BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of Capital City Water Company for authority to file tariffs increasing rates for water service provided to customers in the company's Missouri service area.	)))))	Case No. WR-90-118

APPEARANCES: Gerald E. Roark, Attorney at Law, Hendren and Andrae, P.O. Box 1069, Jefferson City, Missouri 65102, and Kathy Lee Pape, Attorney at Law, 950 Haverford Road, Byrn Mawr, Pennsylvania 19010, for Capital City Water Company.

B. Allen Garner, City Counselor, City of Jefferson, 320 East McCarty Street, Jefferson City, Missouri 65101,
and
James M. Fischer, Akre, Wendt & Fischer, 102 East High Street, Suite 200, Jefferson City, Missouri 65102, for the City of Jefferson, Missouri.

Janet L. Sievert, Assistant Public Counsel, P.O. Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the Public.

Robert J. Hack and William K. Haas, Assistants General Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

HEARING
EXAMINER: Alisa M. Dotson

REPORT AND ORDER

On December 15, 1989, Capital City Water Company (Company) submitted to this Commission tariffs reflecting increased rates for water service provided to its customers. The proposed tariffs are designed to produce an increase of approximately 20.86 percent ($516,477) in charges for water service.

On January 12, 1990, the Commission issued its Suspension Order and Notice of Proceedings. In its order, the Commission established an intervention deadline of February 13, 1989, and a procedural schedule. The Commission has granted intervention to the City of Jefferson (City).

On June 11, 1990, a prehearing conference was convened. The Company, Staff and Public Counsel participated and produced a hearing memorandum setting forth, among other things, the matters at issue. The hearing memorandum is Exhibit 1. It was offered at the hearing and will be received into the record.

The matters at issue in this case were heard at the hearing which convened on June 25, and continued through June 26, 1990. Pursuant to the briefing schedule, simultaneous initial briefs were filed on July 26, 1990, and simultaneous reply briefs were filed on August 15, 1990.

Findings of Fact

The Missouri Public Service Commission, having considered all the competent and substantial evidence upon the whole record, makes the following findings of fact.

1. Public Water District No. 2 Contract

Company argued its contract with the Public Water Supply District No. 2 (District) is in the interests of the ratepayers and has a lesser revenue requirement than had the Company chosen to build its own storage tanks. Staff took no position on this issue.

Public Counsel proposed a $238,544 adjustment for the contract between the Company and the District. Public Counsel argued the contract is imprudent and results in Company's ratepayers subsidizing the District customers. The City of Jefferson supported the Public Counsel's position and recommended that the Company conduct an analysis of the water systems of the Company and the District. Public Counsel supported the City's recommendation.

This is the first time the Commission has reviewed the ratemaking treatment to be afforded the contract since its signing in 1977. In every rate filing by the Company since that time, this issue has either been part of a total dollar figure of a stipulation or not an issue taken to hearing by the parties. Thus, the prudency of the contract in regard to how its costs will be recovered in rates has evaded Commission review.

In 1977, the Company needed more water storage facilities and reviewed its only two options: building its own tanks or leasing them from the District.

Company experts recommended leasing facilities if the the lease agreement contained an annual cap of 182.5 million gallons. In August, 1977, the Company entered a lease agreement for the use of three of District's tanks with a total capacity of 1.3 MG and three adjacent wells. In exchange for the use of these facilities, the Company agreed to: (1) pay the District $2,000 a month rent; (2) pay the District a monthly sum equal to the cost of water sold to the District the previous month; (2) pay for the variable costs of the water sold to the District (treatment, electricity, etc.); and (3) pay for the operational and maintenance expenses of District's tanks and wells. The contract is for twenty years (1978 to 1997). It does not contain any cap. The 182.5 MG recommended cap was exceeded by the District in 1979. Because of the unexpected growth of the District, the Company's costs under the contract have been rapidly escalating.

In 1989, the Company's management, concerned about adequate capacity to meet the District's growing needs and Company's rising costs under the contract, approached the District to renegotiate the contract. In March, 1990, the District and Company signed an addendum to the contract. This addendum allows Company the use of District's 1 MG Schott Road tank and its .25 MG Brazito tank; obligates Company to operational and maintenance expenses on the new tanks; obligates Company to pay for installing a valve control; obligates Company to incur the operational and maintenance expenses of future storage facilities created to meet the District's needs, and extends the original terms and conditions of the contract three more years to December 31, 2000.

In the test year, the District used 338,731 MG of water and paid $414,171 to the Company. As part of its rent, Company returned this money to the District as well as paying it $24,000. In addition, the variable cost of the water sold to the District, borne by Company, was $100,016. The Company, Public Counsel and the City agree that Company's costs under the contract have risen sharply and the costs under the addendum will cause them to rise even more.

Company has the burden of proof on the issue of whether its dollar amounts for rental expense is appropriate. In order for the Company to prevail on this issue, it must show the reasonableness of the contract that gave rise to the expense. Company argued that its reasonableness is shown by comparing the costs under the contract and the costs of having built storage facilities in 1977. The Commission believes this is one approach to determining the reasonableness of Company's rental expense. In this approach, Company must prove the rising costs under the contract and addendum are still less than would have been incurred under Company's only other alternative: building its own storage facilities. Thus, the Company must prove (1) what are its costs under the contract and addendum, and (2) what were the costs for building storage in 1977.

Company witness Dysard testified that the costs under the contract were less than what they would have been had the Company built its own storage tanks. He defined "costs" as purchased power, chemicals, deferred maintenance and rental expense of $2000 per month. Dysard also prepared a schedule (Ex. 2, Sch. 1) which compared the revenue requirement had the Company built its own tank to the cost, as he defined it, incurred by the Company in each year since the execution of the contract. In the test year of 1989, the schedule shows the revenue requirement would have been $167,631 and the cost of the contract was $100,016 for a savings of $67,615. However, Dysard testified that the figure of $100,016 represents only the variable costs of supplying water to the District. He testified it does not include the fixed annual cost of $24,000 for the rental fee. Thus, the schedule should read that the cost of the contract to Company's customers is $124,016.

The Company argued that because the $414,171 which Company returned to the District was subtracted from revenues and expenses, its impact on the ratepayer was zero. It contended that this zero impact precluded the classification of the return monies as foregone revenues and as a cost under the contract.

Public Counsel and the City contended the cost of the contract for the Company was around $538,000 in the test year. In addition to the $124,016 of fixed and variable costs paid in the test year by Company, Public Counsel and the City count, as a cost, the $414,171 the Company returned to District as part of its rent. They argued it should be counted as a cost because it is foregone revenues, that is, revenues Company would have been able to retain but for the contract. They argued that these returned revenues included the District's share of, as a user of the company's system, the Company's fixed costs, its rate of return of its capital investment and depreciation expenses.

The Commission is of the opinion that while the subtraction of the $414,171 from expense and revenue would appear to have a zero impact on the ratepayer it declines to make a determination that such is truly the case. It is a well-settled principle of ratemaking that customers should be charged rates that recover the cost of service. Since the Company returns the District's water payment, the District uses the Company's facilities and water without contributing to the cost of such services. Company denied that this lack of contribution is a loss. However, the Commission is not persuaded that it does not cost the Company anything when it returns the District's water payment. In the Commission's opinion, the District's lack of contribution to the cost of serving it has an impact. Company has not shown what that impact is.

Therefore, the Commission finds Company has not produced sufficient evidence as to Company's total costs under the contract and addendum.

The second component of this analysis is the cost to the Company if it had built its own water storage facilities. Company's figures for what it would cost it to build its own storage facilities in 1989 ($481,000 ground facilities, $975,000 elevated facilities) were presented by Dysard. He did not prepare these numbers and Company did not offer any supporting documentation. Dysard's testimony as to facility costs was based on a memo by Milt Leeds. Leeds did not testify how he arrived at these figures. Therefore, the memo upon which Dysard based his testimony is hearsay. Without supporting documents or Mr. Leed's testimony, the Commission finds Dysard's testimony as to cost for Company to build its own tanks is not competent and substantial evidence. Moreover, the revenue requirement listed in Dysard's Schedule 1 of $167,631 is not supported by any evidence in the record and therefore cannot be relied upon as the most accurate estimate of what would have been Company's costs if it had built its own storage facilities in 1977.

The Public Counsel projected an annual revenue requirement of $175,627 based on a 1977 cost estimate which it updated. It proposed an adjustment of $238,544 from this projection. Company witness Dysard testified that in 1989 it would cost $481,000 for ground facilities and $975,000 for elevated facilities. These facilities would be able to store the 1 MG of water projected by Company to meet its needs through 1993. Dysard also testified that Company's figures did not include emergency back-up. Company estimated that the revenue requirement in the test year would have been $167,631 had Company built its own facilities in 1977.

Public Counsel's estimate of revenue requirement of Company to build its own tank is based on a 1977 cost estimate and is updated by rate of return,

return on equity and income tax multiplier. The Commission believes the numbers used for such updates are reasonable. The Commission finds because its numbers are reasonable Public Counsel's adjustment more closely reflects what would have been the Company's true costs. Therefore, the Commission finds the figure proposed by Public Counsel as revenue requirement is supported by the record.

Based on its findings that the Company has not produced sufficient evidence as to its true costs under the contract nor to the costs it would have incurred had it built storage facilities in 1977, the Commission determines that Company has failed to prove the reasonableness of the contract, and in turn, its rental expenses, by a comparison of costs.

The Commission is greatly concerned with Company's escalating costs under the contract. This concern is heightened by Company's failure to decrease its costs under the addendum and its agreement to incur additional costs. Thus, the Commission believes it is appropriate to examine the reasonableness of Company's rental expense by examining the contract terms which gave rise to the expense. One of the components of Company's rental expense is the amount of water used by the District. According to the terms of the contract, this is an unlimited amount. The record shows that it is an unlimited amount because Company ignored advice it received to include a 182.5 MG cap as one of the terms of the contract. The Commission finds the Company agreement to the contract without a cap against the recommendation of its own experts is unreasonable.

The contract has terms which exacerbate the absence of a cap because it required the Company to return the District's water payment. The Company has argued that this exchange of checks is a "wash" and has zero impact on the ratepayer. This Commission has rejected that argument. In the Commission's opinion, the Company's return of the District's water payment is, in effect, the provision of free water. This, combined with the absence of a cap, means

Company agreed to provide an unlimited amount of free water in exchange for a fixed amount of storage.

For a fixed amount of storage, the Company agreed to provide unlimited free water <u>and</u> pay a $2000 a month rental fee <u>and</u> pay for the maintenance of the leased facilities. In the Commission's opinion, this is excessive compensation. That Company would agree to such unequal and burdensome terms is not the concern of this Commission if its shareholders bear the costs but when the costs of such terms fall upon the ratepayers, it is incumbent upon the Commission to act. The Commission finds it would be totally inappropriate to allow the Company to fully recover the expense associated with the execution of this contract.

It cannot be disputed that the Company needs water storage and the District fulfills that need. Thus, while Company is not entitled to full recovery of the costs of a bad bargain, it is entitled to some recovery of rental expenses. Public Counsel offered the only dollar adjustment. The Commission found that this amount was reasonable and supported by the record. Therefore, the Commission also finds that it should be adopted.

Upon reviewing the addendum, the Commission finds that Company's obligations are increased further without receiving equivalent benefits. The Company not only failed to take the addendum negotiations as an opportunity to put a ceiling on its escalating costs but Company agreed to obligate itself further, without limitation, to maintaining storage facilities created to meet the District's needs. If Company's shareholders are satisfied with the prudency of these terms, the Commission has no objection to these terms with the understanding the shareholders bear the costs. However, to expect the ratepayers to pay for the extension of a bad to worse bargain is unreasonable.

<u>2. Rate Case Expense</u>

The Company contends it should be entitled to recover the actual rate case expense for this case plus the unamortized balance of rate case expense from Company's last rate case, Docket No. WR-88-215, amortized over two years. Staff recommended Company should recover the average of the costs actually incurred in its rate case (WR-88-215) and the budgeted costs in its current case over a two-year period. Public Counsel supports Staff's inclusion of a normalized level of rate case expense in the cost of service. The City took no position on this issue.

Company argued that it should be allowed to recover the actual costs of its rate case expense. It contended that it is improper to normalize, i.e., average its rate case expense because Staff has no basis for assuming Company's next rate case will not be taken to hearing or will not be equal or in excess of the cost of its current case, regardless of whether the next case is litigated.

Staff witness Meyer testified that Staff averaged the expenses incurred in Company's last two rate cases because since 1974, the Company has only had two rate cases go to hearing. Meyer testified that because of this history it would be inappropriate to assume that a normal level of rate case expense would include a full amount of trial costs.

In In re: Missouri Cities Water, 26 Mo. P.S.C. (N.S.) 1 (1983), the Commission stated that rate case expenses are ordinary expenses which should be in Company's cost of service and based on the Company's historical data. The Commission finds the historical data of this Company indicates that a normal level of rate case expense should not be at a level to recover the costs of a full trial. Moreover, the actual costs of Company's present rate case are only relevant as a basis for estimating Company's future rate case expense, they are not relevant for the purpose of recovering those particular amounts. The Commission finds that Company's rate case expense should be normalized. Based on these findings, the Commission determines the Staff's proposed adjustment should be adopted.

3. Inflation Adjustment

Company proposed to increase test year expenses by applying the GNP Implicit Price Deflator of 4% to certain operation and maintenance expenses. Company stated it applied its application of an inflation adjustment because unless expenses are increased to account for inflation which has taken place between the end of the test year and the point rates go into effect, the Company will not be earning its authorized rate of return from the outset.

Staff opposed the adjustment. It stated that such an adjustment will provide double recovery on items which Staff has already annualized and would include recovery on expenditures that Staff proposed be eliminated from cost of service such as sponsorship of a local ball team. Staff also contended that such an adjustment would provide a mismatching of revenues and expenses and be an isolated adjustment. Public Counsel supported Staff's position.

The Commission believes it is proper to consider proposed adjustments which will reflect changes that occur after the test year and impact the Company's expected revenue requirement for the period rates will be effective. But such proposals must be scrutinized to determine whether they fit the test year concept and account for a known and measurable change.

The test year concept is the determination of what level of revenues will match expected expenses plus a return on rate base. In this case, Staff witness Meyer testified that all allowable expenses have been annualized for known and measurable changes through March 31, 1990. In annualizing operation and maintenance expenses, Staff has already updated expenses to reflect the level they should be at when rates go into effect. The inflation adjustment would be an additional recovery above the expected level of expenses. Thus, the

Commission finds that revenues and expenses would be mismatched and the test year concept violated.

Moreover, the inflation adjustment is speculative. The Company asserts there will be inflation and presents the 4% factor as the best guess as to the rate of that inflation. However, the Commission declines to speculate with the Company as to the exact level of inflation and the absence of any offsetting decreases in costs. Thus, the Commission finds the inflation adjustment fails to account for a known and measurable change. Based on these findings, the Commission determines the Staff's recommendation to exclude such an inflation adjustment should be adopted.

4. Deferred Expenses

Company proposed to include in its rate base the unamortized balances of deferred charges for tank painting, certain maintenance procedures, the capacity of Docket No. WO-89-76 and the expenses of relocating an employee. Company contends these expenditures should be in rate base to compensate the Company for a return on investor-supplied funds which must be invested several years before recovery from the ratepayers. Company witness Hill testified that the deferred charges are like prepayments which are included in cash working capital which is indisputably included in rate base.

Staff opposed the inclusion of the charges in rate base. Staff argued that a normal level of such expenses is included in Staff's cost of service. Public Counsel supported Staff's position on this issue. Both relied on the Commission's Report and Order in Missouri-American Water Company, Case No. WR-89-265, (issued May 11, 1990).

In that case, the Commission found that storage tank painting does not raise to the level of an addition to rate base but is part of a company's cost of service. Company attempted to distinguish this case from Missouri-American

Water Company by pointing out the differences in the sizes of the companies and the different amortization periods. However, the Commission finds this distinction immaterial because the focus of the finding is the activity of tank painting and that the cost of such activity does not belong in rate base. Thus, the Commission finds Company has failed to introduce any evidence into the record that can support the Commission departing from its ruling in Missouri-American Water Company. The Commission finds the Company's placement of storage tank painting in rate base is not supported by the record and the cost should be normalized and placed in its cost of service.

Similarly, the Commission finds nothing in the record to support Company's characterization of the maintenance procedures as outlined, relocating *an employee or capacity docket as extraordinary expenses which justify inclusion* in rate base. The Commission, therefore, finds the expenses should not be included in rate base. The Commission finds Staff's recommendation that they should be included as an expense in cost of service is reasonable and should be adopted.

5. Plant Additions Through May 31, 1990

Company proposed a rate base increase of $80,276 by including non-revenue producing plant through May 31, 1990. Staff opposed the inclusion of this cost. It argued that no cost should be made for changes occurring after March 31, 1990, the end of Staff's known and measurable period. Public Counsel supported Staff on this issue.

Company's proposal includes two additional months beyond the established known and measurable date. The Suspension Order and Notice of Proceedings requires any Company requests for a true-up audit and hearing be filed with the party's direct testimony. Staff argued no such request was made. Company stated its request was in the cover letter which accompanied its prefiled direct testimony. However, Commission rule 4 CSR 240-2.080 states that a cover letter cannot contain any matter for Commission decision. Thus its request is not properly before the Commission. In addition, Company signed a hearing memorandum which stated it did not request a true-up. The Commission notes that the Company did not renew its request at hearing. Company made no mention of a true-up request in its initial brief as part of its argument for including plant beyond the known and measurable date of March 31, 1990. For these reasons, the Commission finds Company's adjustment should be disallowed.

6. Deferred Taxes

Company contended that the level of deferred taxes to be deducted from rate base should be the amount which has been collected from ratepayers, not the book amount. Staff argued the level of deferred taxes deducted should be based on the amount booked. Public Counsel supported Staff's position.

Deferred taxes arise through the use of the normalization method of accounting for income taxes. Income tax normalization means that book net income is used as the basis for calculating income tax expense. The actual deductions a utility can take on its federal and state income return are ignored in the calculation of income taxes for ratemaking purposes under the normalization methodology, but instead are reflected in rates over the life of the asset giving rise to the deduction. Deferred taxes represent the differences between the amounts actually paid in taxes to the federal and state taxing authorities by the utility and the amounts collected through rates from customers to cover income tax expense. As income tax expense collected through rates under income tax normalization is usually greater than the amounts paid to taxing authorities, the accumulated balance of deferred taxes is properly an offset (deduction) to rate base to recognize the utility's use of ratepayer-provided funds.

In December 1988, Company removed $102,414 from its books for deferred tax expense. Company contended its books reflected larger amounts than actually paid by the ratepayers. Company witness Hill testified this occurred because of the lag that was created when it began recording such taxes as normalized in 1976 and began recovering them in its cost of service until 1979. Company argued because its books are overstated the level of deferred taxes to be deducted from rate base should be the actual amount collected from ratepayers, not the book amount.

Staff proposed to reinstate the dollars that Company removed from its books. Staff argued Company should not reduce its booked deferred tax expense. Staff witness Meyer testified because the Company normalizes its tax liability, income tax expense for ratemaking purposes is based solely on book net income. He testified that the deferred tax balances result from tax normalization and simply reflect a timing difference between a book expense amount and a tax expense amount.

In the Commission's opinion, the theory advanced by Company violates Commission policy that revenues are presumed to cover the level of booked expenses until a utility receives rate relief. It also overlooks that the effect of tax normalization is a focus on booked amounts, not actual amounts. Moreover, Staff witness Meyer testified Staff is unaware of any Missouri utility that has received approval to reduce deferred taxes in the manner advocated by the Company. The Commission finds the record supports Staff's adjustment.

7. Capitalization Policy

Company contended its policy to capitalize expenditures of $750 or more and expense lesser amounts is reasonable. Company proposed twelve expenditures (Ex. 18, p. 3) be expensed and included in its cost of service. Staff argued Company's capitalization policy is unreasonable and is abused on a widespread basis. Staff also contended that the twelve items identified by Company to be expensed should, theoretically, be included in rate base; however, the purposes of this rate case, the items be excluded from rate base as well as cost of service.

Company stated this issue was addressed by the Commission in the Company's last rate case (WR-88-215) and that the Commission found Company's use of $750 limit was appropriate for determining when a cost should be capitalized. Company also contended that to exclude the twelve items listed in Exhibit 18 from cost of service as well as rate base was confiscatory.

Staff argued that Company's policy of capitalizing costs greater than $750 caused it to ignore other determinative factors such as the useful life of an item. It recommended that items with a useful life in excess of one year be charged to capital accounts, while items charged with a useful life of less than one year be expensed. Staff argued that Company's policy is contrary to the Uniform System of Accounts (USOA), Sections 3(3) and 9.B, and that this violation is a probable contributing factor to the Company's excessively long-lived mains. Staff also contended the policy is widely abused resulting in inflated expenses for rate case purposes.

In reviewing USOA Section 3(3), the Commission notes the dollar amount in the note is illustrative, not mandatory, in nature. Moreover, the Commission is of the opinion that Section 3(3) states what items of equipment shall not be capitalized, not what shall not be expensed and that Section 9.B. can be similarly read. Therefore, the Commission finds that Company's capitalization policy does not violate these portions of the USOA.

Staff argued Company's emphasis on a dollar amount is misplaced and Company ignores other determinative factors. However, in reviewing Company's policy, the Commission finds the $750 threshold is but one of the many considerations Company personnel are admonished to make in determining whether an item cost should be capitalized or expensed. In this case, Company's justification of expensing the twelve items is based on three points under its capitalization policy, not just one as espoused by Staff. Company's policy justifies expensing of the items not just on its cost but because in its judgment the expenditures do "... not result in addition, reconstruction or betterment of the rate base" and "do not benefit future years." The Commission finds this analysis to be reasonable.

Based on its findings, the Commission has determined that the record does not support a reversal of its earlier ruling that the $750 limit is an appropriate threshold for the determination of capitalization.

Staff recommended if the Commission kept Company's capitalization policy intact, it should accept its adjustment to Company's depreciation reserve for water mains. Staff also recommended that Company be required to keep a property unit catalog. These recommendations are based on Staff's "suspicions" that Company is abusing its capitalization policy and Staff's conclusion that there "may" be a problem. However, the testimony of Staff witnesses on this point offers little more than speculation and innuendo. The Commission finds Staff offers no evidence of the alleged abuse. Therefore, the Commission finds these recommendations should not be adopted.

Staff also proposed the elimination of the twelve items from expenses and rate base as listed in Exhibit 18, page 3. Staff opposed the inclusion of the cost of these items in cost of service because it believed the cost of these items should have been capitalized. Staff also maintained that the costs of these items should not be included in test year rate base because it would effect a retroactive recording of prior years' expense for items that would prospectively fall under Staff's proposed capitalization policy. Staff recommended that Company be allowed to add the cost of such items to plant when the items are replaced.

To exclude the items from the Company's cost of service and its rate base as recommended by Staff presumes adoption of Staff's proposed capitalization policy. But having found the Company's expense treatment of these items is appropriate, the Commission finds that inclusion of these items in Company's cost of service is reasonable.

8. Depreciation Expense on Customer Advances

Company proposed that a depreciation expense on customer advance be included in its cost of service. Staff recommended that the Company not be permitted to recover in rates depreciation expense on plant that has been funded by customer advances for construction.

Company based its argument that it is entitled to recover a depreciation expense on the possibility that it will refund a customer advance. Rates are based on known and measurable facts. Thus, the Company's cost of service should not include recovery of a depreciation expense based on a possible refund. The Commission finds Company's proposal to recover in rates the expense of a possible event is inappropriate. Based on this finding, the Commission determines that this expense should be disallowed.

9-12 Bookkeeping Items: Work Order System (9), Equipment Logs (10), Ledger Balances (11) and Retirement Practices for Main Relocations (12).

Staff made recommendations for four of Company's bookkeeping practices. None of the bookkeeping issues have a revenue impact. Company objected to all of them arguing its current practices are reasonable and that the adoption of Staff's methods will cause the additional work it will take to implement them to significantly exceed the benefit to be derived.

The Commission has reviewed the record and finds that the Company practices in the four areas outlined by Staff are reasonable. Therefore, the Commission finds that Staff's recommendations should not be adopted.

13. Rate of Return

The parties agreed to Staff's capital structure. They also agreed to Staff's mid-range figure of 12.75% for its cost of equity and 11.12% for its overall cost of capital. The Commission finds these figures are reasonable and should be adopted for the purposes of this case.

14. Rate Base - Revenue Requirement

Company filed rates to meet a proposed revenue requirement increase of $516,477. The weather normalization issue was settled before the hearing and the revenue requirement was stipulated at $15,200. However, the adjustment of $238,548 of Company's rental expense negates the increased revenue requirement effect of all issues decided in Company's favor. The Commission finds the record does not support any increase in Company's revenue requirement. The Commission finds rate base is $5,058,296.

15. Rate Design

The parties agreed on rate design. Therefore, the parties agreed the prefiled testimony of Bill Sankpill as it relates to rate design, may be accepted into the evidence without cross-examination. The rate design is addressed by Staff witnesses in Exhibits 41 and 42. The Commission finds the agreed upon rate design reasonable and adopts it for the purposes of this case.

Conclusions of Law

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

The Company is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 393, RSMo 1986, as amended.

The Company's tariffs herein were suspended pursuant to authority vested in this Commission by Section 393.150, RSMo 1986, as amended, which places upon Company the burden of proof to show that the proposed increase in rates is just and reasonable.

Pursuant to Section 393.270(4), RSMo 1986, as amended, the Commission may consider all facts which in its judgment have any bearing upon a proper determination of the price to be charged for water service with due regard, among other things, to a reasonable average return upon capital actually expended.

Based on its findings that the Company is not entitled to any increased revenue requirement, the Commission concludes Capital City Water Company shall not be permitted to file tariffs which reflect an increase in revenue requirement. The Commission also concludes that Capital City Water shall be permitted to file tariffs reflecting the rate design as approved herein.

IT IS THEREFORE ORDERED:

1. That pursuant to the findings and conclusions in this Report and Order the proposed tariffs filed by Capital City Water Company of Jefferson City, Missouri, in this case are rejected hereby.

2. That Capital City Water Company shall file tariffs which reflect the rate design agreed to by the parties.

3. That the tariffs to be filed pursuant to this Report and Order shall become effective for service rendered on and after November 14, 1990.

4. That any objections not heretofore ruled upon are overruled hereby hand any outstanding motions are denied hereby.

5. That Exhibit 1 is hereby received into the record.

6. That this Report and Order shall become effective on November 14, 1990.

BY THE COMMISSION

Dan Ross

Dan Ross
Interim Secretary

(S E A L)

Mueller, McClure and Letsch-Roderique,
CC., Concur.
Steinmeier, Chm., and Rauch, C., Dissent
with opinion.

Dated at Jefferson City, Missouri,
on this 31st day of October, 1990.

DISSENTING OPINION OF CHAIRMAN WILLIAM D. STEINMEIER
AND VICE-CHAIRMAN DAVID L. RAUCH

CASE NO. WR-90-118 (CAPITAL CITY WATER COMPANY)

We must respectfully dissent from the Report & Order of the Commission in this case. Although we agree with the majority that Capital City Water Company's contract with Public Water Supply District No. 2 ("District") is unreasonable, it is our view that the quantification of the appropriate ratemaking adjustment in this case is unreliable. Instead of a permanent disallowance based on a questionable analysis, the Commission should have ordered expedited hearings to take further evidence on the correct quantification of the revenue requirement impact of Company's imprudent contract with the District.

Even if the facts and circumstances known and available to the Company in 1977 indicated that entering into a contract with the District was reasonable, their own information also indicated some cap should have been included in order to limit the potential responsibility of the Company under the contract. Instead, the Company agreed to a 20 year contract in which it receives a fixed and finite quantity of storage capacity in exchange for an ever-escalating and unlimited volume of treated water, plus $2,000 per month in actual rental charges. Under the contract, the Company's storage costs increase based upon factors which have no bearing upon the value of the storage received by the Company. This is illogical and unreasonable. In addition, the Company has now entered into an addendum to that contract, further extending its increasing obligations and enlarging the imbalance between the liabilities and benefits to the Company which had already become clear under the original contract.

Although we are convinced that the Company's rates need to be adjusted to reflect that its contract with Water Supply District No. 2 is a bad deal for the Company and its customers, we are very uncomfortable with Public Counsel's quantification of the revenue requirement impact of that conclusion. The revenue requirement impact proposed by the Public Counsel, and accepted by the majority in this case, assumes the reasonableness of the tariff rate at which the water company bills the District for water, assumes that the same water could be sold to some other customer or customers at the same tariff rate were it not sold to the District, and assumes the reasonableness of Public Counsel's quantification of the rate base effect of building its own storage had the Company taken that alternative in 1977. We believe that all three elements need further development and evaluation on the record before the revenue requirement affect of disallowing the contract is permanently assigned. Therefore, we would hold this issue open for further, expedited hearings limited to the quantification of the revenue requirement effects of the Company's contract with the District vis-a-vis the Company's costs associated with constructing and owning the storage it needs.

Pending additional hearings on that limited issue, we would protect both the ratepayers and the Company by authorizing an interim rate increase, in the amount of $235,864 on an annual basis, subject to refund with interest. After the additional hearings, the Commission could have finally determined the accurate revenue requirement impact of its decision, and refunded to customers any excess in rates which they had paid in the meantime.

In the alternative, the Commission should at least have adopted the City of Jefferson's alternative suggestion of ordering Company to recover an additional $236,044 of its revenue requirement from the District, through a surcharge or a new rate classification.

Under the Commission's decision today, the Company will almost undoubtedly experience the permanent loss of revenues to which it is entitled. In addition, the entire contract issue will undoubtedly be addressed in the Company's next rate case, where it will be accompanied by innumerable other expense, revenue and investment issues which will detract from the Commission's ability to focus as clearly and fully upon the contract issue as is needed.

We believe additional proceedings would have been more reasonable for all parties involved. Therefore, we dissent.

William D. Steinmeier

William D. Steinmeier, Chairman

David L. Rauch

David L. Rauch, Vice-Chairman

Dated: October 31, 1990