BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of Missouri-American Water Company's tariff revisions designed to increase rates for water service provided to customers in the Missouri service area of the company.	)	**Case No. WR-95-205**
In the matter of Missouri-American Water Company's tariff revisions designed to increase rates for sewer service provided to customers in the Missouri service area of the company.	)	**Case No. SR-95-206**

REPORT AND ORDER

Issue Date: November 21, 1995

Effective Date: December 5, 1995

APPEARANCES

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Leland B. Curtis and **Carl J. Lumley**, Curtis, Oetting, Heinz, Garrett & Soule, P.C., 130 South Bemiston, Suite 200, Clayton, Missouri 63105, for the City of Warrensburg, Missouri.

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John B. Coffman, Senior Public Counsel, Office of the Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

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

ADMINISTRATIVE LAW JUDGE: **Dale Hardy Roberts, Deputy Chief.**

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Procedural History

On November 23, 1994, Missouri-American Water Company (Missouri-American or Company) submitted tariff sheets in Case No. WR-95-174 designed to increase rates for water service. On that same date Missouri Cities Water Company (Missouri Cities) submitted tariff sheets in Case Nos. WR-95-172 and SR-95-173 designed to increase rates for water and sewer service. At that same time Missouri-American and Missouri Cities had a case before the Commission, Case No. WM-95-150, in which these two companies were requesting authority to merge Missouri Cities Water Company with Missouri-American. On December 22, 1994, the Commission issued an order in WM-95-150 which approved the merger and directed Missouri-American, as the surviving corporation, to refile a general rate case with a single revenue request. In an effort to avoid undue delay, the Commission's order permitted the new rate case filed to proceed under the procedural schedule already in effect for WR-95-174.

On January 6, 1995, Missouri-American filed tariff sheets designed to implement a general rate increase for water and sewer service provided by the merged company and Cases No. WR-95-205 and SR-95-206 were established. The tariff sheets filed on January 6, 1995, bore an effective date of February 5, 1995. With the suspension of 120 days plus six months, the resulting effective date for these tariff sheets is December 5, 1995. On January 13, 1995, the Missouri Public Service Commission (Commission) issued a Suspension Order And Notice in response to the January 6 filing. This Order And Notice suspended the tariffs submitted by Missouri-American and granted leave to intervene to the City of Warrensburg, to the City of O'Fallon, to the cities of Riverside, Parkville, Platte Woods, Lake Waukomis, Houston Lake (Riverside, Parkville, Platte Woods, Lake Waukomis and Houston Lake were collectively referred to as the Platte County Intervenors), to AG Processing, Inc. (AGP), to Public Water Supply District No. 1 of Buchanan County, Public Water Supply District No. 1 of DeKalb County, Public Water Supply District No. 1 of Andrew County, Public Water Supply District No. 2 of Andrew County, and Public Water Supply District No. 6 of Platte County. Within this same Order And Notice the Commission granted the City of St. Joseph leave to participate without intervention and the Commission established a deadline of February 3, 1995, for the filing of applications to intervene.

On February 22, 1995, the Commission issued an order in which it consolidated Cases No. WR-95-205 and SR-95-206. This same order established a uniform procedural schedule for the consolidated docket which culminated with an evidentiary hearing scheduled for July 31 through August 4, 1995.

As a result of the prehearing conference(s) the parties filed a Hearing Memorandum on July 7, 1995, which delineated those issues which had been resolved by the parties and those issues which remained contested and thus would be addressed at the evidentiary hearing. The items identified in the Hearing Memorandum as "Agreements" were as follows:

1. The Company has agreed to perform a depreciation study, as described in the direct testimony of Staff witness Birenbaum, before tariff sheets are filed in its next general rate case or within two years of the effective date of the Report And Order issued in this case, whichever occurs first. In addition, the Company will address in the depreciation study the early retirement of sewer plant in the Parkville District and the recovery of the cost of its comprehensive planning studies.

2. The parties, other than AGP, agree that the Commission should approve the economic development tariff provision filed by the Company.

3. The Company agrees to file, within thirty days of the effective date of the Report And Order issued in this case, a complete sewer tariff for the Parkville Sewer District which it acquired from Missouri Cities.

4. The Company agrees to use a ten-year amortization of deferred gains and losses in calculating its pension expense in accordance with FAS 87. In addition, the Company agrees to ask its plan administrator for a bid to separately track the pensions and Other Post-Retirement Employee Benefits (OPEBs) for Missouri-American Water Company. The Staff agrees to work with the Company in listing the items that should be tracked. The parties, other than AGP, agree that the Commission should approve an amortization over 17.25 years in accordance with the Emerging Issues Task Force (EITF) Pronouncement No. 92-12, of the OPEB costs deferred for the St. Joseph and Joplin Districts from July 1, 1994, up through the effective date of the Report And Order issued in this case. AGP has taken no position on the amortization of OPEB costs over 17.25 years.

5. The Company agrees to write off the design costs for a proposed Joplin Distribution Center which the Company did not construct and the Company agrees not to seek recovery of those costs in future rate cases.

6. The parties do not object to the Commission ordering a management audit of Missouri-American as proposed in the direct testimony of

Public Counsel witness Robertson. The parties, other than AGP, agree to support some method for the Company to recover any prudent and reasonable costs associated with the audit in the Company's next rate case.

7. The parties, other than AGP, agree to update the Company's cost of service for the Commission assessment for fiscal year 1996. Currently, $200,892 is included in the Staff's case for last year's Commission assessment. AGP does not agree to update the case for the Commission's assessment for fiscal year 1996 and has argued that this is too far out of the test year in this case.

8. Although the parties disagree on which capital structure is appropriate for use in this case, the parties agree that the capital structures and embedded cost rates are correctly calculated as set out on pages 7 and 8 of the Hearing Memorandum.

The contested issues remaining in the Hearing Memorandum are the acquisition adjustment, the capital structure, the cost of equity, the rate design, FAS 106, the rate case expense, the depreciation reserve deficiency, the plant held for future use, the premature retirement of sewage plant, lobbying activities, deferred maintenance, depreciation rates, and some miscellaneous issues. Although these were designated as issues to be resolved at the hearing, on August 2, 1995, the Company announced that it was withdrawing its request for consideration on the issues of deferred maintenance, lobbying activities, and plant held for future use.

On September 15, 1995, pursuant to a request from the Commission, a revised reconciliation was filed in this case. This request was based upon the fact that the original reconciliation filed in this case was presented in a format which did not comport with Commission standards. The figures regarding the value, or revenue requirement, of various issues used herein are those figures contained in the revised reconciliation. The revised reconciliation also included adjustments and updates made at the time of the hearing.

With these issues remaining for disposition, this matter came before the Commission for a full evidentiary hearing on July 31, 1995. The evidentiary hearing concluded on August 2, 1995. Initial briefs in this matter were scheduled to be filed on or before September 6, 1995, and reply briefs were scheduled to be filed on or before September 15, 1995.

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.

RATE OF RETURN

The Staff has framed the issue of rate of return by stating that in order to determine the appropriate rate of return for Missouri-American, the Commission will need to consider the following issues. First, Missouri-American does not have publicly traded stock and is a wholly owned subsidiary of American Water Works Company Inc. (AWWC). Therefore, the Commission must determine the most appropriate capital structure to use for Missouri-American. Second, the Commission must decide the most appropriate method for calculating the cost of common equity for Missouri-American. This will require the Commission to determine whether there is any justification for departing from the standard discounted cash flow (DCF) model that the Commission has consistently adopted when determining return on equity for a utility under its jurisdiction. Third, the Commission must consider whether to allow for quarterly compounding in a DCF analysis and whether to make any upward adjustments for flotation costs. And fourth, if a double leverage capital structure is adopted for Missouri-American, then the Commission will have to consider whether it would be appropriate to allocate certain administrative and general expenses incurred by AWWC to Missouri-American.

Capital Structure

Capital structure is the relationship between a company's debt and equity and generally influences the overall cost of capital. It may be said that there is an optimum balance in this structure which will produce the minimum cost. A utility must meet its obligations and maintain a balanced but flexible capital structure so that it may raise capital whenever necessary. The two primary components of capital structure are debt and equity.

The Missouri Public Service Commission Staff (Staff) has recommended the use of double leverage methodology in order to calculate the appropriate rate of return for Missouri-American in this case. This is the same method which was used in the last Missouri-American rate case (WR-93-212) as the Commission found that double leveraging was the most appropriate method for making the most accurate capital structure calculation at that time. Staff's rationale for the use of double leveraging is the concept of having debt at two distinct levels of corporate structure. Staff alleges that the double leverage approach recognizes that a wholly owned subsidiary such as Missouri-American does not raise common stock capital in the open market. In fact, a subsidiary's true cost of equity depends on the parent company's combined cost of capital, which is substituted for the subsidiary's cost of equity in computing the utility's rate of return.

Missouri-American has proposed the use of its actual capital structure as of April 30, 1995, which is alternately referred to as its "stand-alone" capital structure. Missouri-American has stated that under this structure its common stock equity, as a percentage of capital, is 39.30 percent, its preferred stock is 4.19 percent, its long term debt is 56.51 percent of capital, and its short term debt is 0.00 percent of capital. Missouri-American asserts that this capitalization ratio compares quite favorably, and is in line, with other water utilities. Moreover, use of the Company's stand-alone capital structure recognizes the fact that it is the entity which issues capital (i.e., common stock, preferred stock and long term debt) necessary to finance its operations.

Staff utilized the Company's stand-alone capital structure for purposes of developing its overall rate of return. For purposes of arriving at a cost of equity for Missouri-American, however, Staff proposed the use of the double leverage calculation.

The Office of the Public Counsel (OPC) has utilized Missouri-American's per-book capitalization ratios in order to properly determine the overall cost of capital in this case. OPC notes that despite the fact that the Commission has adopted double leveraging in recent Missouri-American rate cases, OPC does not believe that it is necessary to utilize a double leverage capital structure in this case. In support of this argument, OPC finds it significant that the Company's parent, American Water Works Company, uses both debt and equity securities to finance its investments in its subsidiaries. OPC does not believe the Commission should ignore this relationship; however, OPC asserts that a reasonable rate of return can still be determined in this case by using the Company's per-book capitalization ratios since the Company's capital configuration is in line with the water utility industry average.

Missouri-American has argued that no party in this docket has shown that Missouri-American's actual capital structure as of April 30, 1995, is inappropriate or is out of line with the industry norm. Missouri-American has asserted that its equity ratio of 39.30 percent compares quite favorably with the average equity ratio of 39 percent for the water utility industry as reported by Value Line for 1994. In fact, Missouri-American's equity ratio is well below the average equity ratio of 47 percent for the water utility industry as reported by C.A. Turner's <u>Financial Statistics for Public Utilities</u> (1993).

The Commission's Report And Order in WR-93-212 (issued November 18, 1993) criticized the Company for its attempt to utilize some hypothetical structure or pro forma alteration to the capital structure which then existed. At that time the Commission wrote:

> The Company ceased to utilize the capital structure which, in fact, does not exist. Traditional ratemaking concepts reject using projected numbers. The Commission has long recognized a preference for those matters which are known and measurable versus those which are projected to exist at some future time. . . . The Commission finds that the most accurate measure of capital structure is that measure which reflects the facts as they may now be known and actually measured.

If the Commission were to follow the same logic from the last Missouri-American rate case in the case sub judice, it would adopt the stand-alone capital structure of Missouri-American as it currently exists and as Company has proposed.

In essence, the parties have proposed three alternatives for establishing the appropriate capital structure for Missouri-American. The Company and OPC jointly support Missouri-American's actual capital structure, or stand-alone capital structure. The Staff has argued in favor of the use of the Company's stand-alone capital structure but would subsequently employ a double leverage calculation to determine the appropriate return on equity. The Platte County Intervenors have argued in support of a parent company consolidated capital structure.

The Commission finds that it has recently chosen not to use the double leverage concept in rate proceedings concerning telecommunications companies which are wholly owned subsidiaries of publicly traded holding companies (see Cases No. TC-89-14, et al., and TC-93-224, et al.). Staff witness Moore testified that Missouri-American is the most recent and possibly only water company which is double leveraged. Staff witness Moore further testified that at least three other water companies regulated by the Commission are wholly owned subsidiaries of publicly traded holding companies and the Commission has not used the double leverage concept for these companies. These companies are United Water Missouri (formerly Capital City Water Company), St. Louis County Water Company and Missouri Cities Water Company (prior to its acquisition by and merger with Missouri-American). The Commission finds Mr. Moore's testimony to be competent and substantial evidence on this issue. The Commission finds that unusual circumstances existed in the last Missouri-American rate case (Case No. WR-93-212) which required the use of the double leveraging concept under those circumstances. Those circumstances do not exist in this case.

The Commission finds that the double leverage calculation is an appropriate calculation under certain circumstances but the Commission finds that those circumstances do not exist in this case. The Commission finds no such circumstances here and, in fact, the Commission finds that no party to this case has shown that Missouri-American's actual capital structure as of April 30, 1995, is inappropriate or out of line with the industry norm. The Commission finds that Missouri-American's actual equity ratio of 39.30 percent compares favorably with the average equity ratio of 39 percent for the water utility industry as reported by Value Line for 1994. The Commission finds Missouri-American's equity ratio is well below the average equity ratio of 47 percent for the water utility industry as reported by C.A. Turner's Financial Statistics for Public Utilities (1993).

The Commission finds that the Platte County Intervenors have, likewise, failed to meet their burden of persuading the Commission to use a capital structure other than Missouri-American's actual capital structure at the time of this case. Intervenor Platte County argues that the consolidated capital structure is necessary in order to address "phantom equity" which exists for this

Company. The Commission finds that the equity existing on the books of Missouri-American is an accurate reflection of the current capital structure of Missouri-American. The Commission finds that the flaw with the consolidated capital structure is similar to the flaw which would result from the use of double leveraging in that this approach fails to allocate or allow for certain factors such as administrative expenses which are currently borne by American Water Works Company, Inc. The Commission finds that consolidated capital structure may be appropriate under certain circumstances but the Commission does not find those circumstances in this case.

The Commission finds that Missouri-American's actual cost of debt and capital structure should be used in calculating Missouri-American's actual rate of return. The Commission finds that the use of a consolidated capital structure or the use of a double leveraging method in this case could prevent Missouri-American from recovering its actual debt costs. Therefore, the Commission finds that Missouri-American's stand-alone capital structure is its own actual capital structure and accurately reflects the financial status of Missouri-American as it exists at this time. The Commission finds that the actual capital structure or stand-alone capital structure is the appropriate capital structure for use in this case.

Cost of Equity/Return on Equity

The Company notes that within the originally filed case, it proposed a return on equity of 12.25 percent. This recommendation was based upon three market-determined approaches which were used to estimate the current and prospective cost of capital for Missouri-American; i.e., the discounted cash flow model (DCF), the risk premium model, and the capital asset pricing model (CAPM). Missouri-American's DCF cost of equity estimates ranged from 10.25 percent to 13.22 percent. Its risk premium estimates ranged from 11.71 percent to

13.82 percent, and its CAPM estimate was 12.47 percent. These approaches produced an overall equity cost rate range of 11.6 percent to 12.5 percent, and Company witness Phillips recommended a 12.25 percent return on equity based upon the unique risks faced by the water industry in general and by Missouri-American in particular.

At the time of hearing, Company witness Phillips updated his recommended return on equity. Although his DCF results did not change, a drop in interest rates since the filing of his direct testimony caused his CAPM and risk premium calculations to come down. Thus, Dr. Phillips's updated return on equity at the time of hearing was in the range of 11.54 percent to 11.64 percent with the midpoint of 11.59 percent.

OPC has recommended a return on common equity no higher than 10.86 percent as its witness arrived at this recommendation by applying a DCF analysis to a proxy group of water companies. In addition, OPC's witness used the CAPM to estimate the cost of equity, resulting in a range from 10.37 percent to 10.86 percent. The final result of OPC's CAPM analysis was 10.73 percent. The Commission finds OPC's recommended return on equity has failed to take into consideration the fact that Missouri-American has an equity ratio substantially below the proxy group analyzed by OPC. Use of the sustainable growth rate in determining a DCF cost of equity, as proposed by OPC, has been declined by the Commission in the past and the Commission finds that it is not sufficiently accurate for use in this case.

Staff also used the DCF model as its primary tool to determine the cost of equity; however, this was used on the parent company, American Water Works Company. This calculation produced a range of returns on common equity of 11.2 percent to 12.15 percent with a midpoint of 11.68 percent as a DCF company-specific cost of equity range for American Water Works Company. In addition, the Staff witness performed a risk premium cost of equity analysis for

AWWC resulting in an estimated cost of equity range of 10.28 percent to 11.15 percent, and this provided support for the low end of his DCF cost of equity recommendation. The Staff witness also performed a CAPM cost of equity analysis for AWWC which produced an estimated cost of equity range of 11.91 percent to 12.58 percent. This result provided support for the high end of Staff's cost of equity recommendation. Finally, Staff witness Moore analyzed a proxy group of water utility companies in order to determine the reasonableness of his company-specific DCF results for AWWC. His DCF analysis of his proxy group produced a cost of equity range of 11.1 percent to 12.2 percent for the water industry. He also performed a CAPM analysis of his proxy group of companies and calculated a return on equity for the comparable company group in the range of 11.42 percent to 12.9 percent. All of these analyses led witness Moore to believe that the DCF cost of equity range which he had calculated for AWWC of 11.2 percent to 12.15 percent was reasonable. At this point, the Company emphasizes that after double leverage, witness Moore's recommended range of returns on equity for Missouri-American dropped to the range of from 10.73 percent to 11.53 percent.

At the hearing Staff witness Moore also updated his cost of equity recommendation to account for the drop in interest rates and stipulated on the record that his updated analysis was not as thorough or complete as the analysis initially prepared for this case. As a result, Mr. Moore's updated return on equity range for AWWC was 11.0 percent to 11.95 percent with a midpoint of 11.48 percent. Using Staff witness Moore's double leverage calculation produced a recommended return on equity for Missouri-American in the range of 10.56 percent to 11.37 percent with a midpoint of 10.97 percent.

For the sake of clarity as to the return on equity, the Commission has found, *supra*, that double leverage calculation(s) are inappropriate in this case. The Commission finds that the appropriate return on equity for

Missouri-American is 11.59 percent. This number represents the middle of the range proposed by Missouri-American and is nearly at the middle of the range proposed by Staff's witness for AWWC prior to Staff's proposed application of the double leverage calculation. This return on equity corresponds with the recommendation of Missouri-American's witness on this issue (Phillips). Witness Phillips employed a traditional DCF analysis and subsequently performed a "modified" DCF approach for reasons which were set out in his testimony. Missouri-American's witness Dr. Phillips testified that a potential problem exists with the traditional DCF model. Dr. Phillips cited as his authority for this proposition a finding of the Federal Communications Commission which recognized that "the DCF method underestimates the fair return on book equity since it produces a capitalization rate which, if applied to book equity, will produce a market price equal to book equity." (Supporting calculations and citation omitted). The Commission finds that the potential limitations of the DCF model have been appropriately recognized in this case by Missouri-American's witness through the modifications which he employed. The Commission finds that the adjustments to the three analyses (DCF, risk premium and CAPM) to account for flotation costs are appropriate under the circumstances of this case.

The Commission finds that Staff's updated return on equity for AWWC reflects a midpoint of 11.48 percent. The Commission finds this midpoint is only 11 basis points less than the Company's updated return on equity, albeit Staff's is based on AWWC and the Company's figure was based on Missouri-American's actual capital structure. Subsequent double leveraging of Staff's 11.48 percent would reduce the return on equity and the Commission finds that reduction is unnecessary in this case. Therefore, the Commission finds the appropriate return on equity for Missouri-American in this proceeding, therefore, is the 11.59 percent figure cited by Company as its midpoint in the range.

ACQUISITION ADJUSTMENT

Acquisition adjustment is the difference between the cost of acquiring an operating unit or system and the depreciated original cost of the acquired property. The acquisition adjustment, or purchase premium, is the price paid over and above the original cost. The traditional treatment of an acquisition is to allow a utility to earn a return on the original cost of the property that is used and useful for public service less the depreciation which has previously been taken on that property.

On August 31, 1993, after obtaining authorization from the Commission in Case No. WM-93-255, Missouri-American acquired all of the outstanding common stock of Missouri Cities Water Company (MCWC) for the purchase price of $15,700,000. On December 31, 1994, after obtaining authorization from the Commission in Case No. WM-95-150, MCWC was merged into and became a part of Missouri-American. At issue is a "positive" acquisition adjustment, or purchase premium, in the amount of $4,392,316. This is the amount by which the purchase price paid for MCWC's stock exceeded the book value of that stock. Book value is the value placed on utility property as it is recorded in the Company's financial books and records. Net book value consists of the property's original cost less depreciation and amortization.

The Staff, OPC, and all of the intervenors oppose ratemaking treatment or allowance for the acquisition adjustment. Staff, for example, believes that the acquisition should be treated for ratemaking purposes at the original cost of MCWC less accumulated depreciation. In support of this position, Staff argues that this same rate base, or the same assets, will still continue to be used to provide the same services to the same ratepayers, and the rate base or assets will still remain subject to the same ratemaking jurisdiction of the same regulators.

Missouri-American is proposing recovery of this acquisition adjustment in its revenue requirement. Missouri-American is requesting that it be authorized to amortize the acquisition adjustment over a 40-year period as well as include the unamortized acquisition adjustment in its rate base. This has the effect of increasing the Company's revenue requirement by $692,513. Missouri-American has stated four primary arguments in support of its request. First, the Company has demonstrated that the acquisition has already resulted in actual cost savings which more than offset the associated revenue requirement of including the acquisition adjustment in cost of service. Second, these (aforementioned) cost savings to ratepayers will continue to increase over time. Third, ratepayers of Missouri-American (including former ratepayers of MCWC) are receiving improved service as a result of the acquisition. Fourth, public policy is best served by encouraging mergers and acquisitions where cost savings or other benefits can be demonstrated to accrue to ratepayers.

As to the benefits of consolidation, Missouri-American has argued that such consolidations add to the economies of scale and strengthen the financial capability of the existing subsidiary as well as the acquired system, so that both will be better able to meet their public service obligations. Missouri-American has cited its cost savings which it offers as the result(s) of this consolidation. These include a reduction in manpower, reduction in administrative costs, cost savings attributable to the merger and thus enhanced bulk purchasing procedures, and cost savings associated with its computer system. Missouri-American has argued that the service quality has improved as a result of the acquisition and merger and that it has received no customer complaints regarding the consolidation.

In further support of its request regarding the acquisition adjustment, Missouri-American has noted that the Company invested, on average, approximately $896 per customer to acquire MCWC and that this amount is significantly less than the average cost incurred by the Company in connecting new customers to its system. Missouri-American went on to demonstrate the ways in which *(a) the purchase price resulted from arm's length negotiation between* seller and buyer, (b) the purchase price was reasonable and reflective of the fair value of the underlying assets acquired, and (c) the long term benefits from the acquisition and consolidation justify the ratemaking treatment. These three assertions have not necessarily been challenged as incorrect but assuming, *arguendo,* their veracity, the question remains as to whether an allowance for acquisition adjustment is in the public interest.

In response to that, it has been noted that MCWC was not a small, troubled water company which was rescued. Rather, MCWC was a company approximately two-thirds the size of Missouri-American which appeared to be sufficiently desirable so as to become the subject of a bidding war to acquire its properties. (In short, there was no compelling public interest for the purchase and/or merger.)

The original cost principle as defined by the 1976 Uniform System of Accounts (USOA) for Class A and B Water Utilities states that all utility plant shall be recorded "at the cost incurred by the person who first devoted the property to utility service." Thus, the acquired property is valued at the same amount that the seller valued it. The original cost principle became prevalent after abuses in the 1920s and 1930s clarified its importance. Before the original cost principle was applied, utilities were allowed to acquire other utility properties for amounts in excess of net book value and thus inflate rate bases. As a result, ratepayers were paying higher rates for the exact same property that had been providing them utility service prior to the acquisition. Policy-makers began to understand how unreasonable it was to charge customers higher rates for the same utility property simply because the utility property providing the service was acquired by another company. Because the proposed acquisition adjustment consists of excess purchase costs over and above the net original cost of the Missouri Cities Water Company properties, OPC has recommended that these amounts be booked to USOA Account 114 (Utility Plant Acquisition Adjustments) and amortized below the line over 40 years to USOA Account 425 (Miscellaneous Amortization). The Company's proposal included the excess purchase price in rate base as an acquisition adjustment of $4,392,316 and further proposed the inclusion of $109,808 in the cost of service to reflect a 40-year amortization of this acquisition adjustment.

The Commission finds that, on a policy basis, it is not necessarily opposed to consideration of acquisition adjustment. The Commission stated in Case No. EM-91-213 (*In the matter of the application of The Kansas Power and Light Company* . . .) that it was not opposed to the concept of the savings sharing plan (as a part of an acquisition adjustment request) provided that only merger-related savings would be shared. The Commission went on to state, and finds in this order, that it does not wish to discourage companies from actions which produce economies of scale and savings which can benefit ratepayers and shareholders alike.

Staff witness Boltz (Boltz) testified that the recovery of positive acquisition adjustments in rates would not provide sufficient incentive for the purchaser to negotiate the best possible price owing to the assumption that the acquisition premium could be passed on to the ratepayers. Boltz highlighted the fact that the alleged benefits of the acquisition omit or underestimate the costs of the acquisition to the customers. Boltz cited as examples of this the failure on the part of the Company to take into consideration the revenue requirement associated with the impact of the acquisition on the deferred taxes and investment tax credit. Boltz has asserted that because of these additional income tax costs alone, the net savings from the acquisition as shown on Schedule JES-5, page 1 of 5, in the first year would become net costs to the ratepayers. In addition, Boltz notes that where the Company lists the "401K" plan as an area of merger savings, it is in reality an additional cost inasmuch as the employees of the Missouri Cities Water Company had available to them no 401K plan prior to the acquisition. Similarly, the employees of the former Missouri Cities Water Company had available to them no Employee Stock Option Plan (ESOP) and they will now have one with Missouri-American. Boltz testified that the additional cost of the 401K plan is $14,786 and the additional cost of the ESOP is $16,368. The Commission finds the testimony of Boltz to be competent and substantial for the showing that instead of the savings alleged by the Company, the reverse is true.

Boltz has also highlighted the allegations of labor savings asserted by the Company and noted that the Company has failed to consider the possibility that some of these employees may have retired or quit or left for other reasons. Another example of additional expenses not included in the Company's argument in favor of acquisition adjustment centers on the personnel issue. The Company argues that one particular cost savings will be that certain employees who were previously utilized in two districts will now be able to provide their services to all seven districts and thus remove the necessity for duplication of employees. However, Boltz has noted that the Company has failed to address in this analysis the increase in travel expenses between and among the seven district locations as well as to the corporate headquarters in New Jersey. This potential for increased car expenses, meals, lodging, and possibly airline fares has not been accounted for by the Company's testimony. The Commission finds the testimony of Boltz to be competent and substantial for the proposition that the Company's argument as to the acquisition adjustment does not portray an entirely accurate scenario.

The Commission finds in this case that the Company has failed to justify an allowance for the acquisition adjustment. The Commission finds that, as argued by OPC, the ratepayers will already suffer one negative effect from the sale of MCWC stock. Because the transaction is considered a "sale of assets" for federal tax purposes, the deferred taxes that have accumulated throughout the life of the property will be lost. Missouri-American's shareholders will retain the benefits of the Missouri deferred taxes which were previously paid by MCWC customers, while the customers of the merged Company will lose the initial rate recognition of the "flow-back" of deferred taxes. (Ex. 54, p. 13). Therefore, the Commission finds that the original cost principle is sound for the purposes of this case. The Commission finds it is appropriate that the excess purchase costs over and above the net original cost of the Missouri Cities Water Company properties be booked to USOA Account 114 (Utility Plant Acquisition Adjustments) and amortized below the line over 40 years to USOA Account 425 (Miscellaneous Amortization).

DEPRECIATION RESERVE DEFICIENCY

Depreciation accounting is a system of accounting which generally aims to distribute costs or other basic values of tangible capital assets less salvage, over the estimated useful life of the unit or group of assets in a systematic manner. It is a process of allocation, not of valuation. Depreciation is an attempt to match capital recovery with capital consumption. The emphasis is upon systematic and rational allocation of expense of capital consumption. The accounting does not purport to follow the actual rate of consumption of property during individual accounting periods. It is an equitable and sound accounting method to spread the depreciation expense in equal annual charges over the useful life of the property, but the actual rate of consumption may be different. Re: Depreciation, 25 Mo. P.S.C. (N.S.) 331.

Any attempt to allocate such costs over a period of time requires an analysis of expected future events such as useful life, salvage value, and cost of removal. To the extent such analyses prove incorrect, depreciation rates will fail to match capital recovery with capital consumption, resulting in a depreciation reserve deficiency.

In this case, in the original filing, the Company proposed to recover a depreciation reserve deficiency which existed in Missouri Cities Water Company's plant accounts prior to acquisition by Missouri-American. The Company proposed to continue the amortization of this deficiency which had been established in the prior Missouri Cities Water Company rate case. In addition, Missouri-American sought to include the unamortized balance of the deficiency in its rate base. As a result of the prehearing conference, the Company agreed to forgo recovery of the rate base amount and now seeks only to continue the amortization of the deficiency in its test year cost of service.

Staff has noted that the Company keeps its records on two different computer systems in two different cities. Depreciation reserve is accumulated by applying the depreciation rates for the premerged entity monthly to the premerged plant account balances maintained on the appropriate premerged computer system. The Company has expressed a desire to consolidate all of its continuing property record functions to one system within 18 months. The Staff attempted to perform a depreciation study on the merged company. However, Company was unable to provide salvage data merged from the two prior entities and the analysis was abandoned. Therefore, the Staff recommends composite rates as the next best approach to performing an analysis on merged data. The Staff's recommended depreciation rates are the plant direct weighted composite depreciation rates of the former Missouri-American and Missouri Cities companies. As to the depreciation rates for the sewer case, SR-95-206, the Staff recommends that the Commission approve the sewer rates previously approved for Missouri Cities for use by Missouri-American.

Although OPC agrees that the Company should be allowed the ten-year amortization, it has generally opposed rate base treatment of the deficiency. In this case OPC does not believe that Company and Staff have correctly calculated the amount to be recovered pursuant to the stipulation approved in Case No. WR-86-111, as corrected in Case No. WR-92-173, with regard only to the amortization of Mexico Well No. 3.

Missouri-American has submitted that it is OPC who has incorrectly calculated the amortization amount. The correct amount of the depreciation reserve deficiency currently being amortized over the ten-year period is $345,724. Missouri-American notes that its proposed amortization of the depreciation reserve deficiency did not include the Mexico Well because the amortization of that well was denied by the Commission in Case No. WR-91-172. Based upon these facts, the Company submits that the Commission should approve the agreement between Staff and Company allowing the ten-year amortization to continue, and Staff joins in this recommendation.

The Commission finds that the depreciation reserve deficiency requested herein existed, at least to some extent, in the Missouri Cities Water Company's plant accounts prior to acquisition by Missouri-American. Missouri-American has agreed to forgo recovery of the rate base amount and the Commission finds it reasonable that Missouri-American be allowed to continue the amortization of the deficiency in its test year cost of service. The Commission finds this continued amortization of the unrecovered plant investments is consistent with the Stipulation And Agreement filed and approved in the Missouri Cities Water Company's Case Nos. WR-86-111 and SR-86-112. Therefore, the Commission will approve the agreement as between Staff and Company allowing the ten-year amortization to continue. The effect of this issue in favor of Staff and the Company is $34,612.

FAS 106

In 1990 the Financial Accounting Standards Board (FASB) issued Financial Accounting Standard No. 106 (FAS 106) regarding Employers' Accounting for Post-Retirement Benefits Other Than Pensions (OPEBs). Traditionally, such costs have been treated, both for financial reporting and for ratemaking purposes, on a "pay as you go" basis (PAYGO). This meant that OPEB expenses were booked at the time the utility paid out the cash for benefits to its retired employees. FAS 106 mandated that companies change to an accrual method of accounting for OPEBs. Use of the accrual accounting method means that utilities must attempt to estimate, and charge to expense, the OPEBs earned by employees during the current period of service with the company. FAS 106 was adopted by the Missouri Legislature and is now incorporated into state law in Section 386.315, R.S.Mo. 1994.

Missouri-American has established three Voluntary Employment Beneficiary Associations (VEBAs) under IRC Section 501(C) for the purpose of maintaining its OPEBs. One VEBA was created for medical benefits for active and retired union employees, their spouses and dependents. The second VEBA was created for medical benefits for active and retired nonunion employees, their spouses and dependents. The third VEBA was created for life insurance for all employees. In August 1993, the Company began making quarterly contributions to the three VEBAs for OPEBs based upon Towers Perrin actuarial reports. These contributions represent cash contributions to the three VEBAs for the sole benefit of the employees. They represent actual expenditures made by the Company and are not available for any other purpose. Moreover, these contributions earn a return which helps to reduce future OPEB costs that will be reflected in future costs of service. Missouri-American alleges that a benefit will inure from these contributions to the VEBAs, and thus to the ratepayer, without the ratepayer having to provide a portion of the funds that have created these benefits. For these reasons, Missouri-American asserts that it is fair and appropriate that the contributions which are the net of the "PAYGO" and capitalized portions of OPEBs should be included in Company's rate base. The Company is not requesting recovery of any OPEB expenses for that period. The treatment of the excess amounts was not foreclosed in Case No. WR-93-212.

Staff supports rate base treatment for the FAS 106 contributions (net of PAYGO and capitalized portions of OPEBs) which the Company funded prior to July 1, 1994. Staff asserts this position based upon the proposition that the funded amounts will serve to reduce the overall revenue requirement associated with FAS 106 for the Company in the future due to the accumulation of earnings on the amounts in the trust fund.

OPC opposes any rate base recovery of FAS 106 contributions made to the VEBAs prior to July 1, 1994. OPC seems to base its argument, at least in part, upon the fact that the Commission denied Missouri-American's FAS 106 expenses in its last rate case, WR-93-212. OPC fails to discuss the distinction which arises here and is based upon the fact that in the interim between that case and the one sub judice, the Missouri Legislature enacted revisions to Section 386.315, R.S.Mo. 1994.

The Commission finds that the position which Company proposes and in which the Staff joins the Company is neither prohibited by statute nor prior Commission order. The Commission finds that Missouri-American's proposal on this issue is consistent with the Commission's order in Case No. WO-93-155 which authorized the accounting authority order. The Commission finds that the Company's quarterly contributions towards the three VEBAs for OPEBs represent cash contributions for the sole benefit of the employees. The Commission finds these represent actual expenditures made by the Company and that these expenditures are not available for any other purpose. The Commission finds that the contributions to these funds earn a return which helps to reduce future

OPEB costs and that this benefit will be reflected in future costs of service. The Commission finds that the customers of Missouri-American will gain a benefit from these contributions to the VEBAs without having to provide a portion of the funds that created the benefits. Therefore, the Commission finds that it is appropriate that the contributions which are the net of the PAYGO and the capitalized portions of OPEBs should be included in the Company's rate base. Based upon these findings, the Commission finds, in conclusion, that Missouri-American's proposed FAS 106 proposition will benefit current and future ratepayers and that it is in the public interest. The Commission will approve the $752,918 adjustment jointly proposed by the Company and Staff.

RATE CASE EXPENSE

The Company originally proposed to include in its test year cost of service its actual rate case expense amortized over a two-year period. However, as a result of the prehearing conference, Company and Staff have agreed that the Company should be permitted to recover its prudently incurred rate case expense as incurred through August 31, 1995, amortized over two years.

OPC believes that Company should be allowed a normalized annual level of its verifiable rate case expense, based upon a two-year occurrence rate, provided that Company is not allowed recovery of more than $135,373 on an annual basis. OPC argues this amount reflects the highest level of annualized rate case expense ever allowed for either this Company or Missouri Cities Water Company in prior rate cases. In their simplest terms, OPC's arguments would seem to suggest that Missouri-American may never recover more in rate case expense than it has in the past.

This argument, on behalf of OPC, fails to recognize several salient issues. First, utility operations, utility regulation and therefore utility rate cases are becoming more complex and involve more time to prepare as well as to try. In an effort to quantify the Company's prudently incurred expenses, it has cited Staff witness Baldree's testimony as to the number of hours spent by the Commission Accounting Staff and other Commission Staff auditing and preparing for this case. This may be taken as a measurement of the Company's involvement in preparation for this case. To a certain extent, the Commission Staff performed the same functions as the service company staff and the amount of time spent on the case by the Accounting Staff may be suggestive of the amount of time incurred by the service company staff. Moreover, the Commission employees who worked in the service company's offices had the opportunity to observe the time and effort spent by Company employees on this case and Staff witness Baldree testified that she found no imprudently incurred expenses in her examination of the Company's invoices and records. Similarly, OPC has failed to identify any Company expense which it may suggest was imprudently incurred.

On the other hand, Company cites to what it has termed as OPC's protracted discovery dispute and has properly asserted that the Company alone does not control the rate case expense which it incurs. Company is required to engage in negotiation which may lead to settlement and in discovery disputes, and as a result the total rate case expense may be the result of the efforts of all parties involved.

The Company has the burden of substantiating its rate case expenses, but absent a specific allegation of imprudently incurred rate case expense the Commission will not instigate a rate case within a rate case to examine the actual expenses incurred. Staff and Company have agreed to a figure which would have an effect on the revenue requirement of $289,867.

The Commission finds that the general rule governing rate case expense provides that those expenses which are known and measurable, reasonable, necessary and prudently incurred in the preparation and presentation of the Company's case may be included in the expenses of the Company. The Commission finds that it is in the public interest to allow such expenses for the accurate and adequate presentation of Company's rate case. The Commission finds that the rate case expense which is reasonable, necessary and prudently incurred in the preparation and presentation of the Company's case herein shall be $289,867 amortized over a two-year period.

EARLY PLANT RETIREMENT

Company has stated that it has been informed by the Missouri Department of Natural Resources (DNR) that the permit for its sewage treatment plant in Platte County will not be renewed. As a result, Missouri-American has negotiated an agreement with the City of Riverside, Missouri, whereby the Company will construct a connecting main from its sewer system to that of the City of Riverside. In return, the City of Riverside has agreed to accept and transmit the sewage through its system to the City of Kansas City, where it will ultimately be treated. Missouri-American initially proposed to include $30,391 in its sewer rate base to reflect the projected cost of the connecting main. In addition, Missouri-American proposed an adjustment of $35,074 to reflect the premature retirement of its sewage treatment plant. In addition to the connecting main, Missouri-American proposed to include in its cost of service the projected annual cost of $27,144 which it will pay either to the City of Riverside or to the City of Kansas City for treatment of the sewage. As a result of the prehearing conference, Missouri-American has agreed to eliminate its rate base adjustment to reflect the undepreciated amount of the sewer plant created by the premature retirement and, instead, has agreed to address the appropriate treatment of this retirement in the context of the depreciation study which it has agreed to perform. Thus, Missouri-American's request on this issue asks only for an increase of $6,096 in sewer revenues even though the record reflects that the Company will actually experience an increase in sewer expenses of an excess of $24,000.

Staff has specifically calculated that the Company will have an increase in sewer expenses of approximately $24,000 as a result of the proposed change in operations.

OPC argues the existing sewer plant which is in service should be kept in rate base and the projected costs of the sewer main should not be included in rate base since the Company did not construct the main during the test year or update periods approved by the Commission. Likewise, OPC argues that Missouri-American should not be allowed to recover the proposed charge for water disposal expenses since the related property is not in service, and thus not used and useful.

The Commission finds, as argued by Staff, that the elimination of the Company's sewer treatment plant and the construction of a connection to the City of Riverside's sewer system constitutes an isolated change, imposed by a governmental body, that should be reflected in the Company's revenue requirement. The change is known. Missouri-American has a contract allowing it to connect with and discharge to the City of Riverside's sewer system and Missouri-American has a contract for construction of the connecting main. As the Staff has stated, the change is measurable and Missouri-American is proposing to recover only a fraction of the revenue requirement associated with the connection to Riverside's system. In this case the Company proposed to increase its sewer revenue by $6,096. Even with the proposed increase in revenues, the Company will incur an annual loss of $24,000 of the sewer operations after the connection to Riverside's system is completed. Staff asserts that even if the final cost of constructing the sewer main cannot now be calculated with absolute certainty, the measurable increase in costs attributed to the waste disposal charge is certain and it will dwarf the revenue increase requested in this case. Staff has argued that this proposal does not violate the matching principle. Staff has testified that "this is a non-revenue producing item, so customer growth should not come into play. And there is no customer growth in the sewer district."

Therefore, the Commission finds on this issue that Missouri-American is proposing simply to reflect during the period that the rates set in this case will be in effect the costs that it has actually incurred. The Commission finds that these costs have been mandated by the Missouri Department of Natural Resources, that Missouri-American has an agreement with both the City of Riverside and the City of Kansas City to dispose of sewage, and that Missouri-American has signed a contract with a construction company to construct the main. The Commission finds, at this time, that the costs are known and measurable and have been incurred by the Company. The Commission finds that in spite of this allowance the Company will still have an increase in sewer expenses of approximately $24,000 above and beyond the amount approved herein.

RATE DESIGN

In developing proposed rates to recover its revenue requirement, Missouri-American has proposed to move toward single tariff pricing (STP) for all seven of its districts. Single tariff pricing is a pricing system which has, as a core concept, the establishment of a uniform unit price for water service for each class of customer within a large comprehensive geographical area. Application of the single tariff pricing concept to a water company reflects the ultimate goal of achieving uniform rates for water service, for each rate classification, in the company's entire service area. Under STP, the unit price for water service is the same for all customers in each classification and customers are classified according to similar usage and service characteristics. In other words, all customers within the same customer classification would pay the same unit price for water service irrespective of geographic location, source of water supply or physical integration of transmission and distribution systems. This concept involves, in part, cost averaging. Missouri-American has set out in its initial brief the fact that STP expands the scope of cost averaging to more than one operating district, and cost averaging in a multidistrict water company is already being achieved to the benefit of the Company's customers. For example, Missouri-American has stated that financing for all the Company's operating districts is achieved on a consolidated basis. As a result, each operating district has the same cost of capital irrespective of its size, customer base, prospects for future growth, or its financial rating on a separate-entity basis. Mass purchasing procedures are also used to achieve economies of scale that result in lower operating costs. By employing mass purchasing procedures, all operating districts pay the same average unit price for major items of materials such as pipe, fittings, valves, hydrants, meters and chemicals.

STP yields benefits to the Company as well as to its customers. The Company benefits include ease of administration and record-keeping as well as consolidation of customer service and management functions. Rate case efforts are also simplified for the Company and all of these savings translate into lower costs for the customers. This process should also serve to simplify the complexities usually involved in the regulatory process.

In this docket the Company has proposed to merge the tariff rates of the districts into three rate zones. St. Charles and St. Joseph would have a common rate, Joplin and Warrensburg would have a common tariff, and Mexico and Parkville would have a common rate. However, Brunswick's rates were proposed to be frozen at their current level.

Staff performed a cost of service study using the Base Extra Capacity method. Staff recommended that rates be set uniformly for the Company's entire operations. That is to say, the Staff proposed in its initial filing that

Company move completely to STP in the context of this case. Staff has cited the benefits of STP and concluded that such benefits far outweigh any associated detriments.

OPC supports the Company's proposed move toward STP provided that the resulting increase would not increase ten percent to the residential class in any particular division.

Pursuant to the prehearing settlement process, Missouri-American, Staff and OPC reached an agreement on a rate design proposal which would move toward STP more rapidly than that originally proposed by Missouri-American but not as quickly as that proposed by Staff.

After reviewing the initial briefs of all parties to this docket, it would appear that in addition to Staff, OPC and Missouri-American, the various intervenors have adopted or voiced support for the joint proposal as well. The lone possible exception to this statement would be the intervening City of Warrensburg which stated:

> . . . The immediate consequences of the three-phase rate design settlement agreed to by Staff, the Company and Public Counsel at the revenue requirement ranges established by the evidence in this case, while disproportionately higher for Warrensburg, are not inherently unjust in view of Staff's cost of service study.

The City of Warrensburg has expressed reservations regarding the Company's future construction plans and the impact which those plans would have upon a state-wide uniform tariff structure. However, it was made clear upon the conclusion of the hearing that future capital expenditures were not an issue in this case. This question was not presented for resolution in this case and so the Commission need not reach that issue. The Commission is not committed to a specific position as to such expenditures and as to the effect of those expenditures within a single tariff structure. The Commission will not reach a position on this issue until it is properly presented in a future case.

Consequently, the Commission is able to order a rate design which is, in essence, supported by all parties to this case. This rate design was set out by the parties as follows:

First, a uniform customer service charge and uniform private fire service charges would be established for all districts.

Second, for the St. Joseph, Joplin, Parkville and St. Charles districts, a uniform volumetric tariff would be established. This tariff would remain in effect until the next rate case. The volumetric pricing for all districts will change depending on the overall level of increase approved by the Commission. The Company calculated sample tariffs at a Company-proposed increase of $3,192,000 and the Staff calculated sample tariffs at a Staff-proposed increase of $1,450,000. Service charges and fire service charges are uniform and would not change under the agreement unless the allowed level of increase was outside the range of from $1,450,000 to $3,192,000.

Third, volumetric rates for Brunswick would be reduced between 31.60 percent (Company) and 36.66 percent (Staff) for both blocks. The first block charge at Mexico would remain the same as it currently is, the second block charge would be increased between 20.35 percent (Staff) and 29.96 percent (Company) depending upon the overall level of increase granted by the Commission. The third block at Mexico would be reduced between 35.94 percent (Company) and 40.68 percent (Staff). At Warrensburg, the first rate block would be changed by an increase of 5.70 percent (Company) ranging to a decrease of 9.2 percent depending on the overall increase allowed. The second and third rate blocks would be increased by 10.30 percent (Staff) and 22.98 percent (Company) depending on the overall level of increase allowed.

Under phase 2, which would take place twelve months after the effective date of the tariffs filed at the conclusion of this case, a revenue-neutral adjustment would be made to the volumetric rates at Brunswick, Mexico and Warrensburg to bring them 50 percent of the difference between the phase 1 tariffs and the uniform tariff for the Joplin, Parkville, St. Charles and St. Joseph group.

The final step toward single tariff pricing would be made in the following rate case. The final rate design in that case would fully equalize all volumetric rates.

Company has stated that it fully supports the agreement it has reached with Staff and OPC regarding rate design and urges the Commission to adopt it. Missouri-American notes that as a result of compromises in the agreements reached during the prehearing conference, the Company's request has been reduced to approximately $2.5 million or an approximate 10.83 percent increase over existing revenues. While variations will occur in the amount of the increase from district to district, these variations have been mitigated to some degree by the proposed phase-in. Company has specifically noted that many of the existing rates are not necessarily cost-based. Accordingly, some of the increases experienced by a particular district in this case may be the result of cross-subsidies which were built into historic rates.

The Commission finds the proposed move toward single tariff pricing for Missouri-American and all of its districts, as jointly agreed to by the Staff, Missouri-American and OPC and as, to some degree, supported by all intervenors, is therefore in the public interest.

DEPRECIATION RATES

For purposes of calculating an annual level of depreciation expense, the Company used the existing authorized rates of depreciation for Missouri-American and Missouri Cities Water Company. However, after the prehearing conference the Company has agreed to use Staff's proposed "weighted" depreciation rates. Company has stated that both methods produce roughly the same annual level of depreciation expense. However, Staff's method has the advantage of using one set of depreciation rates for all plant accounts.

The Staff proposal uses weighted composite whole-life depreciation rates for the Company's water plant and a continuation of the depreciation rates previously approved for Missouri Cities Water Company for the Company's sewer plant. Staff witness Birenbaum testified that it was inappropriate to apply the limited salvage experience available for the two companies to the merged Company, now approximately twice the size it was three years ago. This witness went on to state that since the rates for premerged companies were set not long ago, he had confidence that they are appropriate until a full study of the entire Company can be undertaken.

No evidence was presented by any party nor was it suggested that the depreciation rates previously authorized or Staff's proposed "weighted" rates were not appropriate. Company has agreed to perform a depreciation study as described in the direct testimony of Staff witness Birenbaum before tariff sheets are filed in its next general rate case, or within two years of the effective date of the Report And Order issued in this case, whichever first occurs.

This was not presented as a contested issue. The Commission will accept and authorize the weighted composite whole-life depreciation rates as agreed to by Staff and Missouri-American. OPC has specifically stated that it does not support Staff's position and OPC has criticized the way in which Staff reached that position. However, OPC has not offered evidence to support a different result.

The Commission will accept the proposal set forth by Staff and Missouri-American.

MISCELLANEOUS

The Commission notes that paragraph 2 of the settled issues states:

> 2. The parties, other than AGP, agree that the Commission should approve the economic development tariff provision filed by the Company.

The Commission finds that though this has been set out as a settled issue, the failure of the parties to obtain AGP's agreement on this issue makes it an unclear issue. However, AGP has not presented testimony on this issue nor has it argued this issue in its brief or its reply brief. Therefore, the Commission finds that all of the evidence in the record as to this issue supports the agreement which appears to be unanimous as to all parties but for AGP. Therefore, the Commission finds that the economic development tariff provision is not opposed by any party to this proceeding and is, therefore, in the public interest. The Commission finds this issue is a settled issue.

The Commission also notes that paragraph 7 of the settled issues states:

> 7. The parties, other than AGP, agree to update the Company's cost of service for the Commission assessment for fiscal year 1996. Currently, $200,892 is included in the Staff's case for last year's Commission assessment. AGP does not agree to update the case for the Commission's assessment for fiscal year 1996 and has argued that this is too far out of the test year in this case.

The Commission finds that though this has been set out as a settled issue, the failure of the parties to obtain AGP's agreement on this issue makes it an unclear issue. The Commission finds that the assessment for fiscal year 1996 for Missouri-American is known and measurable and that it has been prudently incurred. Based upon the record the Commission finds that it is appropriate and reasonable to address and dispose of this item within this rate case rather than defer it, possibly for several years or more, to the next Missouri-American rate case. The Commission finds that the Commission assessment is a necessary expense for this regulated utility and that payment of this assessment is in the interest of the customers of Missouri-American. The Commission will approve the update of the Company's cost of service to include the assessment for the fiscal year 1996 as agreed to by all parties except AGP.

The Commission finds that on August 2, 1995, OPC reserved exhibit numbers 72 and 73 for late-filed exhibits. No such late-filed exhibits were received by the Commission and therefore these items are not admitted into the record. These numbers will be unused and the next admitted exhibit shall begin with number 74.

Conclusions of Law

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

Missouri-American Water Company is a public utility subject to the jurisdiction of the Commission pursuant to Chapters 386 and 393, R.S.Mo. 1994. Missouri-American's tariffs, herein, were suspended pursuant to authority vested in the Commission by Section 393.150, R.S.Mo. 1994, which places upon the company the burden of proof to show the proposed increase in rates is just and reasonable.

Pursuant to Section 536.060, R.S.Mo. 1994, the Commission may approve a stipulation and agreement concluded between parties as to any issues in a contested case. The Commission has determined that the agreements among the parties as to the issues regarding the performance of a depreciation study, the filing of a complete sewer tariff for the Parkville sewer district, Missouri-American's use of a ten-year amortization of deferred gains and losses in calculating its pension expense in accordance with FAS 83, the separate tracking of pensions and OPEBs for Missouri-American, the write-off of design costs for a proposed Joplin distribution center, and the management audit of Missouri-American as proposed in the direct testimony of OPC are reasonable and, therefore, the Commission concludes that these agreements should be approved. These agreements are specifically set out in the Hearing Memorandum in this docket.

The Commission must also determine what is a just and reasonable return on equity for the Company. In doing so the Commission ultimately relies on ***Federal Power Commission v. Hope Natural Gas Co.***, 320 U.S. 591, 602, 64 S. Ct. 281, 287, 88 L. Ed. 333 (1945). The Commission in its determination also relies upon ***State ex rel. Mo. Public Service v. Pierce***, 604 S.W.2d 623 (Mo. App. 1980). Based upon its findings herein and the conclusions of law as herein set forth, the Commission finds and concludes that the return on equity as herein set out is just and reasonable.

Based upon the Commission's findings in this case, the Commission concludes that just and reasonable revised tariffs should be filed by Missouri-American designed to increase its total revenue by $1,922,846. This figure has been arrived at by completion of the scenario which is attached hereto and incorporated herein as Attachment A.

IT IS THEREFORE ORDERED:

1. That the tariffs submitted by Missouri-American Water Company on January 6, 1995, are hereby rejected and Missouri-American Water Company is authorized and required to file tariff sheets consistent with this order to increase total revenue by $1,922,846 for service on and after December 5, 1995.

2. That all objections and offers of proof not specifically ruled upon are hereby overruled or denied.

3. That the Commission approves the stipulation(s) and agreement(s) on settled issues as set out in the Hearing Memorandum which has been admitted as Exhibit No. 1.

4. That the Commission accepts the scenario (B) and hereby admits same as Exhibit No. 74.

5. That this Report And Order shall become effective on December 5, 1995.

BY THE COMMISSION

David L Rauch

David L. Rauch
Executive Secretary

(S E A L)

Mueller, Chm., McClure, Kincheloe,
Crumpton and Drainer, CC., concur
and certify compliance with the
provisions of Section 536.080,
R.S.Mo. 1994.

Dated at Jefferson City, Missouri,
on this 21st day of November, 1995.

SCENARIO

[assuming error correction] [B]

Issued November 14, 1995

	REVENUE REQUIREMENT
Company's request	3,777,966
Revisions/updates to company request	(624,350)
Items settled during prehearing conference	(333,053)
Hearing Revisions/updates	(398,283)
PSC fees	3,817
Rate case expense update	116,782
Current company position	$2,542,879

ISSUES	DECISION	VALUE	REVENUE/EFFECT
Capital Structure	Actual capital structure	0	0
Return on Equity	11.59	13,563	-13,563
Acquisition Adjustment	Staff/OPC		
Rate Base		4,392,316	-503,281
Amortization		178,227	-178,227
Tax Depreciation	Error Correction [B]	75,038	75,038
Depreciation	Staff/Company	26,105	0
FAS 106	Staff/Company	752,918	0
Rate Case Expense	Staff/Company	154,494	0
Early Plant Retirement	Staff/Company		
Rate Base		-4,683	0
Amortization		27,144	0
Rate Design	Single Tariff Pricing	0	0
Depreciation Rates	Staff/Company	0	0
Revenue Requirement		N/A	1,922,846
Tax Effect		N/A	[A]
TOTAL REVENUE REQUIREMENT			$1,922,846

[A] The tax effect of each issue is included in total revenue requirement.

[B] During calculations for this Scenario request, the parties discovered a tax depreciation error related to the acquisition adjustment.