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September 13, 2000

FILED[3]
SEP 13 2000
Missouri Public Service Commission

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

Re: Missouri-American Water Company
- Case No. WR-2000-281/SR-2000-282

Dear Mr. Roberts:

Enclosed for filing on behalf of Missouri-American Water Company, please find an original and (8) copies of an Application for Rehearing.

A copy of this filing will be provided to parties of record.

Please see that this filing is brought to the attention of the appropriate Commission personnel. I thank you in advance for your cooperation in this matter.

Sincerely,

W.R. England, III

WRE/da
Enclosure
cc: Parties of Record

BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

FILED[3]

SEP 1 3 2000

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 Case No. SR-2000-282

APPLICATION FOR REHEARING

Comes Now Missouri-American Water Company ("MAWC" or "Company"), in accordance with Section 386.500, RSMo (1994), and 4 CSR 240-2.160, and for its Application for Rehearing, respectfully requests that the Missouri Public Service Commission ("Commission") rehear its Report and Order issued in the above-captioned matters on August 31, 2000, to become effective on September 14, 2000 (the "Report and Order"). For the reasons stated herein, the Report and Order, and certain findings and conclusions contained therein, is unlawful, unjust, unreasonable, arbitrary, capricious, involve an abuse of discretion, are unsupported by competent and substantial evidence upon the whole record and are unconstitutional in the particulars hereinafter stated for the following reasons and in the following respects:

I. PREMATURE RETIREMENT

At page 52 of the Report and Order, the Commission found and/or concluded as follows:

> MAWC is permitted a reasonable return only on the value of its assets actually devoted to public service. From the moment of its retirement, a moment controlled by MAWC, the old plant was no longer used and useful in public service. In an early case involving the retirement of utility assets, the Missouri

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Supreme Court stated:

> The abandonment of property which is never replaced, but is superseded by another instrumentality, as gas lamps by electric lights, or by another agency or company, is an extraordinary supersession. Its loss is "one of the hazards of the game," just as the extraordinary increase in values following the war was an unexpected gain . . . . It follows that the abandoned property, lights, service mains, and the like should not be considered for the purpose of determining the annual depreciation reserve.

> State ex rel. City of St. Louis v. Public Service Com'n of Missouri, 329 Mo. 918, 941, 47 S.W.2d 102, 111 (1931).

> It follows that the treatment proposed by Public Counsel is correct. Utility plant-in-service will be reduced by the original cost of the old St. Joseph plant, while the depreciation reserve will be reduced only by the amount of depreciation accumulated with respect to the plant. The difference, the plant's net original cost of $2,832,906, will be written off. Likewise, any amount expended by MAWC to retire the old plant is also not recoverable in rates.

These findings and/or conclusions, which refuse to recognize in MAWC's revenue requirement any portion of the net depreciation, are unlawful, unjust, unreasonable, arbitrary, capricious, involve an abuse of discretion, and are unsupported by competent and substantial evidence upon the whole record.

This issue resulted from the fact that the old St. Joseph treatment plant was not fully depreciated at the time it was retired. "If the accounting convention were perfect, an asset would be fully depreciated at the time it is actually retired, that is, removed from service. . . . In the case of the old St. Joseph treatment plant, the accounting convention yielded an imperfect result and the plant was not yet fully depreciated at the moment of its retirement." (Report and Order, p. 50).

A water corporation, such as MAWC, must utilize the depreciation rates which are established by the Commission. Section 393.240, RSMo (1994). Thus, the "imperfect result" is the result of the Commission ordered depreciation and a failure to match depreciation to the life of the plant is based upon the Commission's own decisions. In fact, this Commission was specifically made aware of this problem in the Company's last rate case[1] and chose to do nothing about it. The Commission found as follows:

> The Commission agrees with the opposing parties that the 2001 retirement date is somewhat speculative and institution of this amortization would be premature. Presumably, MAWC will have made a start on the new St. Joseph plant by the time of its next rate case. At that time the Commission may have evidence to support such an amortization proposal.

(Case No. WR-97-237).

Further evidence of the imperfect match of Commission ordered depreciation rates and the actual retirement of plant is demonstrated by the fact that the original investment in this account was over $6 million. After one hundred years plus of depreciation (as directed by this Commission) approximately $2.8 million of investment remains on the books. This mismatch is not "controlled" by MAWC, as the Commission seems to believe, but rather it is one over which the Commission has control. To require the Company to suffer the consequences of the inadequacy of Commission established depreciation rates is hardly fair or reasonable.

The Commission acknowledges that it must "permit the utility to recover a 'just and reasonable' return on the assets it has devoted to public service. *Utility Consumers' Council*, 585 S.W.2d at 49. There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment. *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981)." (Report and Order,

[1] *In the Matter of Missouri-American Water Company's Tariff Designed to Increase Rates for Water Service*, Case No. WR-97-237 (1997).

p. 36).

The Company's constitutional right has been found by the United States Supreme Court to include the recovery of depreciation expense.

> Broadly speaking, depreciation is the losses, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. Annual depreciation is the loss which takes place in a year. In determining reasonable rates for supplying public service, it is proper to include in the operating expenses, that is, in the cost of producing the service, an allowance for consumption of capital in order to maintain the integrity of the investment in the service rendered.

Lindheimer v. Illinois Bell Telephone Co., 292 U.S. 151, 167 (1934).

Failure to provide for some type of recovery of this amount is a huge disincentive to system improvements. If the Commission is going to disallow recovery of the amount of a utility's investment that has not been fully depreciated, the Commission has sent a strong message that new construction should not be based on needs of the customers, but rather, on the status of depreciation accounts. It would be a detriment for both utilities and their customers if the Commission seeks to penalize utilities for making reasonable investment decisions.

The United States Supreme Court recognized the dangers involved in the confiscation of private property through the regulatory system in *City of Knoxville v. Knoxville Water Company*, 212 U.S. 1, 31-32 (1909). The court stated that:

> [t]he courts, in clear cases, ought not to hesitate to arrest the operation of a confiscatory law, but they ought to refrain from interfering in cases of any other kind. Regulation of public service corporations, which perform their duties under conditions of necessary monopoly will occur with greater and greater frequency as time goes on. It is a delicate and dangerous function, and ought to be exercised with a keen sense of justice on the part of the regulating body, met by a frank disclosure on the part of the company to be regulated. The courts ought not to bear the whole burden of saving property from confiscation, though they will not

> be found wanting where the proof is clear. The legislatures and subordinate [bodies], to whom the legislative power has been delegated, ought to do their part. *Our social system rests largely upon the sanctity of private property, and that State or community which seeks to invade it will soon discover the error in the disaster which follows. The slight gain to the consumer, which he would obtain from a reduction in the rates charged by public service corporations, is as nothing compared with his share in the ruin which would be brought about by denying to private property its just reward, thus unsettling values and destroying confidence.*

(Emphasis added).

The Report and Order cites *State ex rel. City of St. Louis v. Public Service Commission*, 47 S.W.2d 102, 111 (Mo banc. 1931) for the proposition that the "abandonment of property which is never replaced, but is superseded by another instrumentality, as gas lamps by electric lights, or by another agency or company, is an extraordinary supersession." The Commission goes on to quote the Missouri Supreme Court as explaining that in these situations "Its loss is 'one of the hazards of the game,' just as the extraordinary increase in values following the war was an unexpected gain . . . ."

First it must be noted that the case cited by the Commission confirms that MAWC has a right to the recovery of depreciation. The Missouri Supreme Court stated "A public utility is entitled to earn a reasonable sum for depreciation of its property, including necessary retirements, ordinary obsolescence and diminishing usefulness which cannot be arrested by repairs . . . ." *State ex rel. City of St. Louis*, 47 S.W.2d at 111.

The "extraordinary supersession" exception to this right of recovery identified in *State ex rel. City of St. Louis* is inapplicable to the case at hand for the following reasons:

1) *State ex rel. City of St. Louis* is based upon the "abandonment of property which is never replaced . . . ." Such is not the case at hand. The old St. Joseph surface

water treatment plant was replaced with a new ground water treatment plant. In the case cited by the Commission, the abandoned property was Laclede Gas street lamps which were replaced by electric lamps, a completely different technology. The Missouri Supreme Court explained this difference as follows:

> It is an economic truth that public utility appliance will wear out. By the Public Service Commission statutes the state undertakes to protect utility companies against loss on that account by allowance of depreciation reserves, but when an appliance becomes obsolete by reason of scientific discoveries and inventions, it is a risk which investors in such utilities must take.

State ex rel. City of St. Louis v. Public Service Commission, 47 S.W.2d 102, 111 (Mo banc. 1931). The old St. Joseph treatment plant was not "obsolete by reason of scientific discoveries and inventions." Water was not replaced by some other substance. The plant had substantial length of service consisting of structures that predate 1900 and filters that predate World War I. (Young Reb., Ex. 17, p. 20). This treatment plant needed to be replaced for a variety of reasons. However, these reasons were not based on "scientific discoveries and inventions;"

2) While the Commission has found that the construction of the new St. Joseph treatment plant is extraordinary for the purpose of denying recovery of net depreciation, it simultaneously found in ruling on MAWC's request for an Accounting Authority Order ("AAO") that "MAWC has failed to show any extraordinary or unusual event" related to the construction of the St. Joseph treatment plant. Thus, elsewhere in the Report and Order the Commission has

made the conflicting finding that the construction was not an extraordinary event;[2]

3) Lastly, the case cited by the Commission was decided during a time when the prevailing theory of plant valuation was "fair value" as opposed to "original cost" valuation. Thus, the statement from the court that "extraordinary increase in values following the war was an unexpected gain." Under original cost valuation, as used by the Commission, there is no such off-setting ratemaking benefit for the public utility relating to any increases in the fair market value of the property.

The only lawful question for the Commission is not whether or not the net depreciation may be recovered by MAWC, but rather HOW it will be recovered. The cases cited by the OPC – *In the matter of United Telephone of Missouri*, 2 Mo. P.S.C. 3d 403, Case No. TR-93-181 (1993) and *In the matter of GTE North Incorporated*, 30 Mo. P.S.C. (N.S.) 88 (1990) – actually provided for recovery of premature retirements through an amortization. The Staff's proposal to leave the amounts in rate base is a practical solution to the problem which preserves the issue until it can be addressed by the Commission in the context of a company-wide depreciation study.

However, if the Commission is concerned that the old St. Joseph treatment plant is no longer useful and, therefore MAWC should not earn a return on the investment, an amortization is the only remaining response which will avoid a taking. The net depreciation is the result of insufficient depreciation rates set by the Commission. The Commission now seeks to penalize

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[2] If, however, the Commission truly believes that the retirement of the old St. Joseph treatment plant is an extraordinary event then the Company requests that the Commission issue an accounting authority order which would allow the Company to defer on its books the undepreciated investment in said plant until it can be reviewed and addressed in the Company's next rate case when a complete depreciation study will be available.

MAWC for the Commission's own depreciation rates and MAWC's otherwise prudent investment. If no provision is made for the net depreciation related to the old St. Joseph treatment plant, MAWC will suffer a taking or confiscation of its property in violation of the Fifth Amendment of the United States Constitution, applicable to the States under the Fourteenth Amendment, and Art. I, Sec. 26 of the Missouri Constitution. The record supports an amortization of the reserve deficiency (to include net salvage) over twenty years, resulting in an adjustment of $166,645, consistent with MAWC's original amortization proposal in this case. (Gutowski Dir., Ex. 2, Sch. LJG-2.27).

II. CAPACITY

At pages 31 and 32 of the Report and Order, the Commission found as follows:

The new plant has a firm capacity of 30 million gallons of water daily, of which 28.5 million gallons are available for distribution; the remaining 1.5 million gallons are used by the plant for its internal purposes. "Firm capacity" means that the plant can operate at the rated capacity even with the largest unit of any major component out of service. With every component in service at operating at rated capacity, the plant's daily capacity is 36,288,000 gallons daily. However, for the first year of operation, the Missouri Department of Natural Resources (DNR) has imposed a limitation on the plant so that it will operate at a firm capacity of only 21,600,000 gallons daily; 25,920,000 if all components are on line.[31]

Peak day demand in St. Joseph has consistently been 23.0 million gallons daily for some years; average daily demand in 1999 was 16.0 million gallons. In 1991, with about 3,000 fewer customers, MAWC pumped 25.6 million gallons per day in St. Joseph. MAWC projects maximum day demand for the St. Joseph district in 2009 to be 27.7 million gallons daily. MAWC used 2009 as the design year for the new plant. The Design Guide for Community Public Water Supplies of the Missouri Department of Natural Resources (DNR), at section 2.1, states that "[t]he system shall be designed for maximum day demand at the design year."

The peak day demand of 23.0 million gallons daily that the plant is presently producing could have been met with only five vertical wells at the well field, rather than seven; two *clarifiers rather than three; and three 300 horsepower distributive pumps rather than two 300 horsepower pumps and two 200 horsepower pumps which MAWC actually installed. The clearwell could have been constructed as two 750,000 gallon units rather than as two 1,000,000 gallon units. The aggregate capital cost represented by these unnecessary items is $2,271,756.*

[31]These calculations have to do with the plant's filters. There are six filters, each with a surface area of 750 feet. They are rated at 5.6 gallons per minute per foot; however, DNR will not permit operation at more than 4.0 gallons per minute per foot for the first year.

These findings are based on misunderstandings with respect to definitions and MDNR rules; but more critically, they ultimately present a holding that precludes the building of any capacity in a new plant for margin of safety or future growth. This is not only extremely bad policy, but it is virtually unprecedented in utility regulation.

The following language from the Report and Order transitions from discussion of the design year to a recitation of present system demands. Effectively, it holds that "the design year" is the present. Any other interpretation would be inconsistent with the recited DNR regulation.

The <u>Design Guide for Community Public Water Supplies</u> of the Missouri Department of Natural Resources (DNR), at section 2.1, states that "[t]he system shall be designed for maximum day demand at the design year."

The peak day demand of 23.0 million gallons daily that the plant is presently producing could have been met with only five vertical wells at the well field, rather than seven; two clarifiers rather than three; and three 300 horsepower distributive pumps rather than two 300 horsepower pumps and two 200 horsepower pumps which MAWC actually installed. The clearwell could have been constructed as two 750,000 gallon units rather than as two 1,000,000 gallon units.

To conclude that a plant should be built without any capacity for growth, margin of safety or planning horizon would be virtually unique in regulation. The Company used the year 2009 as the design year in its planning. This horizon was accepted by OPC witness Lee as cited in the Company's brief. Even Staff witness Merciel, whose capacity disallowance recommendation is ostensibly being accepted by the Commission, testified that "...it is not practical to expect utilities to increase capacity every two years." (Merciel Rebuttal, Ex. 49, p. 16).

The findings reference and define "firm capacity," but it is unclear how this factors into the Commissions ultimate holding:

> *"Firm capacity" means that the plant can operate at the rated capacity even with the largest unit of any major component out of service. With every component in service at operating at rated capacity, the plant's daily capacity is 36,288,000 gallons daily.*

This finding confuses two different criteria and is incorrect. One criterion is the MDNR Design Guide that requires plant capacity to be calculated with one filter out of service, and the other is an optional design criteria, <u>that was not used by the Company</u>, that would dictate design on production capacity measured with one "component" out of service. The 36 MGD number is apparently the result of multipliers applied to the capacities of the six filters. The MDNR Design Guide would require that the calculation should be applied to five, thus producing the 30 MGD. The 36 MGD finding also ignores the limitations of other components, which do not reach 36 MGD. The plant does not have a rated capacity of 36,288,000 gallons daily, and there was no evidence to that effect.

While the significance of the Commission's incorrect determination of "firm capacity" is unclear, what does apparently evolve from this finding is the Commission's decision that one of the three clarifiers need not have been built. This would have dangerous ramifications to the plant's production capacity even under average conditions. The ramifications of this were explained by Mr. Young as follows:

> It would be ill advised to construct only two clarifiers as illustrated by the following example. If only two clarifiers were constructed as advocated by Mr. Merciel, then when one clarifier was taken out of service for service and

> maintenance, the treatment capacity of a single unit would be only 11.4 mgd. This capacity is approximately equal to the minimum day demand throughout the year. Operation with only a single clarifier is not feasible to meet even average day demands. . (Young Surrebuttal, Ex. 18, p. 9).

Also incorrect is the Commission's finding that MDNR presently has imposed a limitation on the plant:

> *However, for the first year of operation, the Missouri Department of Natural Resources (DNR) has imposed a limitation on the plant so that it will operate at a firm capacity of only 21,600,000 gallons daily; 25,920,000 if all components are on line.*[31]

This is simply incorrect; there is no DNR "imposed limitation." As Young explained in his Surrebuttal (Ex. 18, p. 6):

> *...the conditions for St. Joseph are unique. In MDNR's construction permit approval in the "Report On Plans And Specifications For A New Water Treatment Plant" (Report), dated January, 22, 1998, MDNR approved the construction of the 30 mgd water treatment plant. A copy of the Report is attached as Schedule JSY-22. Condition No. 4 of the Report states that "The size of the filters is being approved initially as a demonstration until sufficient information is collected...".*
>
> *Given this permit condition, the filters may be operated at rates up to their design capacity of 5.56 gpm/sf and are not limited to 4 gpm/sf. The plant's full capacity of 30 mgd is available and is not restricted to a lesser capacity by MDNR.*

Finally, the Commission's finding that peak demand "has consistently been 23.0 million gallons daily for some years" is both factually incorrect and inappropriate to support a capacity adjustment. First, demand is indeed increasing, and second, the evidence used to arrive at this finding is from years subsequent to 1995.

Staff witness Merciel's testimony was "...peak day demand has been <u>relatively</u> consistent for a number of years at a approximately 23 MGD..." Obviously, peak demand has varied. (See Young Rebuttal, Ex. 17, Sch. JSY 16). Furthermore, demand projections made at that time are essentially materializing as can be seen in Schedule JSY 21 to Young Surrebuttal Ex. 18. The

Schedule shows that it has been improved control of unaccounted-for water that has controlled demand.

More significant than this characterization, is the fact that the plant was designed in 1995 using facts available at that time. In 1995 the Company's peak day had occurred just four years earlier, with another peak day just two years before that. (Young Rebuttal Ex. 17, Sch. JSY 16) To use data subsequent to that time to criticize conclusions is inconsistent with the standard in the *Union Electric* case that the Commission will assess management decisions at the time they were made based on information available at the time the decisions are made.

The Commission's holding with regard to excess capacity sets a dangerous precedent with respect to the health and safety of the public. Without reserve capacity for growth, a margin of safety for such contingencies as equipment failure and fire fighting, and an appreciation of the economies of scale associated with building capacity in minor increments, the message is that no plant capacity above present peaks will be tolerated. This holding is consequently unlawful, unjust, unreasonable, arbitrary, capricious, involves an abuse of discretion, and is unsupported by competent and substantial evidence upon the whole record.

III. RETURN ON EQUITY

At page 26 of its Report and Order, the Commission stated that "McKiddy testified, and the Commission finds, that MAWC and AWWC have a similar level of risk." Then at page 56, the Commission found "that the appropriate ROE for MAWC is 10%. This figure is within the range proposed by Staff and close to the value proposed by Public Counsel." While a 10% ROE is within the range proposed by Staff and close to the value proposed by Public Counsel, it is nevertheless unlawful, unreasonable and inadequate given the competent and substantial evidence in this proceeding.

First, the Commission's finding that MAWC and AWWC possess a similar level of risk appears to be based solely upon the fact that they are "in the same line of business and have comparable capital structures." (Report & Order, p. 26) In fact, MAWC is an "operating" water company, while AWWC is the parent, holding company of 23 operating companies, of which MAWC is only one. That is the extent of the similarity among their respective lines of businesses. A more appropriate comparison of risk is to look at specific financial and business benchmarks. In that regard, the Commission correctly noted, at page 55 of its Report and Order, that MAWC is smaller in size, has a greater proportion of debt in its capital structure and is more capital intensive than its parent AWWC. In addition, MAWC's greater exposure to risk is further demonstrated by the Commission's own findings at page 25 of its Report and Order that MAWC's 1998 return on year end common equity of 9.40% is below the average of 10.5% earned by other water utilities (according to the Value Line Survey; Ratings and Report, February 4, 2000); and that MAWC's pretax interest coverage ratio for 1998 was 2.21 times, which is below the industry average of 3.12 times as reported by Edward Jones & Company's Financial and Common Stock Information - Water Utility Industry, June 30, 1999. Clearly, the overwhelming weight of the evidence reveals that MAWC possesses greater business and financial risks than its parent, AWWC, as well as other comparable water companies.

Second, the Commission's determination that a 10% ROE is appropriate is inconsistent with its own finding that Value Line estimates the water industry will earn 11% return on equity for both 1999 and 2000. (Report & Order, p. 25)

Third, the inadequacy of the Commission's 10% return on equity is also demonstrated by the fact that return on A-rated public utility bonds is 8.42%, only 158 basis points less than the authorized ROE in this case. No rationale investor is going to accept a "premium" of only 158 basis points over the guaranteed return on A-rated public utility debt given the additional risks associated with an equity investment in MAWC.[3] The inadequacy of a 10% return on equity is further demonstrated by the fact that both Staff and Public Counsel recommended higher returns on equity for this very same Company in its last rate case when A-rated public utility debt was actually less than it is today (i.e., 7.82% v. 8.42%). In MAWC's last rate case, Staff witness Broadwater recommended a common equity cost range of 10.10 to 11.10% (compared to Staff's current recommended range of 9.5% to 10.75%) at a time when A-rated public utility bonds were yielding 60 basis points less than they are today. In that same case, OPC witness Burdette recommended a common equity cost rate of 10.62% (compared to OPC's current recommended return of 9.92%). It is clear from the competent and substantial evidence in this case that a 10% ROE is woefully inadequate to compensate an investor for the additional risks associated with an equity investment in MAWC. Indeed, the authorized return falls short of the requirements of the *Hope* and *Bluefield*[4] cases in that it is not similar to the returns being made in investments in other comparable water companies and does not assure confidence in the financial soundness of the Company.

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[3] These risks, by the way, are only gong to become greater given the Commission's disallowance of 1) a portion of the new St. Joseph treatment plant; 2) all of the investment in the old St. Joseph treatment plant; and 3) a portion of accrued AFUDC.

[4] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and *Bluefield Water Works & Improvement Company v. Public Service Commission*, 262 U.S. 679 (1923).

Finally, even though the Commission has determined that a 10% return on equity is appropriate for this Company, its decisions regarding other cost of service elements will assure that investors in this Company will not have a meaningful opportunity to achieve the "authorized" 10% ROE. For example, the Commission has also determined, in this case, that the Company's actual investment in its new St. Joseph treatment plant shall be reduced by approximately $2.3 million in order to reflect what the Commission has determined to be "excess capacity." In addition, the Commission has determined that the Company shall also write down earnings previously accrued on construction work in progress in order to reflect a lower rate for the allowance of funds used during construction (AFUDC). This amounts to a disallowance of approximately $1.3 million. Finally, the Commission has denied the Company any opportunity to recover its actual investment in the "old" St. Joseph treatment plant of approximately $3.2 million. All of these disallowances, taken together, guarantee that the Company will not be able to achieve the 10% ROE that the Commission has determined is appropriate in this case since the Commission has disallowed, from the ratemaking process, equity dollars which have actually been invested in the Company. These equity dollars do not disappear, they simply will not earn a return based on the revenue requirement established by the Commission in this case.

Consequently, the Commission's findings and/or conclusions are unlawful, unjust, unreasonable, arbitrary, capricious, involve an abuse of discretion, and are unsupported by competent and substantial evidence upon the whole record.

IV. AFUDC CAPITALIZATION RATE

At page 48 of the Report and Order, the Commission found and/or concluded as follows:

> The Commission agrees that the actual carrying costs of MAWC's $35 million in short-term debt should be reflected in rates. The use of the actual cost of any item is preferred, where known. The amount of $1,289,674 shall be deducted from rate base to reflect this change in the capitalization rate of AFUDC.

These findings and/or conclusions are unlawful, unjust, unreasonable, arbitrary, capricious, involve an abuse of discretion, and are unsupported by competent and substantial evidence upon the whole record.

The Commission's statement that "MAWC has proposed capitalizing AFUDC at the rate of return on rate base authorized in its most recent rate case" does not fully describe the impact of the events leading up to the Commission's decision. While MAWC has proposed that treatment, it also has been acting in accordance with that approach for some time. MAWC must book AFUDC during the course of construction, not after. Thus, MAWC has already booked these amounts and MAWC's financial statements contain these entries.

The approach taken by MAWC in booking AFUDC was not new or novel. MAWC acted in accordance with the Commission's past practice in booking its AFUDC based on the authorized rate of return from its last rate case. (Salser Reb., Ex. 7, p. 5). This process began in November of 1997 and continued through the date the St. Joseph treatment plant and related facilities were placed in-service. (*Id.* at p. 6). In fact, utilizing the last authorized rate of return is the approach that the company has taken for approximately the last thirty years. (*Id.* at p. 5). Thus, the Commission must understand that it has not merely rejected a prospective MAWC proposal, it has pulled the rug out from under MAWC in a retroactive manner after MAWC acted in compliance with past Commission decisions.

V. RATE DESIGN

At page 60 of the Report and Order, the Commission addressed the issue of the allocation of rate increases in each district across customer classes (i.e., inter-class allocations). The Commission correctly noted that both "Staff and MAWC advocate the use of the base extra capacity (BXC) method to allocate cost among the various customer classes . . ." However, the Commission erroneously stated that "Staff and MAWC are evidently in agreement that, if the Commission adopts a DSP rate design, then (Staff witness) Mr. Hubbs' class cost of service study should be employed. . ." This finding is in error and is not supported by competent and substantial evidence upon the record. The Company's position regarding inter-class allocation shifts in this case is stated in its Initial Brief as follows:

> "If the Commission decides to adopt district specific pricing in this case, then it is MAWC's position that Staff witness Hubbs' allocation of district specific costs to the various customer classes is based upon appropriate methods and factors and results in indication of cost by class that are reasonable. . . However, <u>given the fact that any movement from single tariff pricing to district specific pricing will result in dramatic shifts in revenue requirements between districts, further shifts between customer classes within districts would not seem to be warranted at this time and Company would recommend, if the Commission adopts district specific pricing, that rates within districts simply be increased by the uniform percent necessary to achieve the revenues allocated to each district</u>." (Brief, p. 66) (emphasis added).

Thus, while Staff has employed appropriate methods and factors in the development of its Base Extra Capacity class cost of service study, it was not Company's position that the results of that study should be followed or adopted in this case. In fact, given the substantial shifts in revenue requirements attributable to each district due to DSP, the Company recommended that all of the customer classes simply receive a uniform percent increase in order to achieve the desired revenue requirement by district. Shifts among existing customer classes should be postponed to future rate proceedings.

While the Company does not contend that the Commission was without record evidence to adopt the class cost of service study performed by Staff, it does contend that to do so produces unnecessary and unreasonable shifts of revenue requirement among customer classes that only serve, in many instances, to exacerbate the substantial rate increases that are already occurring because of the movement to DSP. For example, total revenues in the St. Joseph district need to be increased by approximately 89 % in order to recover its district specific costs. (See Hubbs rebuttal testimony, Exh. 42, Sch. WRH-2-1 - St. Joseph District) However, rates for each class of customers within the St. Joseph district vary widely from a decrease for Private Fire customers of approximately 14% to increases for Sales for Resale and Industrial Customers of 269% and 200% respectively. (Id.) This result would appear to be inconsistent with the Commission's other finding that "in moving toward DSP, however, the Commission will adhere to the principle that no district will receive a rate decrease." (Report & Order, p. 58) If the Commission truly believes that "one factor for consideration in determining just and reasonable rates is public perception" (Report & Order, p. 58), it must ask itself whether the customers in St. Joseph will perceive their rates to be fair and reasonable when some customers in St. Joseph receive a rate decrease and others a substantial rate increase. By contrast, if the Commission simply decides to increase rates for each class by a uniform percent, then all customer classes in St. Joseph would receive a uniform 89% increase. As the Commission itself notes, it has a great deal of discretion in the design of rates, not just between districts but also between customer classes. The

Company would urge the Commission to exercise that discretion and forego adopting Staff's class cost of service study in this case.

VI. SUFFICIENCY OF FINDINGS AND CONCLUSIONS

The findings of fact made by the Commission in its Report and Order as to the premature retirement of the St. Joseph treatment plant, excess capacity, return on equity, capitalization rate for AFUDC and rate design are conclusory and provide no insight into how the issues were resolved. Consequently, the findings of fact are inadequate as a matter of law and the reviewing court will be unable to discharge its duty within the limits of its authority. *See State ex rel. Noranda Aluminum, Inc. et al. V. PSC, et al.*, 2000 Mo. App. Lexis 702 (Mo.App. W.D. 2000).

WHEREFORE, MAWC respectfully requests the Commission to rehear its Report and Order issued on August 31, 2000, and, thereafter, issue a new Report and Order consistent with this pleading.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, or hand-delivered on this 13th day of September, 2000, to the following:

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