



Commissioners  
KELVIN L. SIMMONS  
Chair  
CONNIE MURRAY  
SHEILA LUMPE  
STEVE GAW  
BRYAN FORBIS

## Missouri Public Service Commission

POST OFFICE BOX 360  
JEFFERSON CITY, MISSOURI 65102  
573-751-3234  
573-751-1847 (Fax Number)  
<http://www.psc.state.mo.us>

March 26, 2002

ROBERT J. QUINN, JR.  
Executive Director  
WESS A. HENDERSON  
Director, Utility Operations  
ROBERT SCHALLENBERG  
Director, Utility Services  
DONNA M. PRENGER  
Director, Administration  
DALE HARDY ROBERTS  
Secretary/Chief Regulatory Law Judge  
DANA K. JOYCE  
General Counsel

Mr. Dale Hardy Roberts  
Secretary/Chief Regulatory Law Judge  
Missouri Public Service Commission  
P. O. Box 360  
Jefferson City, MO 65102

**RE: Case No. WR-2000-281**

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of the **STAFF'S RESPONSE TO ORDER DIRECTING FILING**.

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Keith R. Krueger  
Deputy General Counsel  
(573) 751-4140  
(573) 751-9285 (Fax)

KRK/lb  
Enclosure  
cc: Counsel of Record

FILED<sup>2</sup>

MAR 26 2002

Missouri Public  
Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

FILED<sup>2</sup>

MAR 26 2002

Missouri Public  
Service Commission

In the Matter of Missouri-American Water )  
Company's Tariff Sheets Designed to )  
Implement General Rate Increases for )  
Water and Sewer Service Provided to )  
Customers in the Missouri Service Area of )  
the Company )

Case No. WR-2000-281

**STAFF'S RESPONSE TO ORDER DIRECTING FILING**

COMES NOW the Staff of the Missouri Public Service Commission and, for its Response to Order Directing Filing states to the Missouri Public Service Commission as follows:

1. On March 7, 2002, the Commission issued its Order Setting Prehearing Conference and Directing Filing. In this Order, the Commission ordered the parties to each prepare and file on or before 4:00 p.m. on March 26, 2002, a pleading setting out its suggestions as to the course of action that the Commission should follow with respect to the issues that were remanded to the Commission by the Cole County Circuit Court. The Commission further ordered the parties to divide each pleading sections corresponding to the issues in question and to state whether the existing record is sufficient on each issue to support the necessary findings of fact.

**Joplin District Revenue Requirement**

2. The Circuit Court of Cole County made the following ruling on this matter:

that the decision of the Respondent Public Service Commission in this matter is **reversed** as to the Respondent's refusal to reduce the Joplin District rate to its cost of service, such decision being lacking in findings of fact in violation of Section 536.090 and Section 386.420.2, RSMo. 2000, and this issue is remanded to the Commission;<sup>1</sup>

<sup>1</sup> Amended Findings of Fact, Conclusions of Law and Judgment, issued by the Cole County Circuit Court on October 3, 2001, at page 20.

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3. The Commission made the following pertinent findings regarding this issue in its Report and Order in this case:

The Commission will move away from STP and toward DSP. ... In moving toward DSP, however, the Commission will adhere to the principle that no district will receive a rate decrease.<sup>2</sup>

4. The Commission issued an Order of Clarification on September 12, 2000 and addressed its exact intent of the effect of the Commission's Report and Order:

MAWC must calculate its revenue requirement separately for each of its seven districts, as though each were a stand-alone water company, applying the Commission's Report and Order as appropriate. The Commission stated in its Report and Order that it "will move away from STP and toward DSP" because it is clear, on the extensive record developed in this case, that the Joplin district will produce surplus revenue. Staff is correct in its suggestion that this surplus will be used to ameliorate the rate increase impact on the other six districts. (Footnote omitted).<sup>3</sup>

5. Staff submits that no further evidence is necessary on the issue of the revenue requirement for the Joplin District. The Commission's intent is clear in regard to what is to happen regarding the surplus revenue from Joplin above its cost of service. The only issue for the Commission is to produce further findings explaining why the Commission decided to not reduce the Joplin district to its exact cost of service.

6. While such a decision is certainly within the discretion of the Commission in its determination of just and reasonable rates<sup>4</sup> GET CASE FROM CIR. COURT BRIEF, Staff notes that evidence adduced at the hearing by the Office of Public Counsel provides some evidentiary basis for this issue.

7. OPC Witness James A. Busch stated the following in his direct testimony:

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<sup>2</sup> Report and Order, issued August 31, 2000, at p. 58.

<sup>3</sup> Order of Clarification, issued September 12, 2000, at p. 2.

With respect to the goal of proposing rates that are just and reasonable for all consumers of MAWC, Public Counsel thinks that the rates should be set in such a manner that would move MAWC's rates away from STP, but also try to mitigate the rate shock that will result from the addition of the new plant in St. Joseph.<sup>5</sup>

8. Mr. Busch elaborated on his methodology for determining just and reasonable rates in his rebuttal testimony, where he stated as follows:

I then looked at the other three districts, Joplin, St. Charles, and Warrensburg. I then determined that a district could end up paying up to 10% above its cost of service in this case, as long as the increase that was due to the move towards DSP, plus any additional revenues to be shared, did not exceed 15%. This caveat meant that Warrensburg would merely pay its cost of service. Looking at the other two districts, it was determined that, at this time, *Joplin would receive a zero increase to its rates* and St. Charles would receive an additional increase of 3.7% to its allocated revenues, which gives the St. Charles district an overall increase of 8.4%. This total was then split among the three smallest districts such that their respective increase would be limited to 50%.<sup>6</sup> (Emphasis added.) It is therefore seen that Mr. Busch supported a zero increase, and by the same token, a zero decrease, to the rates for the Joplin District.

#### **Effect of Main Size on Cost of Service**

9. The Circuit Court of Cole County made the following ruling on this matter:

that the decision of Respondent Public Service Commission in this matter is **reversed** as to the Respondent's failure to provide any findings of fact from which the Court may review the administrative decision as regards the issue of the proper treatment of the costs associated with smaller

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<sup>4</sup> *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*, 41 S.W.2d 41 (Mo. Banc 1979),

<sup>5</sup> Busch Direct, Ex. 27, p. 7, lines 17-20.

<sup>6</sup> Busch Rebuttal, Ex. 28, p. 8, line 17 – p. 9, line 2.

distribution mains as distinguished from larger transmission mains, and the issue is remanded to the Commission;<sup>7</sup>

10. The Commission made the following findings on this issue:

The final issue in the rate design is the allocation on rate increases in each district across customer classes. ...

Both Staff and MAWC advocate the use of the Base-Extra Capacity (BXC) method to allocate costs among the various customer classes of within (*sic*) each district. This method allocates costs in proportion to each class's use of the commodity, facilities and services involved. Its purpose is to accurately allocate costs on a causal basis. Once costs are allocated to customer classes using this method, rates can be developed to recover the necessary revenue from each class.

The BXC method considers four categories of costs: base costs, extra capacity costs, customer costs, and fire protection costs. Base costs vary with usage and are the costs of providing service under average load conditions. Extra capacity costs incurred to meet usage in excess of average load. Customers' costs are those costs associated with providing water service regardless of usage, such as billing and collections, and meter reading. Finally, fire protection costs are associated with meeting peak fire protection demands. Each category of costs is allocated among the customer classes using allocation factors. Rates are then developed to recover the allocated cost from each class.

Staff witness Randy Hubbs applied the BXC method on a DSP basis. ...

Having considered the evidence and the arguments of the parties, the Commission concludes that Staff's class cost of service study, developed using the BXC method, is the appropriate method by which to allocate costs among customers classes in each district and to design rates by which to recover appropriate revenues within each district.<sup>8</sup>

11. The circuit court order that remanded this issue to the Commission (quoted above in Paragraph 8) was issued on October 3, 2001, in response to a writ of review that was obtained by the St. Joseph Industrial Intervenors. However, the Staff notes that the circuit court had previously issued another order in response to writs of review that were obtained by other parties to this case.

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<sup>7</sup> Amended Findings of Fact, Conclusions of Law and Judgment, issued by the Cole County Circuit Court on October 3, 2001, at page 20.

<sup>8</sup> Report and Order, issued August 31, 2000, at pp. 60-61.

12. In that prior order, the Cole County Circuit Court had specifically affirmed, as lawful and reasonable, the Commission's decision to allocate costs based upon the Base-Extra Capacity method. The court there said:

59. The Staff advocated the use of the "Base-Extra Capacity" method of allocating the Company's cost of service among the various classes of customers that the Company serves, such as residential, commercial and industrial customers. The Staff of the Commission provided an expert witness who applied the Base-Extra Capacity method on a district specific basis.

60. The principal purpose of the Base-Extra Capacity (or "BXC") method is to allocate the Company's costs so that the costs are borne, as nearly as possible, by the customers who cause the costs to be incurred. The Commission concluded "that Staff's class cost of service study, developed using the BXC method, is the appropriate method by which to allocated costs among customer classes in each district to design rates by which to recover appropriate revenues within each district." Report and Order, p. 61.

61. The Commission's decision to adopt the Staff's cost-of-service study, which was developed using the Base-Extra Capacity method was reasonably calculated to allocate the Company's cost of providing a service to the customer who caused the cost, and was supported by competent and substantial evidence on the whole record. Also, as to this issue, the Commission's findings of fact set out the basic facts from which it reached its ultimate conclusion.

62. The Commission's decision to allocate costs based upon the Base-Extra Capacity method, which resulted in fair and reasonable interclass rate shifts, was lawful and reasonable.<sup>9</sup>

The circuit court then affirmed the Commission as to "the ruling on the class rate design issue."<sup>10</sup>

13. Staff submits that no additional evidence on the subject of "the costs associated with smaller distribution mains" is necessary because there is already sufficient evidence in the record to show that the Commission, at the very least, specifically rejected anything contrary to the Staff's cost-of-service study even if no specific mention of it was made. This includes the

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<sup>9</sup> Order and Judgment, issued by the Cole County Circuit Court on May 25, 2001, at p. 17.

<sup>10</sup> Order and Judgment, issued by the Cole County Circuit Court on May 25, 2001, at page 18,

“costs associated with smaller distribution mains” opinion asserted by Mr. Ernest Harwig in his rebuttal testimony (Harwig Rebuttal, Exhibit 61, p. 5, lines 10-23 through p. 6, line 11).

14. Staff suggests that the Commission adopt the following findings of fact and conclusions of law regarding this matter:

The Commission finds that the Circuit Court of Cole County, in its Amended Findings of Fact, Conclusions of Law and Judgment, issued October 3, 2001, remanded the issue of the proper treatment of costs associated with smaller distribution mains, as distinguished from larger transmission mains, for entry of findings of fact from which the circuit court may review the Commission’s decision.

The Commission finds that, as the circuit court noted in its Order and Judgment issued May 25, 2001, the Commission specifically adopted the Staff’s cost of service study in the Report and Order that it issued in this case on August 31, 2000. The circuit court further found that this decision to adopt the Staff’s cost of service study was supported by competent and substantial evidence on the whole record and was lawful and reasonable.

The Commission was cognizant of opinions that Mr. Ernest Harwig expressed about the “costs associated with smaller distribution mains” in his rebuttal testimony. (See Harwig Rebuttal, Ex. 61, p. 5, line 10 – p. 6, line 11). However, the Commission specifically determines that the opinion advocated by Mr. Harwig was not credible and specifically rejects Mr. Harwig’s opinion suggesting a modification of the Base-Extra Capacity Method when it adopted the Staff’s class cost of service study. In other words, the Commission rejects Mr. Harwig’s opinion since it was contrary to the class cost of service study adopted by the Commission.

The Commission further specifically finds as credible the testimony of Staff Witness Wendell R. Hubbs in his surrebuttal testimony, wherein Mr. Hubbs specifically stated that Mr. Harwig’s observation is incorrect. The Commission finds that that Mr. Harwig’s allocation would erroneously allocate distribution-related capital and operating costs to classes other than the industrial class. The Commission concludes that a modification of the Base-Extra Capacity method as advocated by Mr. Harwig would not be appropriate and specifically rejects such an idea as invalid.

#### **Premature Retirement**

15. This issue is unlike the others that the circuit court remanded to the Commission, in that, as to this issue, the circuit court did not direct the Commission to provide better findings of fact and conclusion of law, but rather said simply that the case was “reversed as to the ‘premature retirement’ issue and remanded to the Public Service Commission for further proceedings consistent with this opinion.”<sup>11</sup>

16. It therefore appears that the entry of new findings of fact and conclusions of law would not be sufficient to persuade the circuit court that the Commission’s ruling on this issue in the Report and Order was correct. The Commission is therefore confronted with the question of whether to appeal the circuit court’s order or to accept the circuit court’s order and conduct such further proceedings as are necessary to comply with it. If the Commission decides to appeal this aspect of the circuit court order, then any additional proceedings are premature pending the resolution of such an appeal. If the Commission decides not to appeal this aspect of the circuit court order, then Staff presents its suggestions on this issue.

17. As a result of its decision to construct the new water treatment plant at St. Joseph, the Company abandoned its existing plant, which had an undepreciated balance of \$2,832,906. In addition, the Company expected that it would incur costs of about \$500,000 for the removal and demolition of the old plant. The Staff argued that the Company should not be allowed to amortize this unrecovered investment until a depreciation study could be conducted. However, once that was done, the Staff supported the recovery of the undepreciated balance. The Commission rejected this, however, and ordered that the old plant’s net original cost of \$2,832,906 be written off.<sup>12</sup> Evidence in support of the position that the Commission took may be found in the testimony of Public Counsel witness Kimberly K. Bolin. The circuit court

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<sup>11</sup> See the Order and Judgment, issued May 25, 2001, at p. 18.

<sup>12</sup> See Report and Order issued August 31, 2000, at p. 52.



reversed the Commission on this point, stating that since the Commission had decided the Company's decision to construct a new plant was prudent, the Company could not be ordered to write off this undepreciated balance.

18. Following the circuit court's instructions on remand will result in an increase in the Company's revenue requirement. The question then becomes: Which ratepayers should bear the burden of this increased revenue requirement? Various answers to this question are possible. Some might argue that all of this additional revenue requirement should be allocated to the St. Joseph District, and the costs allocated among the ratepayers in that district the same as all other costs that are allocated to the St. Joseph District; but it is likely that the ratepayers in that district would disagree.

19. In its Order Setting Prehearing Conference and Directing Filing, issued March 7, 2002, the Commission stated: "By statute, all remands to the Commission are general remands." That being so, the Commission should consider how to allocate this cost among the ratepayers in the light of all relevant factors. In order to do this, it would be necessary to conduct an additional hearing for the limited purpose of determining the amount of the additional costs that result from the premature retirement and how those costs should be recovered from the ratepayers.

20. The Staff emphasizes, however, that the new evidence that is presented in these additional proceedings should be strictly limited to only the specific issues related to the remand of the premature retirement issue. The Commission could then consider this new evidence together with all of the evidence that has already been presented and issue a new Report and Order that considers all relevant factors.

### **Decision Not to Phase In the Rate Increases**

21. The circuit court's discussion of the "phase-in" issue was very brief.<sup>13</sup> The circuit court reversed the Commission on this issue, stating that the Report and Order was:

Reversed as to the "phase-in" issue and remanded to the Public Service Commission with instructions that the Commission make findings of fact and conclusions of law sufficient to support a resolution of the phase-in issue in Case No. WR-2000-281 and to permit the Court to determine whether such resolution is based upon and supported by the competent and substantial evidence on the whole record in that case and is otherwise reasonable and lawful.<sup>14</sup>

22. The Staff advocated that the rate increases be phased in to mitigate the effects of "rate shock."<sup>15</sup> The Office of Public Counsel and other parties also urged the Commission to order a phase-in of the rate increase. The Commission declined to do so, however, stating: "As the Company requested, no phase-in of rate increases shall be permitted."<sup>16</sup>

23. With the passage of time, however, the issue of a phase-in may have become moot. The Staff no longer supports a phase-in, and it is possible that no other party would support a phase-in at this time, either since the benefits that might be expected from a phase-in can no longer be realized.

24. The rate increases that were ordered in this case became effective in September 2000 – more than 18 months ago. Any "rate shock" that might occur as a result of the large rate increases that were ordered has already taken place. The ratepayers can no longer be "shocked" by the immediate implementation of a rate increase that has already been in effect for more than 18 months.

25. Furthermore, if a phase-in were ordered at this late date, there would be very little that could be postponed, and determining exactly what shape the phase-in would take would

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<sup>13</sup> See the Order and Judgment, issued May 25, 2001, ¶ 63, at pp. 17-18.

<sup>14</sup> See the Order and Judgment, issued May 25, 2001, at p. 18.

<sup>15</sup> Rackers Direct, Ex. 52, pp. 11-13.

probably require additional evidence and hearings. The Staff's phase-in proposal contemplated that rates would be increased each year during the first five years following the Report and Order, and that carrying charges would accrue on the deferred revenue. By so doing, the rates during the first year (September 2000 – September 2001), the rates would be considerably less than they would be (and have been) with no phase-in ordered. But to compensate for this, the rates during the fifth year (September 2004 – September 2005), the rates would have to be considerably more than they would be with no phase-in ordered. During the third year (September 2002 – September 2003), the rates would have be approximately the same as they would be with no phase-in ordered,<sup>17</sup> and would be approximately equal to the rates over the full five-year period.

26. If a phase-in were now, at this late date, ordered, and if it became effective on September 20, 2002 (the start of the third year after the issuance of the Report and Order), the “phased-in” rates would be virtually the same as the rates now are, without the phase-in. And as the Company would not have had to defer any revenue because of the phase-in, there would be no reason to increase the rates in the fourth and fifth years after the issuance of the Report and Order. The benefits of a phase-in would be nil.

27. If the phase-in could be ordered to take effect before September 20, 2002, the rates might decrease slightly for a short period of time, but would then have to gradually increase over the remainder of the five-year period. If this occurs, the ratepayers would be able to delay a small part of their water bill. But the result would be: first “rate shock” (in September 2000); then nearly two years without a change in rates; then a brief decline in rates; then gradual

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<sup>16</sup> Report and Order, issued August 31, 2001, at p. 58.

<sup>17</sup> They would probably actually have to be slightly higher, to account for the carrying charge.

increases in rates; and finally, assuming no general rate increase in the interim, another decrease in rates to the current levels. This would be confusing and of little benefit to ratepayers.

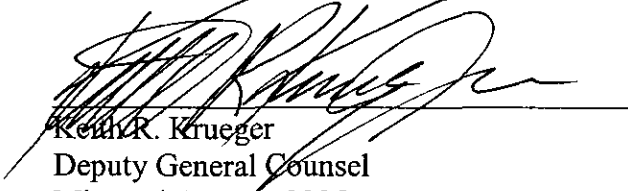
28. In addition, evidence opposing a phase-in of the rates may be found in the testimony of Company witnesses.<sup>18</sup>

29. However, it is necessary for the Commission to set out findings of fact and conclusions of law pursuant to the circuit court's Order and Judgment.

**WHEREFORE**, the Staff submits its Response to Order Directing Filing.

Respectfully submitted,

DANA K. JOYCE  
General Counsel



Keith R. Krueger  
Deputy General Counsel  
Missouri Bar No. 23857  
Robert V. Franson  
Associate General Counsel  
Missouri Bar No. 34643

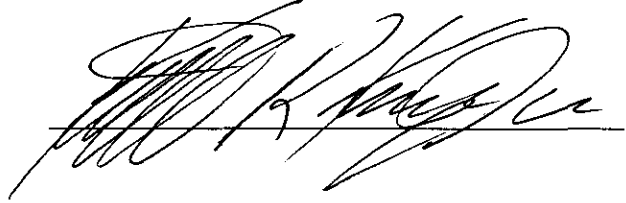
Attorneys for the Staff of the  
Missouri Public Service Commission  
P. O. Box 360  
Jefferson City, MO 65102  
(573) 751-6651 (Telephone)  
(573) 751-9285 (Fax)  
[kkrueg01@mail.state.mo.us](mailto:kkrueg01@mail.state.mo.us) (e-mail)

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<sup>18</sup> See, for example, Jenkins Rebuttal, Ex. 4, p. 5, line 20 – p. 6, line 26; and Hamilton Surrebuttal, Ex. 3, p. 2, line 25 – p. 9, line 21.

### **Certificate of Service**

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 26th day of March, 2002.

A handwritten signature in black ink, written over a horizontal line. The signature is stylized and appears to be "J. H. [unclear]".

**Service List for  
Case No. WR-2000-281  
March 25, 2002 (ccl)**

**Office of the Public Counsel  
P.O. Box 7800  
Jefferson City, MO 65102**

**Charles Brent Stewart  
Stewart & Keevil, L.L.C.  
1001 Cherry Street, Suite 302  
Columbia, MO 65201**

**Stuart Conrad/Jeremiah D. Finnegan  
Finnegan, Conrad & Peterson  
3100 Broadway, Suite 1209  
Kansas City, MO 64111**

**Ed Downey  
221 Bolivar St., Suite 101  
Jefferson City, MO 65102**

**Lisa M. Robertson/Brian Head/ Timothy Kissock  
City Hall – Room 307  
1100 Frederick Avenue  
St. Joseph, MO 64501**

**Karl Zobrist  
Blackwell Sanders Peper Martin LLP  
2300 Main Street, Suite 1100  
Kansas City, MO 64108**

**Chuck D. Brown  
303 East Third Street  
P.O. Box 1355  
Joplin, MO 64802**

**Louis J. Leonatti  
Leonatti & Baker, P.C.  
123 E. Jackson St., P.O. Box 758  
Mexico, MO 65265**

**Leland B. Curtis  
Curtis, Oetting, Heinz, Garrett & Soule  
130 S. Bemiston, Suite 200  
St. Louis, MO 63105**

**Martin W. Walter/Joseph W. Moreland  
Blake & Uhlig, P.A.  
2500 Holmes Rd.  
Kansas City, MO 64108**

**Diana M. Vuylsteke, Esq.  
One Metropolitan Square, Suite 3600  
211 N. Broadway  
St. Louis, MO 63102-2750**

**James Deutsch/Henry Herschel  
Riezman & Blitz, P.C.  
308 East High Street, Suite 301  
Jefferson City, MO 65101**

**James M. Fischer**  
**101 Madison Street, Suite 400**  
**Jefferson City, MO 65101**

**W.R. England III/Dean L. Cooper**  
**Brydon, Swearngen & England**  
**312 E. Capitol Avenue, P.O. Box 456**  
**Jefferson City, MO 65102**