Company presented evidence reducing its projected fuel costs by $17.4 million or 4.2 percent. The reduction makes the Company's fuel requests, subject to true up and refund, to be $4,691,000.

Certain events began to occur in April of 1982 which caused the Company to revise its October, 1981 fuel budget. The Company started to notice a moderation in the price and availability of coal in the spot market. In addition, the Company has found low sulphur coal available in Illinois which had previously been unavailable because its primary market is the steel industry which has reduced its consumption significantly. Due to the general state of the economy the price escalation built into the Company's existing contracts were less than anticipated. There have been no freight increases for the first six months of 1982 and productivity of the coal suppliers has increased unexpectedly. Foreign markets, which have been taking coal from domestic sources, have also deteriorated, making additional coal available in the United States and further depressing the prices. Company has also not burned its anticipated quantity of coal during the first five months of 1982 because of the availability of interchange power at prices less than could be generated by the Company.

The Public Counsel reiterates his belief that the cost of fuel should not be forecasted at all and points to the fairly large error in this case. In the Commission's opinion the refund provision is adequate to protect the consumer from any potential overcharge especially in view of the reduced amount at issue.

Although the Commission does not intend to interfere with the spirit of the method agreed to between the Staff and the Company, the Commission does put the parties on notice that it will require testimony at the fuel true up hearing to ascertain if October is a representative month for fuel costs and whether or not, at that time, there are any unusual fluctuations in the price of coal either upwards or downwards.

P. Nuclear Labor

The Staff proposes to transfer to construction work in progress and thereby capitalize certain expenses as being directly construction related.

The Company agrees that all labor related to the Callaway nuclear power project is appropriately charged to construction work in progress, but contends that $66,000 was mistakenly capitalized because that amount is properly attributable to operations and maintenance.

It is the Company's contention that the amount in question was incorrectly characterized as being related to the nuclear function and while all of those employees charge their time to the nuclear payroll not all of their activities relate to the Callaway Plant. In reviewing approximately 8,000 time sheets the Staff isolated a very small amount of labor that could properly have been attributed to operations and maintenance.

If there is a misunderstanding of the nature of the so-called nuclear labor it has been created by the Company and the Commission finds the Company has not sustained the burden of proving the charges are not properly what the Company stated.

Q. Utility Nuclear Power Oversight Committee (UNPOC) Payments

The Staff proposes the Company's contribution to EEI's UNPOC be excluded from allowable expenses and, if found acceptable, transferred to CWIP. PC and MoPIRG recommend that the contribution be disallowed in its entirety.

Prior to the filing of the Staff's case, the Company informed the Staff that UNPOC's primary function is to further nuclear safety. During the course of the hearing a Company witness indicated UNPOC's purposes to be (1) communication efforts to increase public understanding for the need for and safety of nuclear power and (2) analysis of the design and operating application of events occurring in the nuclear industry and communication of that information to participating companies so they can systematically and effectively utilize data to avoid incidents detrimental to customer interests.

In the Commission's opinion the Public Counsel's position is well taken. The evidence available in this record indicates that the primary purpose of UNPOC is to form or mold public opinion and this type of effort is directly analogous to political advertising. This Commission has fairly consistently disallowed expenses for similar purposes other than incurred for advertising or dues or donations to lobbying groups. In the Commission's opinion it is entirely consistent to exclude the payment of UNPOC from the Company's reasonable and necessary operating expenses and to disallow, for rate-making purposes, the payment in its entirety.

R. Summary

As a result of all of the adjustments, herein found to be reasonable and proper, the Commission finds that the Company's net operating income available for the purposes of this case, is in the amount of $122,178,000.

RATE BASE

As a result of the Staff's investigation it is of the opinion that the Company's net original cost rate base is in the amount of $1,283,718,000. Company claims a rate base of $1,441,802,000. A difference of opinion is contained in a number of issues which will hereinafter be discussed seriatim.

A. Deferred Taxes

The Staff proposes to deduct $142,865,000 of accumulated deferred income taxes from rate base. The Company agrees to a deduction of $83,022,000 but objects to the disallowance of the remainder which represents the deferred taxes associated with the construction of the Callaway Nuclear Plant. It is the Company's contention that the deferred taxes related to the Callaway plant should be deducted from rate base only when the plant itself is included in rate base. The Company feels that if the Staff position is adopted, then the present customers would be given a direct benefit from the construction of Callaway, a benefit which rightfully belongs to the future ratepayers. The Company also is of the opinion that the proposed offsetting against rate base places a part of the cost of construction work in progress in rate base in violation of Section 393.135, RSMo 1978. The Company is of the opinion that the Staff's proposed treatment is inconsistent with the proposed treatment of other expenses associated with the Callaway nuclear projects.

Deferred income taxes are accumulated when a company is authorized to normalize tax timing differences. If deferred income taxes are normalized the company records the taxes as an expense but a payment is actually not made to the Internal Revenue Service. There is no issue in the instant case concerning normalization versus flow through.

This Commission has consistently deducted the accumulated deferred taxes resulting from normalization from rate base even when CWIP is not included in rate base. Re: Missouri Utilities Company, Case Nos. 18,246, 18,352 and 18,371 (1975); Re: Kansas City Power and Light, Case No. ER-77-118 (1977).

Deferred income tax expense has been included in the Company's cost of service in this case. Such an inclusion results in present customers providing cost-free capital to the Company. Staff proposed deferred tax balance treatment gives the current ratepayers recognition for the benefit they have provided in the form of cost-free funds.

Even though current ratepayers do not provide a return on amounts spent for construction work in progress, the Company is compensated through the accrual of allowance for funds used during construction. The Company is being fully compensated through the latter treatment. The Company's proposal eliminates any recognition of the provision of cost-free capital by the current ratepayers. The Staff's treatment is consistent with the practice of attributing a zero cost to accumulated deferred taxes.

The Company argues that this result is not permitted under Section 393.135, RSMo 1978. The Commission has considered the Company's position and finds it without merit.

B. Reclassification of Substations

The Staff proposes to reclassify as transmission substations part of the investment which the Company classifies as distribution facilities. The Staff's proposal is based on the fact that 138 kv lines are the power source. Transmission facilities are considered to serve all jurisdictions and are allocated on that basis. Distribution facilities are treated as local facilities and assigned to the jurisdiction served. Staff is of the opinion that the Company is inconsistent in assigning 138 kv substations to Missouri because they are located in Missouri while allocating 69 kv stations in Iowa and Illinois to Missouri because they are classed as transmission substations.

The Company's system is integrated in that all generating plants in various points of intersection are connected by transmission lines. The Staff and Company utilize the roll-in method of allocating facilities as adopted by the Federal Energy Regulatory Commission (FERC). The roll-in method relies on the capability of a facility to characterize its function. The five 138 kv substations at issue are integrated into the Company's system and can provide a transmission function. As an example, power can be transmitted through the 138 kv transmission line that goes in and out of the Dorsett substation and can be directed to the Company's Wasson substation. The Staff, in its brief, cites FERC Docket No. ER-76-184, Re: Kansas City Power and Light Company , which contains the result the Commission considers to be proper in the instant controversy. FERC determined that if 34.5 kv and 69 kv systems, under any circumstances, under any conditions, can provide transmission function, they should be rolled in.

It was recognized that the facilities could still be classified as distribution facilities if truly isolated from the integrated system and operated in a substantially different manner from the rest of the system, such as serving a single distribution customer.

Although it is possible to show that facilities capable of functioning as transmission facilities are actually used solely as distribution facilities, that evidentiary showing is lacking here and the Staff's position is correct. The reclassification and reallocation of the involved substations result in reduction in the Company's claimed rate base in the amount of $1,338,000.

C. Ashley Plant Allocation

The Company's steam heating business in downtown St. Louis is supplied from the Company's Ashley plant. The Company states the Ashley plant is also used for peaking and standby service in the Company's electric business. The portion of the plant used jointly in the steam and electric business is "common plant", and to must be allocated between the steam and the electric rate bases.

The method of allocating the Ashley plant was established by the Commission in a steam rate case, 17,904, in May 1974. The Company proposes to use an allocation of 66.5 percent of the Ashley plant common facilities for its electric business, and 33.5 percent for the steam business.

The Commission Staff proposes to allocate the common generating facilities between the steam heating system and electric system in proportion to the noncoincident monthly peak demands for steam and electric service. The Staff supports its proposed change in the allocation on the basis that Ashley had negative generation during the test year.

In the Commission's opinion the Staff's proposal should be rejected. The generally accepted allocation was established in a steam rate case. Staff's proposal would decrease electric rates by approximately .07 percent and could increase steam heating rates by approximately 7 percent.

In the Commission's opinion adoption of the Staff's proposal would create a serious due process problem in that the people to be affected the most, the steam heating customers, have not been notified of this proposal and are unaware of any potential increase in steam rates of the magnitude described. An inquiry into this allocation may either take place in a steam rate case or in the Company's next electric rate case, but only with adequate notice to the steam customers of such a substantial change in allocation. For the foregoing reasons the proposed Staff reallocation of Ashley should be rejected.

D. Allocation of General Plant

Various facilities are recorded on the Company's books as "general plant", which consists primarily of the Company's general office building in St. Louis, office furniture and equipment, communication equipment, a garage near the office building, a warehouse and certain power operated equipment. Like other rate base items used for total Company operations, general plant must be allocated among the Company's four rate jurisdictions. The Company allocates general plant on the basis of each jurisdiction's composite labor ratio. Staff proposed to use a composite rate of each jurisdiction's share of production, transmission and distribution plant.

Although Staff stated in direct testimony how its allocation factor was developed, it was never fully explained. In the absence of sufficient contrary evidence, the Commission approves the Company's method for allocating general plant.

E. Allocation of Power Pool Facilities

The Company and the Staff have both allocated production and transmission facilities, included in the "power pool", between the Company's four rate jurisdictions on the basis of relative kw demands. The demand allocations factor has been calculated on the basis of the 12 coincident peak method. The numerator of the allocation factor for any jurisdiction is the average of that jurisdiction's demands at the time of the 12 monthly peaks in the Company's system. The denominator is the average of the 12 monthly peaks for the entire system. The total amount allocated to all four jurisdictions for a given test period should equal 100 percent of the Company's power pool investment.

There are four basic differences in the way the Company and the Staff have performed their calculations. The Company has arrived at a proposed jurisdictional demand allocation factor of 68.75 percent, whereas, the Staff proposes 65.52 percent.

In calculating its power pool allocation factors, the Company does not include the kw demand which it considers to be interruptible in nature. According to the Company, it may interrupt all or a part of the demand of one industrial customer in Illinois, two in Iowa and three municipal wholesale customers in Missouri by working through its subsidiary Missouri utilities. It is the Company's contention that it does not build power pool facilities to serve interruptible load. The Company argues that power pool costs are not incurred by reason of interrputible loads, and no portion of the power pool facilities should be allocated on the basis of such loads.

Responsibility for reserved capacity is directly proportional to the firm loads served in each jurisdiction. Company advocates assigning the fixed costs associated with system reserve capacity in that manner. The revenue derived from interruptible sales are credited back to each jurisdiction in the same proportion as their respective power pool allocations factor.

Since allocations are based on MWH generation, Staff determined the demand of the jurisdictions at the 12 coincident peaks by meter demand, and what capacity was assumed to be Missouri jurisdictional demand.

In addition to the basic dispute over treatment of the nonfirm load, the Staff also contends that the three municipal customers in Missouri are not really inerruptible, as claimed by the Company. Staff's contention is based on the fact that these municipal customers are not served directly by the Company, but through its subsidiary Missouri Utilities, and that the FERC tariff under which they are served does not give Missouri Utilities the right to interrupt their service. It is true that they are not interruptibles in the strict sense of the word, however, the demand charge billed by Missouri Utilities is based on the demand charge paid by Missouri Utilities to the Company. The municipals have their own generating capability which they use when notified that Company is approaching a peak, thereby reducing their own demand charges throughout the entire year. Whether or not the municipal customers are legally obligated to curtail service, the economic incentive in effect makes their service interruptible, and the Company's witness testified that they do in fact curtail service on request. In the Commission's opinion the Company's existing treatment of the Missouri Utility interruptible load is reasonable and should be continued.

The Company's subsidiaries have several peaking type generating facilities, the use of which is coordinated between the load dispatch offices of the Company and the subsidiaries. In calculating the 12 coincidental peak power pool allocations factor, the Company deducts the amount of this generating capability from both the system peak and from the system peaks of its wholesale customers. According to the Company, it is normally more economical on a total system basis to use the company's own generating facilities as opposed to those of the subsidiaries. The subsidiaries could reduce their own peak loads every month by running their generating facilities for several hours, thereby reducing their demand charges from the company. In order to eliminate the incentive for uneconomic generation by the subsidiaries, they are simply given credit for their generating capability. Staff objects to this credit and contends that the Company cannot use the subsidiaries' capacity and thus reduce the demand they place on the Company's system. The FERC has approved the Company's treatment of its subsidiaries' generation and in the Commission's opinion it should be also approved for the purpose of this case.

The Company treats its sales to the City of Columbia as interchage transactions. Such loads are not considered in arriving at an allocation factor by the Company. Interchange sales are accounted for by crediting the interchange revenue to production expenses, resulting in a reduction in the total cost of service. The Staff proposes to treat the sales to Columbia as firm sales, as opposed to a normal interchange transaction.

The contract under which Columbia is served by the Company is subject to the jurisdiction of the FERC, as are all other wholesale tariffs. A Company witness testified no capacity has been installed by the Company to serve the City of Columbia and the Commission does not believe that capacity costs should be allocated to customers for which no capacity has been installed. The Commission is of the opinion that the Company's treatment of sales to the City of Columbia is proper.

The Company's proposed allocation factors have been approved, in the past, by all four regulatory jurisdictions in which it operates, including the State of Missouri. Frequent changes in the allocation methods will lead to instability of rates as well as an inability of the Company to recover all of its cost of service. If the four Commissions regulating the Company employ the same allocation methods, the Company will earn a return on all of its rate base but when different methods are utilitized by different jurisdictions, there is a likelihood of over or under recovery.

While the Commission is willing to adjust Company's allocation factor in a proper case, it cannot do so based on the evidence herein; however, the Commission would encourage the parties to raise the issue in the future, especially if negotiations and proceedings in other jurisdictions have failed to produce a satisfactory result.

F. Cash Working Capital

Cash working capital is generally defined as the amount of cash required to pay the day-to-day expenses incurred by the Company to provide service to the ratepayers. In this case the Company claims a cash working capital allowance in the amount of $601,000 as a componant of its rate base. In the Staff's opinion the Company has a negative cash working capital requirement and $20,028,000 should be deducted from the Company's claimed rate base. Cash working capital can be supplied by either the ratepayers or the shareholders. Specific areas of disagreement include interest expense, depreciation, deferred income taxes and the Staff's proposed expense lag for sales and use taxes.

1. Bond Interest Expense

As a part of its rates the Company collects funds which are required to pay the interest on its outstanding bonded indebtedness. The amount collected from the ratepayers for the purpose of paying the interest expense is a fixed amount and these funds are merely held by the Company for a temporary period and then passed on to the bondholders. In the Staff's opinion the period of time during which the Company holds the interest is one during which the Company has use of the money without cost, which has been supplied by the ratepayer.

The Company concedes that a disallowance of bond interest as a component of the rate base has been approved in the past in cases involving other utilities. The Company contends that the Staff's position amounts to a little more than temporary confiscation of shareholder property and is in conflict with decisions of the Federal Energy Regulatory Commission that such funds belong to the utility and its shareholders so that a utility could not be expected to use them as cash working capital without remuneration.

The Commission recognizes the difference of opinion with the Federal Energy Regulatory Commission but is of the opinion that it is proper to continue its long standing practice of applying accrued interest on long-term debt as an offset to the cash working requirement. Such a generally accepted ratemaking principle should be overturned only on clear and persuasive evidence and that persuasion is not presented by the instant record.

2. Depreciation and Deferred Taxes

Depreciation and deferred taxes are similar in that the Staff proposes to deduct from cash working capital any amount of expense under the contention that they require no cash outlay by the Company although they are booked as expenses. The two items are also similar in that the Company, in its brief, refers to them as "so-called 'non-cash' items." The Company feels that the two items are similar to any other item of expense in that the utility does not enjoy the benefit of the payment until it is actually received. It is the Company's contention that there is simply no logical reason to ignore these items in calculating cash working capital.

In the Commission's opinion the logic of ignoring these items in a cash working capital allowance has been established in numerous rate cases. The function of cash working capital is not to be received by the utility but to be paid by the utility for expenses incurred in rendering service.

There is no contention by the Company, and there could be none, that there is any actual outlay of cash for either depreciation or deferred taxes.

When the definition of cash working capital is considered it can be seen that amounts booked for depreciation and deferred taxes do not qualify. Since no expenditure actually occurs on the booking of an expense, the Commission is of the opinion that it should follow its long-standing policy of disallowing depreciation and deferred taxes as a portion of cash working capital allowance.

3. Expense Lag For Sales and Use Taxes

The Staff proposes to increase the amount of the Company's negative cash working capital by some $230,121. A disagreement stems from two conflicting positions as to when a liability for sales and gross receipts tax attaches. Company expresses the opinion that the liability for sales tax as the time the bill is booked and mailed to the customer and uses a proposed expense lag of 45.63 days. The Staff proposes using an expense lag of 65.22 days based assumed liability at the time the service is actually provided or at the time the meter runs.

The Company justifies approval of its position pursuant to Re: Kansas City Power & Light Company, 38 PUR 4th (1980). Company points out that, in that case, a majority of the Commission agreed that sales tax became a liability on the date the bill is booked and mailed to the customer.

The Staff points out in its brief that it unsuccessfully attempted to persuade the Commission to accept the argument that the Company incurs no liability for sales and gross receipts tax until a bill is rendered in Missouri Power & Light Company ER-80-286.

The case cited by the Company was decided June 19, 1980. In Missouri

Power and Light, decided March 23, 1981, the Commission rejected the Staff's contention that the Company incurs no liability for sales and gross receipts tax until a bill is rendered, and accepted the Company's position that the liability occurs at the time service is actually provided or at the time the meter turns.

In the Commission's opinion the more recent decision expresses the correct view and we herein reaffirm our opinion to that effect and the Staff's proposed increase in the negative cash working capital allowance of $230,121 should be adopted.

G. Callaway-Bland Transmission Line and Substation

The Company proposes to include in its rate base the cost of the Callaway-Bland transmission line and substation at a cost of $12,947,000. The Company contends the transmission line will be placed in service between April 30, 1982 and the operation of law date in this case, July 14, 1982. It is the Staff's opinion that the line will not be "fully operational and used for service" and instead the Commission should authorize the Company to continue to accure AFUDC on the project until the Callaway plant goes into service.

The primary purpose of the transmission line is to provide an outlet for Callaway plant generation. The design and location of the line would not be the same if built solely for system reliability. Secondary purposes of the transmission line is to provide connections to power sources over more than one right-of-way and to provide power to the Callaway site during the initial test program. A conductor size was determined to load-flow study assuming full generator output at Callaway with specific transmission circuits between the Callaway site and the substations out-of-service for maintenance.

In the Commission's opinion, although they are secondary purposes for the transmission line not associated with Callaway, the transmission line and substation would not have been built but for the existance of the Callaway nuclear plant site.

The Company cites a similar instance in Re: Kansas City Power & Light Company, 84 PUR 3d 222 (1970) wherein a Commission outlet was allowed to go into rate base although the plant was not yet in service. Since the decision in that case, Section 393.135, RSMo 1978, has been enacted and states as follows:

> Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other costs associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service is unjust and unreasonable and is prohibited. (emphasis supplied)

In the Commission's opinion the Callaway-Bland transmission line and substation exists only because the Callaway generating station will exist and the inclusion of the facility in rate base is prohibited by the cited sections of the statutes. In the Commission's opinion the Staff's recommendation is proper and costs of the Callaway-Bland transmission line and substation should be not included in the Company's rate base and the Company should continue to accrue AFUDC on this item until such time as the Callaway nuclear facility is fully operational and used for service.

H. Summary

As a result of the foregoing adjustments, the Commission finds the net original cost, depreciated, rate base to be $1,331,399,000.

RATE OF RETURN

Cost of Money/Rate of Return

A. Capital Structure

For purposes of this proceeding Company and Staff have agreed to the method to be used to calculate the cost of debt and preferred stock. Pursuant to late-filed Exhibit 154 the Company and Staff agree that the appropriate capital structure, and the cost of debt and preferred stock, are as follows:

Component	Capital Ratio	Embedded Cost	Weighted Cost
Common Equity	35.46	--	--
Preferred Stock	14.87	9.29	1.38
Long-Term Debt	49.67	9.64	4.79

MoPIRG and Public Counsel contend that the increased cost of debt acquired during the 1970's is in part allocable to the construction of the Callaway nuclear facilities. As such, the increased cost of financing should be attributable to CWIP through the AFUDC formula and not reflected in the cost or proportion of debt in the weighted cost of capital used to determine the return on Company's rate base, and that such facts should be taken into consideration in determining Company's cost of capital appropriate for purposes of this case.

Neither MoPIRG nor Public Counsel presented any testimony on this issue. Company witness testified that the returns to investors in individual securities are not linked to the profitability of individual assets, and the holders of securities are compensated from the income of the entire Company. Company further contends that because a particular financial instrument issued to the public by the Company cannot be attributed to a particular investment project, the capital structure cannot be dissected to assign a different capitalization and cost to any asset owned by the Company.

In its initial brief the Office of the Public Counsel states that it is impossible in this case to quantify the amount attributable to Callaway I included in the Company's current cost of capital and suggests no method by which the Commission could account for this effect, other than recommending that the Commission should limit the Company's return on equity to the low end of the Staff's range in recognition of these increased costs.

Based on the competent and substantial evidence before it in this case, the Commission finds that the appropriate capital structure to be utilized in this case is that agreed to by Company and Staff.

B. Return on Common Equity

Staff and Company disagree as to the return on common equity reasonable and appropriate for purposes of this proceeding. Staff originally proposed a return on common equity within a range of 14.96 percent to 15.87 percent. Staff has amended its recommended range of return on common equity to 15.11 percent to 15.87 percent.

Company proposes a return on common equity of 17 percent. Public Counsel and MoPIRG support a return on common equity of 14.96 percent, which represents the low end of the Staff's original range in this case.

Company determined the current cost of common equity by means of discounted cash flow (DCF) analyses. Company first performed a DCF analysis for a group of companies whose risk is comparable to that of Union Electric. In order to find companies which are similar to Union Electric in terms of risk, Company witness utilized the Value Line Investment Survey as the source of his risk measures. As a result of this initial analysis, 67 companies were found to be of comparable risk to Company. The next step in Company's first analysis was to calculate those companies' average return through the DCF methodology. The formula used was R = D/P + G, where R equals the required return on equity, D equals dividends per share, P equals market price per share, and G equals growth rate in expected future dividends. This analysis produced an average DCF return for the comparable companies of 16.96 percent. Adjusting the raw DCF return for flotation costs, which Company witness testified have averaged four percent in the last four new issues of Company common stock, the average adjusted DCF return of the 67 comparable companies becomes 17.54 percent.

Company's second DCF analysis was essentially the same as the first, except that the calculation was based on Union Electric yield and growth rates, instead of using data for a set of comparable companies. Again, relying on Value Line Investment Survey estimates, Company witness utilized a dividend yield of 13.8 coupled with a growth rate of 2.8, resulting in a return of 16.6 percent. Adjusting this return for flotation costs, the return on equity becomes 17.18 percent.

Company witness also calculated the return on common equity for the non-utility companies in the group of 67 comparable firms. Based on this analysis, and eliminating the high and low extremes, the median return was at approximately 17 percent.

Staff utilized two methods to arrive at the cost of equity for Company, the discounted cash flow model and an econometric model.

It was discovered by the Company that the econometric model as applied by Staff in this case had significant data errors, in that 33 of the 78 companies in the model had load factor (LDFAC) variables incorrectly specified with a value of .001. The Staff confirms that the data errors were present in its econometric model rendering the results of the model inaccurate. In its initial brief filed in this matter, Staff acknowledges that for the purposes of this case, the results of the model are not accurate and, therefore, should be ignored.

In its DCF analysis, the Staff determined the dividend yield portion of the discounted cash flow model by examining historical dividend yields on Company stock from January, 1979 through December, 1981. Calculating the average yield during this period to be 12.62 percent, the Staff determined its reasonable range of dividend yields to be within one standard error of the mean, or .27. This resulted in a range of 12.35 percent - 12.62 percent - 12.89 percent. Staff then adjusted the dividend yield to account for flotation costs, which have averaged approximately 4.0 percent in Company's last five common stock sales. Dividing the dividend yield by one minus flotation costs results in a range of yields of 12.86 to 13.43 percent.

Staff calculated the trended growth rate in dividends per share for the period 1965-1981 to be 1.67 percent. The trended growth rate in dividends per share for the period 1975-1981 was calculated to be 2.76 percent. The trended growth rate in earnings per share for the Company during the period 1975-1981 was 1.69 percent. The Staff witness concluded that the growth which investors can reasonably expect lies within a range of between 2.25-2.75 percent. Staff based this conclusion on the 2.76 percent growth in dividends per share tempered by the lower earnings per share growth. Adding the reasonable range of yields to the reasonable growth rates results in a range of returns on equity of 15.11 to 16.18 percent. When weighting this analysis with Staff's analysis using the econometric model, a range of reasonable returns on equity resulted from 14.96 - 15.42 - 15.87 percent. The Staff still contends that this is a reasonable range, but in light of the fact there were data errors in its econometric model causing it to be useless for purposes of this case, Staff amended the low end of its recommendation to 15.11 percent. Therefore, the range recommended by Staff for purposes of this case is 15.11 - 15.42 - 15.87 percent.

Company contends that Staff's DCF analysis is unreasonable in at least two major respects, both of which deal primarily with the time period utilized by the Staff. As pointed out above, Staff used monthly data from the period 1979 through 1981 to calculate a dividend yield, while Company's dividend yield analysis is based upon investor evaluations for 1980 and 1981. Company contends that data from the first nine months of 1979 have no impact on what investors are expecting for the near future, and thus, such data should have been eliminated from the Staff's analysis. Company's contention is based on the rationale that in October, 1979, the Federal Reserve made a rather dramatic change in policy, the effects of which were significantly increased interest rates. Company contends that investors' expectations regarding utility dividends will be based on expectations regarding interest rates, which in turn will be based on events since October of 1979.

The second component of Staff's DCF analysis which Company contends is unreasonable concerns the expected growth rate utilized by Staff. It is company's position that Staff has gone too far in the past in attempting to determine investors' expectations for the future. Company contends that if historical data is to be used, a reasonable approach would be to use only the data for 1975 to 1981, which gives Staff witness his upper range of 2.75 percent. Company points out that the use of data from only 1975 on, is supported by Staff's witness in the Company's last rate case, and that the resultant 2.75 percent growth rate is slightly below the current Value Line projection of 2.8 percent.

Regarding Staff's revised range of return on common equity, Company contends that although Staff conceded that the results of its econometric model should be ignored in this proceeding, the Staff's revised range of 15.11 percent to 15.87 percent does not fully eliminate the effects of said model. Company points out that Staff witness derived a range from the model of 14.81 to 15.55, and a range from the DCF analysis of 15.11 to 16.18. Staff witness then averaged the two lows and averaged the two highs, producing the initial recommendation of 14.96 to 15.87. Company points out that if the model is in fact ignored as Staff now recommends, the appropriate Staff range is that derived solely from the DCF analysis, which produces a Staff range of 15.11 to 16.18.

In Response to the Company criticism regarding its use of the first nine months of 1979 in determining the dividend yield portion of the DCF formula, Staff maintains that using only the last two years of available data for calculating a dividend yield would not be reasonable. Staff contends that utilization of yields experienced in only 1980 and 1981 would result in basing a reasonable yield on Company's stock solely on a period of near chaotic market conditions, just at that point in time when the threshold may have been reached and Federal Reserve policy is having its intended effect of reducing interest rates. Or stated another way, Company would be looking at a period of time that is only examining those interest rates that reflected only the most negative aspects of the change in Federal Reserve policy without looking forward to any of the benefits that have yet to accrue. Staff further contends that the dividend yield on utility stocks is significantly correlated with the yield on public utility bonds, and that Company itself expects interest rates on first mortgage bonds to decline in 1982 and 1983.

In criticizing Company's approach on this issue, Staff contends that the Company witness did no real independent analysis, but relied wholly on the <u>Value Line Investment Survey</u> estimates which he mechanically plugged into the DCF formula. Staff contends the Company witness did not purport to have any specific knowledge as to the analysis engaged in by <u>Value Line</u>, and that there is no evidence in the record of the data inputs, assumptions or the exercise of judgment inherent in the <u>Value Line</u> estimates.

The Commission finds that the Staff range of dividend yields, as adjusted for flotation costs, of 12.86 to 13.43 percent is reasonable and should be utilized in this case. In this proceeding, the Company has not persuaded the Commission that the first nine months of 1979 should necessarily be excluded in determining the dividend yield portion of the DCF formula. Nor has the Company persuaded the Commission as to the accuracy of its dividend yields as used in its DCF analyses. While financial data and evaluation made by Value Line or other investment advisory services can provide assistance as a support tool, the Commission prefers an independent analysis and supporting evidence such as that produced by the Staff methodology employed herein.

In determining the appropriate growth rate to be utilized, the Commission finds that the utilization of data for the years 1975 to 1981 is a reasonable approach and that a growth rate of 2.76 percent is appropriate in this proceeding.

Having considered the totality of competent and substantial evidence before it in this case, the Commission finds that the appropriate and necessary return on common equity to be allowed Company is 15.62 percent. Applying this figure to the capital structure found appropriate herein results in an overall rate of return of 11.71 percent.

C. Rate of Return Adjustment

While the Commission may raise or lower a company's rate of return to account for management efficiency, or lack thereof (See authorities cited in Case Nos. ER-82-39 and WR-82-50, Missouri Public Service Commission, decided June 21, 1982, pp. 58-62), there is not sufficient evidence in this case upon which to base such an adjustment. However, the parties should be aware of the possibility of such an adjustment in the future and should, in future cases, present testimony, when appropriate, upon which the Commission could base such an upward or downward adjustment.

REVENUE REQUIREMENT

The rate of return found herein to be reasonable and proper results in a total net operating income requirement for Missouri operations in the amount of $155,907,000 or $33,729,000 greater than the net operating income for the test year as adjusted. After applying the proper allowance for income tax, the gross revenue deficiency is found to be $65,205,000.

FAIR VALUE RATE BASE

For the purpose of establishing a fair value rate base the Company's witness portrays the total current value electric rate base applicable to Missouri operations to be $4,818,446,000. For power production facilities the Company used a "modern substitute plant method." For most other property, current costs was arrived at by the trending process.

The Staff witness presented fair value testimony and calculated a trended original cost less depreciation of electric plant for Missouri operations in the amount of $3,063,028,651. Neither of the witnesses were cross-examined.

Company proposes to attribute appropriate weight to both original cost and current value. Based on the Company's capitalization ratios of 63.5 percent fixed dollar capital, and 36.5 percent common equity, the Company proposes a weighting of 63.5 percent original cost and 36.5 percent current value.

In the Commission's opinion the proper fair value rate base for the purpose of this case is in the amount of $1,935,939,000.

Applying the net operating income requirement which has been found reasonable in this case to fair value rate base produces a rate of return of 8.05% which, in the Commission's opinion is fair and reasonable return.

RATE DESIGN

The Company proposes to allocate the allowed increase among and within rate classes by first splitting the increase in to variable and fixed components. The variable portion of the increase would then be applied to each rate class in proportion to the kwh used by each class. The fixed portion of the increase would be allocated in proportion of the fixed costs being recovered from each class under existing rates.

Staff supports the Company's proposal, except that Staff proposes to limit the increase for incandescent street lighting to the overall percent increase allowed in this case.

The industrial intervenors support the Company's proposal.

PC supports the Company's proposed allocation of variable costs, but proposes that only 39.4 percent of the fixed component should to be allocated to the residential class, with the remaining portion of fixed costs allocated among the other classes in proportion to their respective revenue.

Laclede Gas proposes that in the Company's allocation, the costs of new plant designed to permit substitution of lower cost fuels should be treated as variable costs and also proposes to distribute the increase among blocks of the residential rate on a uniform cents per kwh basis.

The School District proposes: (1) to eliminate or reduce the minimum billing demand in rate 3(M); (2) to not increase the rate limiter in rate 3(M); (3) to bill all winter use at a flat, lower winter rate, without regard to demands in the summer billing season; (4) to redefine the process of changing from one rate class to another; and (5) to determine whether the School District is providing a fair rate of return.

St. Charles objects to the Company's street light tariffs and tariffs relating to traffic signals. St. Charles also proposes to major consumers of electricity employed for the maintenance of public health and safety be billed at the winter demand charged throughout the year, and further that all such connections be consolidated for billing.

According to the Company, the basic objective of its proposal is to maintain the existing rate design and class revenue relationship. The variable component of the rate is directly related to kwh consumption. The fixed component of existing rates is generally not altered directly by production or kwh consumption.

In the Commission's opinion PC has demonstrated that as revenue and megawatt hour bills change between classes, the respective classes so-called fixed costs responsibility also changes. A larger increase or decrease to any particular class results in a larger change in the percentage of the proposed fixed cost revenues increased to be allocated to that customer class.

Public Counsel submits that the best method of allocating the fixed cost component is contained in the Commission's Order in Case No. EO-78-163 which is the Union Electric rate design case completed in 1980. The order in that case is based upon cost of service studies submitted by several parties to the proceeding. The order in that case, approving a stipulation of all the parties, allocated 39.4 percent of the fixed cost increase to the 1-M customer class, with the balance being allocated to the other three customer classes in proportion to the revenues of each class. In the Commission's opinion it is proper to continue to allocate 39.4 percent of the fixed cost increases to the 1-M customer class.

The parties, other than Laclede Gas, are generally in agreement that the Company's variable costs should be applied to each rate class in porportion to the kwh used by such class. The Commission is of the opinion that that aspect of rate design is proper for this case and should be applied.

The Commission Staff objects to the Company's proposed measure of the variable component of the street lighting schedule. With respect to the incandescent lighting schedule, those customers who remain on the Union Electric schedule are no longer receiving maintenance by the Company for their facilities. Replacements will not be affected by the Company in the absence of reimbursement for out-of-pocket expenses, including all applicable construction overhead. In spite of the fact that the Company is not performing any unreimbursed maintenance on these facilities, the Company is asking for a substantial increase. In the Commission's opinion the Staff's recommendation that the Company's schedule for incandescent lighting be increased only by the overall percentage increase allowed the Company is reasonable and should be implemented as a part of the rate design in the Company's new tariffs.

Laclede Gas suggests that certain investment costs that directly substitute for higher costs of fuel should be allocated for rate-making purposes in the same manner as variable costs. The specific example cited by Laclede are pollution control and coal blending facilities. The primary difficulty with allocating such facilities as though they are variable costs is the fact that they are in reality fixed. Once such facilities are in place, the cost remains the same, no matter what the kwh output of the Company.

If Laclede's recommendations are followed, customers with tailblock usage would be assessed greater costs which will result in higher rates. Laclede's position is admittedly based on an attempt to combat what it considers Union Electric's unfair competitive practices in seeking customers for space heating. In the Commission's opinion the effects of competition should not be a primary rate-making consideration and the proposal of Laclede Gas should be rejected.

The City of St. Charles implies that an existing street lighting contract precludes any change in rates in the terms of the contract. The contract provides, however, that rates are subject to change by the Missouri Public Service Commission. The City of St. Charles also appears to be of the opinion that traffic signal use is being billed improperly, however, the evidence establishes that the City is being billed under the correct rate. As pointed out by the Company's testimony, the City has the option of segregating its use at certain locations between lighting and traffic signals but the City has elected to take a single metered service.

The City of St. Charles and the School District also raise a number of other issues, primarily attempting to negate the impact of rate reforms approved by the Commission in the rate design case, EO-78-163.

The Commission is sympathetic to the financial problems facing governmental entities, but the very purpose of a rate design proceeding is to increase or decrease various rates in order to minimize any existing cross subsidization among customer classes.

The School District implies that the recent rate changes have caused it to experience an increase in its cost of electric service of 33-1/3 percent. It appears there was no precise comparison of the bills for the two periods and that not all of the increase resulted from rate design. The increase also includes the effect of a rate case which was also affected by changes in use pattern or weather between the two patterns. In attempting to arrive at an equitable rate distribution, based on costs, the solution is not to create exceptions. That method merely shifts the inequity to be borne by another unknown customer class.

Although the Commission is satisfied that the instant rate design is fair and reasonable it is recognized that a more current cost of service proceeding may be justified. A number of parties have attacked the present rate design. The testimony establishes that the cost of service changes with time. Another justification may be the pending placement in service of a new generating facility.

Several parties suggested that the Company should perform a new class cost of service study. The Commission agrees with the suggestion and will order Company to present such a study as a portion of its case in chief in its next general rate case.

MISCELLANEOUS ISSUES

A. Late Payment Charge

The Company has proposed a late payment charge, consisting of 1.5 percent applied to any balance outstanding when the next bill is rendered. The Staff supports the Company's proposed late payment charge, which is opposed by the City of St. Charles, the Public Counsel and MoPIRG.

The Staff supports the Company's proposal because the cost of funds to carry the monthly arrearages adds to the overall cost of doing business and this can be reduced to some degree by a late payment charge. In the Staff's opinion the high cost of short term debt makes it important to encourage timely payments so the overall cost of providing service can be minimized. Late payment charges range from one percent to five percent for those companies that currently have such charges.

Both the Company and the Staff cite numerous cases in their briefs for the proposition that a utility's late payment charge constitutes a device to recover costs incurred by the utility because of late payments.

In the Commission's opinion it should continue to follow the general accepted practice of authorizing late payment charges to recover the costs caused by late payers without discriminating against timely payers.

The proposed charge of 1.5 percent closely approximates the Company's embedded costs of money, and is below the current cost of funding arrearages and should be approved.

B. Study on assistance to subsidiaries

The Staff has recommended that the Company be directed to perform a study quantifying labor hours and wages used in providing service mutually beneficial to the consolidated corporate entity. Staff is of the opinion that the study would be a useful rate-making tool in determining actual costs for Union Electric as well as its subsidiaries.

In the Commission's opinion the Staff's recommendation has merit and will permit a more accurate placement of some costs incurred by the parent which may directly benefit its corporate subsidiaries. At present these costs are not identifiable or assignable. Such a study could be useful for rate-making purposes not only in cases involving Union Electric but also in cases involving its subsidiaries.

Company is of the opinion that the cost of such a study will outweigh its benefit. The Staff has not requested an unnecessarily elaborate system and has expressed a willingness to work with the Company in devising a useful but not unnecessarily burdensome form of study or method of recording the cost and allocation of benefits of services that may accure entirely, or in part, to one or more of the Company's subsidiaries. The Company and the Staff are hereby directed to collaborate in devising a proposed form of study, and anticipated costs, and shall submit the proposal, within 90 days of the effective date of this Report and Order, for Commission approval.

C. Calculation of Allowance For Funds Used During Construction (AFUDC)

Whenever construction work in progress is excluded from rate base, the utility incurs a cost in carrying the construction project from the time construction funds are borrowed until the plant is placed in service and starts to earn a return from the ratepayer. The cost is reflected by capitalizing AFUDC. Conceptually, there is little difference between capitalization of the cost of borrowed funds, and capitalization of other costs of construction such as labor and materials.

AFUDC is calculated according to a formula established by FERC, adopted as part of the Uniform System of Accounts. (18 CFR part 101, Electric Plant Constructions, par. 3 (17). This formula specifies, among other things, the method for determining the cost of the various sources of funds used for construction. The formula requires the cost rate for common equity to be the rate granted common equity in the last rate proceeding for the rate-making body having primary rate jurisdiction. All parties agreed that this Commission is the rate-making body having primary rate jurisdiction for Union Electric.

The Staff is requesting that the Commission order the Company to recalculate AFUDC on all construction work for which the rate applied had an equity component greater than 13.1 percent.

The last rate of return on the Company's common equity that was authorized by this Commission was in Case No. ER-77-154, by order dated January 19, 1978, and was established at 13.1 percent.

The Company, without Commission authorization, recomputed the rate of return on common equity for purposes of the AFUDC formula to 13.5 percent at January 1, 1981, and again to 14.6 percent at August 1, 1981. Although the Company did not seek this Commission's approval on either occasion it did receive the approval of FERC for the second change.

The Company calculated the changes as a result of stipulated settlements in Cases No. ER-80-17 and ER-81-180.

The stipulation in Case No. ER-80-17 recited that it was "intentionally silent respecting an agreed rate of return."

The stipulation in Case No. ER-81-180 recited that it was a "negotiated dollar settlement for the sole purpose of disposing of Case No. ER-81-180" and "that none of the parties to this stipulation and agreement shall be deemed to have approved or acquiesced in any ratemaking principal or any method of cost of service determination, or cost allocation underlying any of the rates and tariffs provided for in this stipulation and agreement."

It can be seen, therefore, neither of the recent settled cases provided a rate of return, but were based solely on a stated dollar settlement. The Company justifies the recalculation of its AFUDC rate by using rates of return that were within the range recommended by the Staff in its prefiled testimony in the two settled cases.

None of the parties, including even the Staff witnesses, have suggested that 13.1 percent is actually a reasonable cost of common equity during 1981. Although continued use of a common equity rate of 13.1 percent may be deemed inadequate, the Company simply did not proceed properly in making any change. As the Staff points out, even in a settled case, Company may specifically bargain for and receive from all parties a proposed rate of return on common equity which can be especially set out as part of a stipulation and agreement.

In the Commission's opinion the Company's contention that the Commission, in approving stipulations and agreements, can be assumed to have made a finding that the Staff's recommended rate of return on equity is reasonable is improper. The Commission is also of the opinion, however, that it would unfairly penalize the Company to force them to continue to use an unrealistic rate of return on equity in calculation of its AFUDC. Staff's recommended recalculation will not be ordered but the Company is directed in making or proposing future changes to its AFUDC rate to inform the Staff of the Commission so that it may consider the propriety of such changes, before the fact. In the event the Staff feels that such changes are not proper it may recommend some remedial action on the part of the Commission. Company also has available to it the method recommended by the Staff for preventing the use of an outdated rate of return on common equity through several successive settled rate cases.

D. Wage Policy

The Commission is concerned by testimony of a Staff witness to the effect that the Staff has not in the past audited the reasonableness of Company's labor costs:

> "Q. In the past, has it been the commissin [sic] Staff practice to more or less accept the labor costs as they are incurred by the company?
> A. The Staff does try to do some type of analysis as to where the costs are distributed and whether those costs are includable as part of the cost of service of providing electric. The overall labor costs as contractually obligated by the company, the Staff has not done any type of analysis to determine whether that is reasonable or not." (emphasis added)

Staff Br., p. 98.

A situation where the appropriate level or reasonableness of Company's labor costs, whether contract or salary, or any other major costs of the Company has not been analyzed by the Staff, Office of the Public Counsel, or any other party cannot continue. The Commission itself obviously cannot do such an audit, yet it is the responsibility of the Commission to determine whether the Company's labor costs, as well as other costs, are fair and reasonable. In order to reach this conclusion, the Commission must rely upon the input provided by the parties.

None of this is to say that even one dollar of the Company's labor costs in this case is not fair and reasonable. By inclusion of labor costs in its testimony concerning its need for rate increase, the Company has provided the Commission with the only evidence on labor costs. No other party introduced any contrary evidence. Thus, under the evidence in this case, the Commission has no choice but to conclude that the Company's labor costs are reasonable.

In future general rate cases, the Commission will expect a company to address the issue of the reasonableness of its level of labor costs, and other major costs of its operations, and that other parties including the Staff, shall examine such issue accordingly.

Conclusions of Law

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

The Company is a public utility subject to the jurisdiction of this Commission purusant to Chapters 386 and 393, RSMo 1978. The Company's tariffs which are the subject matter of this proceeding were suspended pursuant to the authority vested in this Commission by Section 393.150, RSMo 1978.

The burden of proof to show that the proposed increased rates are just and reasonable is upon the Company.

Orders of this Commission must be based upon competent and substantial evidence upon the whole record.

The Commission after notice and hearing, may order a change in the rate, charge, or rental, in any regulation or practice affecting the rate, charge or rental, and it may determine and prescribe the lawful rate, charge or rental and the lawful regulation or practice affecting said rate, charge or rental thereafter to be observed.

The Commission may consider all facts, which in its judgment, have any bearing upon a proper determination of the price to be charged with due regard, among other things, to a reasonable average return upon the capital actually expended, and to the necessity of making reservations out of income for surplus and contingencies.

Any evidence received without objection which has probative value shall be considered along with other evidence in the case. Evidence which is not of such quantity to be persuasive of the fact to be established may be rejected even if not objected to or controverted.

When the Company's existing rates and charges are insufficient to yield reasonable compensation for electric service rendered by it in this State, and accordingly, revisions in the Company's applicable tariff charges, as herein authorized, are proper and appropriate and will yield the Company a fair return on the net original cost rate base or the fair value rate base found proper herein now rates resulting from the authorized revisions that will be fair, just, reasonable and sufficient and not unduly discriminatory or unduly preferential should be authorized.

Although there is no requirement that a test year, or any other specific procedure, be used, a test year is commonly utilized in an attempt to measure a period of normal operations, to which reasonable adjustments may be made to permit the establishment of a reasonable estimate of conditions during the period of time in which the new rates will be in effect.

Under ordinary circumstances, adjustments to a test year are confined to those permitting a matching of revenues and expenses. When known increases in expenses will occur, the inequity in disallowances for a lack of precise measurement may outweigh the potential for unfairness in the allowance of the expense for which the precise corresponding revenues cannot be established.

No individual allowance is improper if it has not contributed to an ultimate rate level that is in excess of that which is fair and reasonable.

Any motion not previously ruled on should be considered denied, and any objection not previously ruled on should be considered overruled.

It is, therefore,

ORDERED: 1. That the proposed revised electric tariffs filed by Union Electric Company of St. Louis, Missouri, and herein suspended, are hereby disapproved and Company is authorized to file in lieu thereof, for approval of this Commission, tariffs designed to increase revenues by approximately $65,205,000.

ORDERED: 2. To the extent that the revised tariffs herein authorized allow the recovery of forecasted increases in the cost of fuel, the increased rates shall be subject to refund in the manner provided for in paragraph IV.A of Exhibit 5, received in evidence in this matter.

ORDERED: 3. That the tariffs to be filed herein shall embody the rate design herein found to be reasonable and proper, and may be charged for service rendered on and after the effective date of this Report and Order.

ORDERED: 4. The Company and Staff shall agree on a proposed form of study, including estimated costs, of the labor hours and wages used in providing service to the Company's subsidiaries and the value of those services. The proposal shall be presented to the Commission within ninety (90) days from the effective date of this Report and Order.

ORDERED: 5. Docket No. EO-83-2 is hereby established for the purpose of investigating Union Electric Company's residential insulation program.

ORDERED: 6. In its next general rate proceeding the Company shall file, as a portion of its case in chief, a new class cost of service study.

ORDERED: 7. That this Report and Order shall become effective on the 14th day of July, 1982.

BY THE COMMISSION

Harvey G. Hubbs

Harvey G. Hubbs
Secretary

(S E A L)

Fraas, Chm., McCartney, Dority,
Shapleigh and Musgrave, CC., Concur.
and certify compliance with the
provisions of Section 536.080,
RSMo 1978.

Dated at Jefferson City, Missouri,
this 2nd day of July, 1982.