

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of Missouri Public Service, a)
division of UtiliCorp United, Inc.'s)
proposed tariffs to increase rates for) CASE NO. ER-93-37
electric service provided to customers in)
the Missouri service area of the Company.)

APPEARANCES: James C. Swearengen, Attorney at Law, Brydon, Swearengen
& England, P.C., P. O. Box 456, 312 East Capitol Avenue,
Jefferson City, Missouri 65102, for Missouri Public
Service.

Richard S. Brownlee, III, Attorney at Law, Hendren and Andrae,
235 East High Street, Jefferson City, Missouri 65102,
for Sedalia Industrial Energy Association.

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

Mary Ann Young, General Counsel, P. O. Box 360, Jefferson City,
Missouri 65102, for the Staff of the Missouri Public Service
Commission.

Hearing

Examiner: Mark A. Grothoff

REPORT AND ORDER

On July 31, 1992, Missouri Public Service, a division of UtiliCorp United, Inc. (MoPub) filed tariff sheets reflecting increased rates for electric service. On August 28, 1992, the Commission issued a Suspension Order and Notice of Proceedings establishing a procedural schedule.

On November 20, 1992, the Commission granted intervention to Sedalia Industrial Energy Association (Association). On November 24, 1992, the Commission established the year ending September 30, 1992, as updated through April 30, 1993, as the proper test year to be used in this case. Prepared testimony was filed by the parties pursuant to the established procedural schedule. On February 1, 1993, a prehearing conference was convened as scheduled

and a hearing memorandum and a reconciliation of the issues were subsequently filed.

On March 8, 1993, a hearing was convened as scheduled. The Commission granted the Association's request to be excused from the hearing. On March 19, 1993, a Nonunanimous Stipulation and Agreement (Stipulation) was filed by MoPub, the Association, and the Staff of the Commission (Staff). The Office of the Public Counsel (Public Counsel) did not join in the Stipulation. Briefs were subsequently filed by the parties.

On April 22, 1993, the parties filed a joint motion requesting that MoPub be authorized to implement the class cost-of-service and rate design changes which were not disputed by any party. On May 5, 1993, a hearing was held on the merits of the joint motion and on May 12, 1993, the Commission granted the parties' joint motion. On May 28, 1993, the Commission approved tariff sheets filed by MoPub implementing the undisputed class cost-of-service and rate design changes on an interim basis pending the final order in this case. On June 3, 1993, a true-up hearing was held in which the Stipulation and the parties' true-up report were received into the record.

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:

On July 31, 1992, MoPub filed revised electric rate schedules designed to increase its annual electric revenue by approximately \$19.4 million or 8.4 percent. The reconciliation filed by the parties on March 5, 1993 (Exhibit 2) shows that MoPub was seeking an increase of approximately \$16.5 million while Staff supported an increase in the amount of \$1.7 million and Public Counsel supported a \$1.4 million increase.

On March 19, 1993, MoPub, Staff and the Association filed a Stipulation (Exhibit 88) in this case. The Stipulation is nonunanimous as Public Counsel is not a signatory. As a result of the Stipulation, MoPub would be allowed to file tariff sheets increasing its electric revenues by \$8 million. On June 3, 1993, the stipulated \$8 million amount was adjusted based on the true-up of customer levels, fuel expense and plant in service. Based on the true-up audit, the stipulating parties requested that MoPub be authorized to file tariffs reflecting an increase of \$4,865,804.

On May 28, 1993, the Commission approved tariff sheets filed by MoPub implementing the class cost-of-service and rate design changes which were not disputed by any party on an interim basis pending the final order in this case. The adjusted increase of \$4,865,804 is based on this rate design.

The ultimate issue to be determined in this case is the establishment of just and reasonable rates to be charged to MoPub's Missouri electric customers. Nonetheless, the Commission cannot simply find the Stipulation to be just and reasonable and summarily adopt it. As the Stipulation is nonunanimous, the Commission must consider and rule upon the specific issues contested by Public Counsel. After making such findings, the Commission may then determine whether the Stipulation results in just and reasonable rates.

Each issue disputed by Public Counsel shall be discussed in turn.

Sibley Deferral (Accounting Authority Orders)

The Stipulation contemplates the inclusion of the Accounting Authority Order (AAO) deferral of expenses associated with MoPub's Sibley Generating Station (Sibley) authorized in Case Nos. EO-90-114 and EO-91-358 to be reflected in rate base and amortized over a 20-year period. Public Counsel believes that all rate base treatment and amortization relating to the Sibley AAOs should be excluded from the cost of service. Public Counsel argues that allowing the expenses deferred pursuant to the AAOs in MoPub's current cost of service would

violate the ratemaking principle of matching. The matching principle requires that expenses from one period must be matched with revenues from that period in order to determine appropriate rates.

Public Counsel contends that MoPub was earning in excess of its authorized rate of return during the period of the deferrals. Public Counsel argues that the AAO deferrals have already been recovered because MoPub's earnings during the deferral periods were high enough to cover the costs of the Sibley projects and still allow an adequate return.

MoPub contends that, rather than violating the matching principle, recognition of the Sibley deferrals enhances the matching of costs and revenues for ratemaking purposes. MoPub argues that the Sibley projects are intended to extend Sibley's useful life by 20 years which matches the 20-year amortization of the deferrals contemplated by the Stipulation. MoPub maintains that Public Counsel's approach would amount to a write-off of over \$3 million of depreciation expense without any matching revenues.

MoPub also argues that Public Counsel's over-earnings argument is based largely on the third quarter of 1991 which was an unusually hot period and which occurred prior to the commencement of the deferrals in question. Moreover, MoPub contends that an analysis of prior earnings is only appropriate if revenues are adjusted to account for the unusual effects of weather in the same manner as is done in order to determine revenue requirement at the outset. MoPub states that when such an adjustment is made its returns are shown to have been below those authorized during the deferral period. In addition, MoPub points out that although Public Counsel uses the over-recovery argument, it also concedes that some level of additional revenues is warranted.

Staff's testimony indicates that MoPub's return on average investment and return on equity increased significantly in 1991 and then declined sharply in 1992. Staff argues in its testimony that the quantification of excess

earnings can be a very difficult and contentious process. Staff states that it has not performed the detailed analysis necessary to present a position on possible excess earnings which MoPub might have experienced in the past. Staff contends that an evaluation of the recovery of AAO deferrals should turn on the overall adequacy of MoPub's earnings.

The Commission determines that the Sibley project costs deferred pursuant to the AAOs should be reflected in the cost of service. The Commission determines that there is substantial evidence of the significant impact of the Sibley projects on MoPub's financial status. The \$55,978,891 in outlays associated with the Sibley projects represent nearly all of MoPub's capital expenditures since May, 1990. The amount deferred from January 1, 1992 through June, 1993 is \$3,069,797, of which \$1,625,495 was deferred from January, 1993 through June, 1993. The net income impact of the 1993 deferral represents approximately 10 percent of MoPub's estimated 1993 net income for this time period. MoPub would experience a significant reduction in its estimated 1993 earnings if the Sibley deferrals were not reflected in rates. MoPub estimates that a write-off of the Sibley deferrals would reduce its return on equity by more than one percentage point.

The Commission also determines that including the Sibley deferrals in cost of service does not violate test year principles but rather matches costs and revenues for ratemaking purposes. The 20-year amortization of the Sibley deferrals will match the costs of the Sibley projects with the revenue produced during Sibley's 20 additional years of useful life. In addition, the Commission finds that this approach matches the payments of the costs by the ratepayers with their enjoyment of the benefits of the Sibley projects. Furthermore, the Commission finds unpersuasive Public Counsel's contention that the Sibley project costs have already been recovered in rates. Public Counsel's argument of over-earnings by MoPub are based primarily on the results of MoPub's 1991 third

quarter which was prior to the commencement of the deferrals at issue. Moreover, when adjusted for the unusually hot weather during that period, MoPub's 1991 third quarter revenues were below those authorized by the Commission. The Commission is of the opinion that weather normalization, while not necessarily dispositive, is a proper consideration for the Commission when examining prior earnings in this context. Regardless, given that Public Counsel acknowledges that MoPub is entitled to some level of revenue increase, the relevance of the issue of past over-recovery in this context is nebulous at best.

Other Post Employment Benefits/FAS 106

Financial Accounting Standard (FAS) 106 is an accounting standard issued by the Financial Accounting Standards Board (FASB) in 1990 which requires that employers account for "other post employment benefits" (OPEBs), also called "other post retirement benefits" (OPRBs) and "post retirement benefits other than pensions" (PBOPs), by an accrual accounting method rather than a "cash" or "pay-as-you-go" accounting method. OPEBs are benefits, other than pensions, such as health care, dental care and life insurance. FAS 106 mandates that companies use an accrual method of accounting for financial reporting of OPEBs after December 15, 1992. Currently, utility companies under the Commission's jurisdiction, including MoPub, have accounted for OPEBs as they are paid on a cash basis. Accrual accounting under FAS 106 requires the employer, MoPub, to accrue the cost of these benefits in the same period the employees are earning the benefits. Thus, FAS 106 requires companies to record OPEB expense, for financial reporting purposes, in the amount of the benefit obligation that it estimates its employees have earned during the period, plus an amortization of OPEB costs of prior periods which have not been previously recorded as expense.

FASB has no direct authority over the ratemaking authority of the Commission. FASB's standards apply to Missouri companies through the Federal Securities and Exchange Commission. Prior to FAS 106, OPEBs have been

recognized, both for financial reporting and ratemaking purposes, on a pay-as-you-go basis. Under the pay-as-you-go method, OPEBs expenses are booked at the time the utility pays cash benefits to its employees. The result of moving from a cash basis to an accrual basis will increase the amount of OPEB expense recorded on MoPub's financial statement. To change from pay-as-you-go to accrual accounting, utilities will incur a transition obligation. The transition obligation represents the OPEB benefits related to employee service already rendered at the time of the change in accounting methods. The transition obligation may be amortized over the average remaining active service period of employees prior to eligibility for retirement or, if longer, 20 years. FAS 106 involves a mismatch of service costs and benefits by permitting companies to amortize over a future period the portion of estimated future OPEB obligations which the accrual accounting method attributes to past service..

MoPub recommends that the Commission adopt the accrual accounting method for determining OPEBs for ratemaking purposes. MoPub asserts that the accrual method will provide a more objective tool for measuring OPEBs expense for rate allowance, will make comparisons between regulated and nonregulated companies more meaningful and will result in intergenerational equity between customer classes. Additionally, MoPub contends it will not be able to create a regulatory asset unless it conforms with the guidance provided by the Emerging Issues Task Force (EITF) consensus.

Public Counsel recommends that the Commission require a continuation of the pay-as-you-go or cash accounting method for ratemaking purposes. Public Counsel's main opposition to converting from a pay-as-you-go to an accrual accounting method centers on the fact that, unlike pensions, nuclear decommissioning and depreciation, OPEBs are not long-term legal obligations of a company because these benefits, and any obligation to fund them, can be altered or eliminated at will by the company. Public Counsel, therefore, reasons that

there cannot be any legally imposed requirement to provide current funding for future payments. Furthermore, Public Counsel objects to the adoption of the accrual method because of the difficulty in estimating OPEBs benefit obligations decades in the future and the fact that FAS 106 is more sensitive to changes in actuarial assumptions than pension costs determined under FAS 87. In addition, Public Counsel contends that the expense level of OPEBs under FAS 106 is not known and measurable as it is based on uncertain, speculative assumptions and estimates of events happening years in the future.

The position taken by Staff in its testimony on this issue is essentially the same as that of Public Counsel. Staff's briefs did not address this issue and the Stipulation is silent as to this issue as well.

The Commission has addressed the issue of OPEBs in three previous cases through accounting authority orders: Case No. EO-92-179, Union Electric Company (UE); Case No. EO-93-35, Empire District Electric Company (Empire); and Case No. GO-93-201, Western Resources d/b/a Gas Service (Gas Service). Essentially, the Commission treated UE and Empire the same wherein the Commission allowed these companies to defer OPEB costs in excess of the pay-as-you-go amount in Account 186. The Commission made a general statement of intent to allow prudently incurred OPEB costs in rates in the future and reserved rate treatment for OPEB costs for future rate cases, including determination of any amortization of a recovery period.

Gas Service received different treatment due to its request to utilize external funding to address FAS 106. In Gas Service's case, the Commission approved special accounting treatment for both OPEB's and Gas Service's company-owned life insurance net income (COLI). Gas Service was granted the ability to book COLI interest start-up costs and COLI expenses in excess of income in the early years of the program (when a deficit occurs) to account 186, Miscellaneous Deferred Debit. In regard to OPEB, Gas Service was granted authority to book

the difference between the accrual expense as calculated under FAS 106 and the pay-as-you-go amount as a regulatory asset, also under Account 186. The COLI start-up costs and expenses in excess of income and OPEB expense, all booked to Account 186, are then to be amortized to expense in direct relation to the net income stream from the COLI program, which will be booked above the line to Account 926, Employee Pensions and Benefits. In granting this treatment to Gas Service, the Commission emphasized that its order accepting Gas Service's application is dependent upon the specific facts and circumstances underlying Gas Service's proposal. The Commission stated in Case No. GO-93-201 that its order in that proceeding should not be construed as an endorsement of the use of FAS 106 accrual methodology for OPEBs for ratemaking purposes or an endorsement of the issuance of accounting authority orders for OPEBs conforming to the Emerging Issue Task Force pronouncement for utilities in Missouri, absent the specifics of Gas Service's proposal in that proceeding. Furthermore, in that proceeding, the Commission found Gas Service's plan and Staff's recommendation a reasonable and acceptable approach in dealing with the implementation of FAS 106 and the accompanying Emerging Issue Task Force pronouncement. The Commission also found that expenses related to the adoption of FAS 106 are extraordinary or unusual items which qualify for deferral and later amortization. The Commission further determined that Gas Service's proposal to use its COLI program as an offset to the sharp increase in OPEB expense as a result of FAS 106, to be a reasonable and prudent mechanism for the avoidance of substantial detrimental impact for both the ratepayer and shareholder alike.

The Commission finds Public Counsel's position on this issue to be more persuasive than MoPub's position at this time. Since MoPub has not adopted an external funding procedure for OPEBs, the Commission determines that, in this proceeding, the cash basis is the appropriate method with which to determine OPEBs expense for ratemaking purposes.

The Commission will grant MoPub an accounting authority order similar to those granted to UE and Empire. Specifically, the Commission will authorize MoPub to continue to use the pay-as-you-go methodology for calculating the amounts charged to post retirement benefit expenses other than pensions on its financial statements based on actual payment to retirees. The differential between the expense amount calculated under FAS 106 and the pay-as-you-go amount shall be booked to Uniform System of Accounts No. 186, Miscellaneous Deferred Debt, as a regulatory asset. Furthermore, the Commission intends to allow prudently incurred OPEB costs to be recovered in the future on a pay-as-you-go basis. OPEBs are legitimate and historically approved costs of providing service and, absent evidence that they are excessive or imprudently incurred, they will continue to be recovered by MoPub on a pay-as-you-go basis. Moreover, the Commission believes that it is probable that OPEBs, capitalized as a regulatory asset, as a result of adopting FAS 106, will likewise be recovered in rates.

In the alternative, the Commission would be willing to grant MoPub an accounting authority order to initially defer in Account 186 the costs associated with an externally funded program, and allow MoPub to amortize the deferred externally funded program costs, deferred OPEB costs and the current year OPEB expense under FAS 106 that exceed current year OPEB payments. This amortization would be limited to an amount which offsets the cumulative OPEB, externally funded program deferral, and current year OPEB expense under FAS 106 that exceeds current year OPEB payments. Additionally, the Commission would be willing to adopt the following position with regard to the accounting treatment approved for FAS 106 under this method:

1. That OPEBs are legitimate and are historically approved costs of providing service, and, absent evidence that they are excessive or imprudently incurred, they will continue to be recovered by MoPub. Further, MoPub is initially authorized to accumulate and defer in Account 186 those OPEB expenses related to the adoption of FAS 106 which will exceed OPEB payments. The Commission

intends to authorize the prudently incurred capitalized OPEB expenses to be recovered in rates to the extent they are not offset by the net income generated as a result of MoPub's externally funded program.

2. That the Commission intends to allow recovery of prudently incurred deferred externally funded costs to the extent they are not offset by an income stream generated as a result of MoPub's externally funded program.
3. That the findings with respect to the appropriate accounting and ratemaking treatment of OPEBs and externally funded income and expense are subject to change by subsequent order of the Commission.

Reclassification Of Distribution Plant

In Case No. ER-90-101, the Commission adopted standards for the classification of facilities as transmission or distribution. Said standards are: (1) the load is totally isolated from the utility's integrated transmission system; (2) the load is served in a substantially different manner; (3) specific identifiable customer loads are the only loads capable of being served from these nonintegrated isolated facilities. The Commission also found that the standards apply to facilities which could, under any conditions, serve a transmission function.

Subsequent to Case No. ER-90-101, MoPub conducted a detailed engineering study of all 34 kV and higher substations in order to determine which of those facilities performed transmission functions according to the criteria adopted by the Commission. As a result of that study, MoPub transferred 33 substations from the distribution plant account to the transmission plant account. MoPub contends that the remaining 90 substations in the distribution accounts perform no transmission function.

The Stipulation is silent as to this issue and Staff's briefs do not address it. However, Public Counsel urges the Commission to adopt the position advocated in Staff's testimony. Staff's witness maintains that the 90 remaining

substations classified as distribution by MoPub should properly be classified as transmission facilities. Staff's witness stated that the analysis in Case No. ER-90-101 served as the basis for his analysis in this case. However, Staff's witness also stated that his examination in this case differed from the analysis in Case No. ER-90-101 in that he did not do a physical examination of the facilities in this case to support his proposal. In this case, Staff's examination shifted from documenting transmission capability to quantifying the actual hourly loads allowed by all substations with an open transmission access/capability. Staff's witness stated that instead of defining actual open transmission access/capability in this case, he focused on quantifying power flow over transmission capable facilities. Nevertheless, Staff's witness goes on to state that a full engineering analysis, including physical inspection, is the preferable method for developing jurisdictional allocations because the allocator recommendations have a significant effect on revenue requirement recommendations.

Given that both MoPub and Staff based their analysis on the criteria set out by the Commission in Case No. ER-90-101, the Commission at this point is presented with the question of which method of analysis is more reliable, MoPub's or Staff's.

Staff's witness acknowledges not conducting a physical inspection of the facilities in question even though he terms a full engineering analysis including physical inspection of facilities as preferable because of the significant effect this issue has on revenue requirement. MoPub on the other hand conducted a detailed engineering study, including physical inspection of the facilities, and applied the standards of Case No. ER-90-101 to its findings in order to allocate its facilities.

Inasmuch as Staff's witness did not use the very method that he termed as preferable while MoPub conducted a detailed engineering analysis of its facilities, the Commission is of the opinion that MoPub's analysis is more

persuasive. Thus, the Commission determines that the 90 substations classified as distribution by MoPub should remain allocated to the distribution account.

UtiliCorp Costs

Public Counsel alleges that some costs incurred by UtiliCorp headquarters and allocated to MoPub should be disallowed. Public Counsel states that while MoPub disallowed some of these costs, MoPub's disallowances did not go far enough to satisfy the Commission's directive in Case No. ER-90-101.

In Case No. ER-90-101, the Commission determined that the administrative and general (A&G) expenses allocated by UtiliCorp to MoPub should be reflected in MoPub's cost of service but that UtiliCorp's expenses for merger and acquisition (M&A) activities should be removed from the expenses reflected in MoPub's rates. The Commission stated that MoPub should account for M&A costs separately so that they can be readily excluded in future rate cases.

MoPub states that M&A costs were not included in the cost for which recovery is sought in this case. MoPub states that it identified the extent of M&A activity by members of the corporate staff by segregating such activity and reporting it separately on time sheets. MoPub stresses that the time related to M&A is not included in the request in this case.

The Stipulation is silent on this issue and Staff's briefs do not address this issue. Nonetheless, Public Counsel cites Staff's testimony in support of its contention that more of the UtiliCorp headquarters costs should be disallowed.

Staff's witness claimed that up to 50 percent of the UtiliCorp corporate costs assigned to MoPub should be disallowed. Staff's witness proposed to disallow a percentage of corporate costs as "ownership" costs. He then equated such "ownership" costs with M&A costs which he argued are of no benefit to MoPub customers.

MoPub states that M&A costs are relatively small in proportion to the total UtiliCorp activity and that such costs in no way represent 50 percent of the costs incurred. MoPub alleges that the proposals put forth by Staff are arbitrary and based entirely on its witness' own subjective judgment. MoPub contends that costs related to the acquisition of new properties and costs incurred in the management of existing properties (i.e., "ownership" costs) are not the same. MoPub notes that "ownership" costs such as accounting, finance, corporate relations, information services, and other corporate functions are costs incurred by every other utility in the state, and that the Commission has consistently found such costs to be appropriate for recovery.

MoPub alleges that in developing its proposals Staff looked at all of the operations of the UtiliCorp Management Group and deemed said operations as serving two separate purposes. Then, according to MoPub, based solely on his own judgment, Staff's witness concluded that a percentage of the costs associated with the operations should be excluded. MoPub states that Staff presumes that the half excluded will in some way approximate the so-called ownership costs and the M&A expenditures. MoPub further notes that Staff's approach was rejected in Case No. ER-90-101 by Staff's own witness as arbitrary and impossible to quantify.

The Commission finds Public Counsel's position unpersuasive. Staff's approach is based on judgments which are arbitrary, unquantifiable and unsupported by substantial evidence. Comparatively, MoPub's approach of segregating and reporting M&A activity separately on time sheets is a more accurate and quantifiable method of identifying and tracking M&A costs. Thus, the Commission finds that MoPub has properly excluded M&A costs from those costs sought to be recovered and that the remaining corporate office costs allocated to MoPub are proper costs to be included in rates.

Integrated Resource Planning Costs

MoPub has included in cost of service an amount of \$618,000 which it says is needed to comply with the new Commission rules regarding integrated resource planning (IRP). MoPub has projected an increase of \$618,000 in total electric costs as a minimum needed in order to comply with the recently adopted IRP rules. MoPub's projected costs include additional labor costs, computer software, CIS modifications, consultants and miscellaneous costs. MoPub argues that these expenses are measurable and that they are reasonable as an absolute minimum level of expense required to comply with the IRP rules.

Staff has proposed including in cost of service \$271,000 which it claims is MoPub's test year level of expense. Staff states that prior to the Stipulation, which is silent on this issue, Staff's position was that only such costs as are known and measurable through the April 30, 1993 true-up period should be included as IRP rules' compliance costs. Public Counsel agrees with Staff's position that the Commission should allow in rates only the actual known and measurable expenditures to comply with the IRP rules, as updated through the true-up period.

The Commission agrees that only those costs which are known and measurable through the true-up period should be included in cost of service. The additional amount of \$347,000 in costs which MoPub wishes to recover but which Public Counsel and Staff dispute is not known and measurable. MoPub describes these costs as "projected" and "estimated". Projected and estimated costs are not definite and are capable of increasing or decreasing. As such, the costs are not known and measurable and should not be included in cost of service at this time. Thus, the Commission determines that the additional \$347,000 in IRP expense above the amount proposed by Staff is not known and measurable and should not be included in rates.

Interest On Customer Deposits

Pursuant to the Stipulation, Staff and MoPub have agreed that the interest paid by MoPub on customer deposits should remain at nine percent. Public Counsel, though, maintains that customer deposit interest should be tied to the gross rate of return determined in this proceeding. Public Counsel's recommended rate of return would result in an interest rate of 12.405 percent.

When addressing the interest on customer deposits, two points should be considered: (1) the rate at which the utility could acquire funds to pay the deposit should a loan become necessary, and (2) the statutory interest rate of nine percent imposed when no other interest rate is specified (Section 408.020, RSMo-1986). The Commission is of the opinion that should MoPub require a loan in order to repay customer deposits, the applicable interest rate on that loan would likely be less than the 12 percent recommended by Public Counsel. Further, the statutorily imposed interest rate of nine percent is a valid consideration. In 1978, the Legislature, responding to increased interest rates, changed the statutory interest rate from six percent to nine percent. The rate has remained unchanged since that time. At the present, very low interest rates are being charged. Yet, Public Counsel seeks an increase in customer deposit interest even though such an adjustment would also increase MoPub's revenue requirement.

The Commission is of the opinion that nine percent is more reasonable than the rate of interest proposed by Public Counsel. Thus, the Commission determines that the interest paid by MoPub on customer deposits should remain at the current level of nine percent.

Rate of Return/Capital Structure

(1) Capital Structure

Public Counsel has proposed using a capital structure based on a group of companies it considers comparable to MoPub. Public Counsel examined the average capitalization ratio for this group of utilities for several years and

created a range of one standard deviation above and below this average. The range is from 44.15 percent to 51.71 percent common equity. Public Counsel set the equity level for its hypothetical capital structure at 44.15 percent. Public Counsel included preferred stock at the average level of the comparison group - 5.85 percent, and the long-term debt component at 50 percent.

MoPub proposes that the Commission adopt its per books division capital structure. MoPub states that the divisional capital structure reflects the actual capital structure shown on its books. MoPub's divisional capital structure consists of common equity of 44.75 percent, preference stock of 5.12 percent, and long-term debt of 50.31 percent.

The Stipulation is silent on this issue and Staff does not address this issue in its briefs.

In comparing Public Counsel's proposed capital structure and MoPub's proposal, the Commission finds that MoPub's divisional capital structure is the most appropriate. MoPub's divisional capital structure is testable, understandable, based on published facts and material, has been in continuous operation for more than five years, and has been subjected to substantial regulatory review. MoPub's capital structure is reproducible in that all of the material assumptions and data involved in its formation are either published, distributed to regulatory authorities or otherwise publicly available. Also, MoPub's book capital structure is reasonable due its continuity. Modifications are made only to reflect year-to-year historical development. It is not as subject to manipulation as Public Counsel's hypothetical capital structure. Furthermore, Public Counsel's hypothetical capital structure cannot reflect the history of activity within a utility nor the particular risks of that utility, as does MoPub's book capital structure. Thus, the Commission finds that the use of Public Counsel's proposed capital structure is not appropriate in this case.

(2) Rate Of Return

Both MoPub and Public Counsel have used the discounted cash flow (DCF) model in calculating the cost of common equity. MoPub has proposed a return on equity of 13.50 percent with an overall weighted cost of capital of 11.08 percent. Public Counsel has proposed a return on equity of 10.27 percent with an overall weighted cost of capital of 9.528 percent.

Using the DCF model, MoPub determined the cost of equity for a group of comparable utility companies and used it as a standard unadjusted electric utility return on equity retirement. MoPub then compared its level of risk to the risk of the group to establish the relative risk for MoPub vis-a-vis the selected group. Based upon this analysis, MoPub estimated its risk adjusted cost of equity.

The Commission finds that the rate of return proposed by Public Counsel is unreasonable. Public Counsel did not include in its calculations any adjustments for the specific risk characteristics of MoPub. Because Public Counsel does not consider the impact of issues specific to MoPub, such as: future generation requirements, special risks associated with serving MoPub's residential load, risks associated with the recently implemented rate design, or the impact of MoPub's management, Public Counsel's calculations do not accurately reflect MoPub's status. By not considering MoPub's specific risks or attributes, Public Counsel's calculations are faulty and its conclusions inaccurate.

Furthermore, Public Counsel's calculations are skewed by an erroneous adjustment in calculating the growth rates, leading to an understatement of the growth component of the DCF analysis. Many of the data points accumulated for Public Counsel's analysis to estimate the growth component of the DCF method were either negative or zero. As it is improper and impractical to add zero and negative growth rates into an analysis for DCF calculations (because no investor buys a security anticipating zero growth or negative growth), Public Counsel

substituted a hypothetical growth rate of 2.5 percent in each of the instances where a zero or negative occurred. Twenty-eight individual data points, or 36 percent of all the data used by Public Counsel, were Public Counsel's hypothetical substitutions because the data accumulated were zero or negative. Such a substitution distorts Public Counsel's analysis because of the large number of negative and zero growth figures and the fact that 2.5 percent is below the inherent average of the group and pulls down the end result.

Any other action by Public Counsel would have resulted in a substantial increase in Public Counsel's recommendation. MoPub recalculated without Public Counsel's substitution and the average difference in the growth rate is 85 basis points higher than Staff's result. (Ex. 45, p. 48). Staff had substituted a 250 basis points hypothetical growth rate. Eighty-five basis points is 34 percent of 250 basis points or an error rate in excess of 34 percent. Public Counsel's inappropriate substitution in the calculation of the growth rate component caused its recommendation to be at least 85 basis points lower than it would have been without the substitution in the calculation.

The Commission finds that Public Counsel's calculations are inaccurate. Thus, the Commission determines that Public Counsel's proposed rate of return is unreasonable, and that the revenue requirement as stipulated will result in a reasonable rate of return.

Revenue Requirement

The Commission finds that the Stipulation and the stipulated revenue requirement of \$4,865,804 are just and reasonable, and that its findings as to specific issues in this case are not inconsistent with the stipulated revenue requirement. Thus, the Commission determines that MoPub should be authorized to file revised tariff sheets and rate schedules designed to produce an increase in electric revenues of \$4,865,804, consistent with the Stipulation and this Report and Order.

Conclusions of Law

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

The Commission has jurisdiction over this matter pursuant to Sections 386 and 393, RSMo 1986, as amended. The Commission must consider all matters which come before it which have a bearing on the determination of the price to be charged for electric service. Section 393.270(4), RSMo 1986. The Commission is authorized to entertain and approve stipulations or agreements among the parties. Section 536.060, RSMo 1986. The standard for Commission approval of a stipulation is whether it is just and reasonable.

Because Public Counsel is not a signatory to the Stipulation in this case, it is nonunanimous. The Commission may not summarily adopt it as just and reasonable. *State ex rel. Fischer v. Public Service Commission*, 645 S.W.2d 39 (Mo. App. 1982). Section 386.420, RSMo Cum. Supp. 1992 requires that the Commission issue a report setting out its findings concerning any disputed issues.

The ultimate issue to be determined by the Commission is the establishment of just and reasonable rates. In considering that question, the Commission has been presented with a nonunanimous stipulation. Prior to determining whether the Stipulation results in just and reasonable rates, the Commission must make adequate findings as to the issues disputed by Public Counsel. The Commission has made such findings and has determined that the Stipulation is just and reasonable. Thus, the Commission determines that MoPub should be authorized to file revised tariff sheets and rate schedules consistent with the Stipulation and this Report and Order.

IT IS THEREFORE ORDERED:

1. That the tariff sheets filed by Missouri Public Service on July 31, 1992, reflecting an increase in its annual electric revenues of approximately \$19,400,000 are hereby rejected.

2. That Missouri Public Service is hereby authorized to file revised electric tariff sheets and rate schedules designed to produce an increase in its annual electric revenues of \$4,865,804, consistent with the Stipulation and Agreement filed in this case as Exhibit 88 and this Report and Order, to become effective for service on and after June 29, 1993.

3. That Missouri Public Service is hereby authorized to implement on a permanent basis the rate design and class cost of service changes approved on an interim basis by the Commission on May 28, 1993.

4. That Missouri Public Service is hereby authorized to continue to use the pay-as-you-go methodology for calculating the amounts charged to post retirement benefit expenses other than pensions on its financial statements based on actual payments to retirees, with the differential between the expense amount calculated under Financial Accounting Standard 106 and the pay-as-you-go amount to be booked to Uniform System of Accounts No. 186, Miscellaneous Deferred Debt as a regulatory asset.

5. That this Report and Order shall become effective on June 29, 1993.

BY THE COMMISSION

(S E A L)

Brent Stewart

Brent Stewart
Executive Secretary

Mueller, Chm., McClure, Perkins and Kincheloe, CC., Concur and certify compliance with the provisions of Section 536.080, RSMo 1986. Crumpton, C., Not Participating.

Dated at Jefferson City, Missouri, on this 18th day of June, 1993.