BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

9-91

In the Matter of Missouri Cities Water Company's tariffs to increase rates for water service.	)))	Case No. WR-91-172
In the Matter of Missouri Cities Water Company's tariff to increase rates for sewer service.	)))	Case No. SR-91-174

REPORT AND ORDER

Date Issued: September 20, 1991

Date Effective: October 3, 1991

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HEARING EXAMINER: Michael F. Pfaff

REPORT AND ORDER

Procedural History

On November 1, 1990, Missouri Cities Water Company (Company or MCWC) submitted proposed tariffs for Commission approval reflecting an annual increase of $1,710,290 in gross revenue from water sales and a $9,036 increase in Company's Platte County sewer rates. The Commission suspended Company's tariffs until October 3, 1991, and ordered all parties to file a Hearing Memorandum and Reconciliation by June 3, 1991.

On January 18, 1991, Interventions were granted to Riverside, Parkville, Platte Woods, Lake Waukomis, Houston Lake and Platte County Public Water Supply District No. 6, hereafter referred to as the Platte County Intervenors. By the same Order, the Commission granted interventions to the City of Warrensburg and the City of St. Peters.

Local hearings were conducted in St. Charles on May 13, 1991; in Platte City on May 15, 1991, and on May 16, 1991, in Warrensburg. A total of 27 public witnesses in these three communities gave sworn testimony opposing the Company's requested increase, the proposed rate design, or both. Witnesses in St. Charles and Platte City brought samples of discolored water to the hearing room and complained of water quality and pressure.

Following the timely submission of direct and rebuttal testimony, all parties of record attended the prehearing conference on May 29, 1991, and following the surrebuttal testimony, executed the Hearing Memorandum (Exhibit 1). The evidentiary hearings commenced on June 17, 1991, and concluded on June 19, 1991.

Pursuant to Company's request, the Commission Staff performed a true-up, extending the test year to May 31, 1991, and offered same as late-filed Exhibit 40. Company objected to the true-up which resulted in a one-day true-up hearing on August 15, 1991, at which time Exhibit 40 was received in evidence. Initial and reply briefs having been submitted pursuant to Commission order, this matter is duly before this Commission for determination.

Findings of Fact

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

I. Introduction

The Missouri Cities Water Company is a public utility providing water and sewer service to customers in five Missouri communities, referred to by Company as Divisions. As shown in Exhibit 2(B), the number of customers affected by the requested increase, and the amount of increase requested, are:

Division	Customers	Overall % Increase Sought	Residential % Increase Sought
Brunswick	526	18.44%	6.58%
Mexico	4,586	17.09%	14.01%
Platte City			
(Water)	3,526	21.74%	19.74%
(Sewer)	100	25.38%	25.38%
Warrensburg	4,907	23.43%	18.08%
St. Charles	17,773	21.47%	21.86%

Following prehearing discussions between the parties, Company has pared its original request for water rate relief from $1,710,290 to $1,503,630. After Staff's true-up from December 31, 1990 to May 31, 1991, Company recommends a revenue requirement of $1,379,482, the point from which Staff, Public Counsel and Intervenors now propose other adjustments. On the basis of plant expense and income ending May 31, 1991, Staff maintains that Company's revenue requirement is $618,020;[1] Public Counsel states it is $585.189.[2] Platte County Intervenors urge the Commission to find that Company's revenue requirement is at the lowest range recommended by Public Counsel owing to poor quality of service in Company's Platte City Division. Platte County Intervenors do not specify an amount, only that Commission authorize the lowest possible rate of return on Company's investment.

[1]This figure assumes the Commission uses the mid-point of Staff's recommended rate of return.

[2]This figure assumes the Commission uses the mid-point of Public Counsel's recommended rate of return.

Company proposes to spread its requested $1,379,482 increment in revenues by, for the most part, following this Commission's order in Case No. WR-90-236, decided on October 12, 1990. Case No. WR-90-236 dealt only with Company's rate design and sought, over time, a rate design that would achieve uniform Company-wide rates, irrespective of the Company's various divisions and the many differences between said divisions. Many of the parties active in Case No. WR-90-236 are also active in this case; some of them have characterized the Commission's decision in Case No. WR-90-236 as irreversibly correct. Others, including Staff and, apparently, Company, feel that the Commission must be free to re-examine its prior determination on rate design in light of the evidence in this case. The Commission concurs with the latter. In Case No. WR-90-236, the Commission, while stating that the then "current rate differential" should be maintained, also said that "this matter can be reviewed in some future rate case." As stated, the "review" will be undertaken in this docket.

Inasmuch as this case has been presented and briefed on an issue-by-issue basis, the Commission's order will follow the same format. Including the issue of Staff's proposed True-up, there are eighteen contested issues.

(1) True-Up

The test year established in this case ended December 31, 1990. Company requested a true-up owing to the fact that a substantial amount of new plant was not in service as of December 31, 1990, but was expected to be in service as of May 31, 1991. These items include the Warrensburg clearwell and Company's St. Charles plant.

Staff agreed to Company's proposed true-up, although the record clearly reflects that Staff's initial filing contained <u>estimates</u> of Company's investment in, and the revenue effect of, the Warrensburg and St. Charles additions. Staff's true-up is contained in late-filed Exhibit 40, admitted into evidence on August 15, 1991.

Company is not disputing the propriety or necessity of a true-up. Instead, Company claims that Staff did not take certain of Company's booked expenses into account. Company witness Harrison, in Exhibit 41, identifies $144,000 of such "booked expense," which Staff characterizes as "unannualized, unadjusted book data." Staff specifically identified only $13,656 of additional expense attributable to the true-up period, but states that its original audit credited Company with most, if not all, of the $144,000 in its claimed expenses, through annualization of expense items.

To achieve a match of Company's investment, expense and revenue, the Staff true-up included the following items of expense:

1. Operation and Maintenance Expense:

   (a) January wage increase,
   (b) April employee increase,
   (c) insurance premiums,
   (d) electricity, chemical and purchased water associated with customer increases, and
   (e) interest expense on additional customer deposits;

2. Other Expenses:

   (a) depreciation expense associated with plant additions and retirements, contributions and advances,
   (b) payroll taxes associated with all wage and employee changes, and
   (c) income tax expense related to all the above items.

Staff's true-up also adjusted both revenues and expenses for customer growth, an adjustment which Company feels is inappropriate. Company states that since the two major plant additions were related to "improvement of the utility system" rather than serving new customers, no increments in revenue should be associated with such "improvements." The Commission disagrees. All capital improvements "serve" Company's existing and future customers. It would be impossible to achieve a match of investment, revenue and expense if this Commission were to adopt the view advanced by Company, that some plant produces new revenue and other plant does not.

The Commission, having examined and considered Company's true-up testimony and Exhibit 41, and Staff's true-up Exhibits 40 and 42, finds that Staff properly measured and matched the increments to Company's investment, revenue, and income for the period ending May 31, 1991.

(2) Allocation of Parent Company Costs

MCWC is one of six operating subsidiaries in a holding company structure which, with some minor deletions, has been represented in Company Exhibit 4, Schedule 1 as follows:

AVATAR HOLDINGS INC.

100%
AVATAR UTILITIES INC.
12 employees

100% BAREFOOT BAY PROPANE GAS CO.	100% POINCIANA UTILITIES INC.	100% AQUA UTILITY CONSULTANTS INC.	99.7% CONSOLIDATED WATER COMPANY

100% CONSOLIDATED WATER SERVICES INC. 22 employees (CONSOLIDATED)	100% FLORIDA CITIES WATER COMPANY	100% INDIANA CITIES WATER CORPORATION	100% MISSOURI CITIES WATER COMPANY	100% NORTHERN MICHIGAN WATER COMPANY - W/S	100% OHIO SUBURBAN WATER COMPANY - W/S

At issue is the amount of "General and Administrative" expenses (G&A) which Avatar Utilities has allocated down to its six operating subsidiaries and, more particularly, the amount of G&A expense it has allocated to MCWC. Company is claiming that $189,962 of Avatar Utilities Inc.'s (hereafter Avatar or Parent) G&A expense should be recognized as a proper expense of MCWC; Staff maintains that the proper expense figure should instead be $88,135. The potential revenue impact of this issue, should the Commission find in Staff's favor, would be to reduce Company's revenue requirement by $102,496. The other parties to this proceeding have neither briefed nor presented evidence on this issue.

The arithmetic formula by which parent's G&A expenses have been allocated to Company, shown below, is contained in Exhibit 6 in Staff Witness Racker's testimony:

Net AVATAR O&M	$1,259,931
10% Retention	(126,031)
Portion Transferred	1,133,900
Allocation to CWC	92.67%
CWC Portion	1,050,785
Outside Professional Services	26,100
Total CWC	1,076,885
2% Retention	(21,538)
Portion Transferred	1,055,347
Allocation to MCWC	18%
MCWC Portion	$ 189,962

As shown, Avatar proposes to retain only 10% of its observed O&M expense. Staff's preferred adjustment would have the effect of increasing the retention percentage to 50%. Staff would permit Company to capitalize a portion of Avatar's allocated expenses.

Staff's adjustment has been driven by Staff's perception that: (1) Avatar doesn't actually perform any "specific" G&A function for MCWC, (2) Staff has already allowed $700,000 in direct expenses for work performed for Company by Consolidated which, in Staff's view, duplicates the work claimed by Avatar, (3) Company has not met its burden of proof regarding this issue, (4) Avatar has already received $700,000 in dividends for its investment in MCWC, and (by inference) Avatar should not be permitted more of a return by saddling its subsidiary with a phantom expense.

Company affirms in its initial brief that Staff's adjustment relates only to allocation of Avatar's general and administrative expenses, and therein states that Staff did not eliminate any of Consolidated's direct charges to MCWC.[3] The Commission finds that Staff has allowed all other charges by Company's holding companies and affiliates.

Company states that Avatar's staff of 12 people provide "management services and corporate guidance" to MCWC pursuant to a contract which specifies that Avatar provide:

(a) advice, direction and counsel on policy matters, including, but not limited to matters involving operations, planned improvement and expansion, cash flow, data processing, engineering and finance;

(b) legal services provided by in-house legal personnel;

(c) financial and operational auditing;

(d) corporate tax assistance;

(e) financial planning;

(f) human resources;

(g) accounting; and

(h) cash management and administration.

As noted, Staff found insufficient documentation to support Company's claim that Avatar actually performed any of the above-listed services on Company's behalf. When asked to provide such documentation, Company instead provided the contract referenced above and cited the results of a "retention study" which Avatar conducted. This study, which was not introduced in evidence, allegedly shows that since Avatar's President spent 6%

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[3]However, Company's reply brief identifies one direct charge to MCWC by Consolidated that Staff did eliminate, relating to Consolidated's Regulatory Affairs Department. This item relates to rate case expense, discussed infra.

of his time on non-utility business, the balance of his time was attributable to utility business, thereby justifying Avatar's retention of 10%, not 15%,[4] of these expenses. Company provided the results of its retention study in response to Staff's Data Request No. 117, which asked Company to justify Avatar's claimed 10% expense retention, and which specifically asked for "Directors Meetings Minutes, Studies, Analyses, etc." Staff witness Rackers stated that he never received the "study" in question, but only a "paragraph" that described the results of Company's two-month review, conducted in 1989, of how the President spent his time.

Company says that Staff failed to insist that Company provide the "actual study." Company nevertheless insists that it "has a study to support its retention percentage." The Commission does not agree. The burden of coming forward with evidence to support Company's position on this or any other issue is clearly on Company. Without a study, there is only anecdotal evidence to lend credence to Company's claim of having such a study. Nor is Staff required, as Company suggests, to perform an "analysis" to compare Avatar's allocated costs with similar costs which Company would pay on a "stand alone" basis.

Company states that Consolidated "primarily" provides bookkeeping and payroll services for MCWC, while Avatar performs auditing, tax, financial planning, cash management and administrative services. MCWC also states that Avatar provides legal, public relations, environmental, and engineering services. Be that as it may, the Commission finds that Staff has already included the costs of many, if not most, of these services as permissible items of expense. The only contested issue is whether the Company has proven

[4]In 1989, Avatar retained 15% of such expenses.

its claim that $189,962 of Avatar's "General and Administrative" expense is properly allocable to Company.

When asked by Commissioner McClure to describe the role of Consolidated's 22 employees vis-a-vis MCWC, Consolidated's President stated:

> "Consolidated Water Services actually does the bookkeeping, prepares the financial statements, prepares the rate case exhibits. They assist in cash flow management, the operating - daily operating functions of the Company on a cost basis."

Regarding decision making for MCWC, Consolidated's witness stated:

> "We are simply there to assist in carrying out the policy and procedures as it relates to accounting, ratemaking, cash management that is established by Consolidated Water Company/Avatar Utilities and as directed. . . . Consolidated Water Company Inc. has no decision making authority as it relates to Missouri Cities operations. We're really directed or work under the direction of the Executive Vice President of Missouri Cities."

The Commission finds that the management of MCWC is by and large in the hands of MCWC, not Avatar. MCWC officers decided to construct the new office building, which is the focus of the next issue, and as noted above, the President of Consolidated states that he works under the direction of the Executive Vice President of MCWC. Perhaps he does so to achieve or realize the policies and goals established by, in his words, "Consolidated Water Company, Inc./Avatar Utilities," but the Commission does not find in this statement of co-mingled corporate responsibilities and allegiances any evidence that Avatar, the parent, has actually performed G&A services directly allocable to MCWC in the amount claimed. The Commission, therefore, finds this issue in favor of Staff. Company will not be permitted to recover this claimed, but not proven, expense in rates.

(3) St. Charles Office

In December 1990, Company moved from its leased offices at the Cave Springs Interexchange in St. Charles to a newly purchased and constructed office in Cottleville. Staff proposes to remove the costs of Company's new building ($765,000) from rate base, as well as eliminating certain expenses associated therewith ($16,000). In lieu thereof, Staff would permit Company to expense $40,000, the price which Staff estimates Company would have to pay to lease facilities. If approved, Staff's adjustment will reduce Company's revenue requirement by $78,770. Staff and Company are the only parties presenting evidence on this issue. Company's evidence supporting the need for the new office complex includes the following:

<u>Company's Former Leased Premises Were</u>:

(1) In highly congested traffic area, creating dangerous condition for employees and customers;

(2) Too small - no room for growth or record storage; new building has nearly twice the space;

(3) Outside yard area too small for Company trucks, backhoe, trailers, other equipment, or storage;

(4) Inadequate restroom and shower facilities for field employees; inadequate lunch and meeting rooms; and

(5) Structure had major maintenance and "landlord" problems, the former requiring Company funds to effect repair.

Company also adduced evidence showing that customer growth, at least up to 1985, supported a need for a more commodious structure. Company noted that unlike its leased premises, Cottleville is nearly in the center of its St. Charles service area, making it easier for more customers to reach the office. Company states that the land is "prime real estate," with adjacent property worth considerably more per acre than the price Company paid.

Schedule 3 of Exhibit 10 contains Company's internal memoranda regarding its then observed "options" for office space. Its first and least expensive "option," which Staff says the Company should have taken, was simply to renew its old lease in St. Charles.

Company's other stated options included (2) building a new division office in Cottleville, but continuing to lease general office space in St. Charles; (3) moving both offices to Cottleville, but leasing space for its general office; or (4) moving both its division and general offices to Cottleville to a new building.

The balance of Company's Schedule 3 contains a summarization of estimated costs for each option, statements of availability regarding possible leases, construction estimates, work orders, bidding information, floor plans, layouts, inventories, and, lastly, "before and after" photographs of certain facilities in Company's old premises versus its new premises.

Staff does not directly state that Company has made an imprudent purchase, only an unnecessary one. Staff maintains that Company's leased premises, however deficient in Company's eyes, still hosted Company meetings, lunches, planning sessions, and Company's showering field workers. Staff suggests that by continuing care and vigilance, the observed traffic congestion at the Cave Springs exit could be managed; Staff says that space for records wasn't required inasmuch as Company had removed many of same to Indiana. As for Company's inadequate outside parking and storage facilities, witness Rackers observed "a huge yard" in the back of the <u>new</u> building that, in his view, was being used "for nothing at all." Inasmuch as Company's new structure is on three acres, the Commission is of the opinion that not every square foot of same need be occupied by trucks, equipment, pipe, etc.

Staff's adjustment derives from Staff's conviction that Company could have continued where they were, and that to do so would have been less expensive.

The Commission appreciates Staff's vigilance in this regard, but the Company has adduced an abundance of competent and substantial evidence which confirms the reasonableness and necessity of their purchase. Company's purchase of good land at a good price, and its decision to construct a non-palatial centrally located division and general office on that land, is both reasonable and prudent. Staff's proposed disallowance is denied.

(4) Return on Equity

The parties agree that Company's capital structure consists of 43.21% common stock equity, 1.64% preferred stock equity, 43.94% long-term debt, and 11.21% short-term debt. The parties also agree that the embedded cost of Company's preferred stock is 5.92%; its long-term debt is 9.50%; and its short-term borrowings are 9.00%.

Staff and Public Counsel are in sharp disagreement with Company regarding Company's estimates of its rate of return. Company urges the Commission to authorize a rate of return on equity of 15.5%. Staff suggests a range of equity return between 12.73% and 13.25%; Public Counsel urges the Commission to approve a rate of return in the lower 1/2 of Public Counsel's range of 12.28% to 13.58%, between 12.28% and 12.9%. The Platte County Intervenors, while presenting no direct evidence on rate of return, would have the Commission find that only the lowest suggested figure (12.28%) should be authorized, owing to quality of service problems in Platte City and environs.

Company, Staff, and Public Counsel all employed the discounted cash flow analysis (DCF) to deduce a recommended cost of common equity. Generally stated, this analysis, which the Commission has approved in many previous cases, estimates the required return on common equity by dividing a stocks dividend by its current price, thus producing a "yield" which, when added to its expected dividend growth rate, will equal the cost of equity.

Since Company has no publicly traded common stock, it is not possible to use the DCF analysis unless the common stock of other publicly traded water companies is used as a surrogate, or representative sample, for MCWC. Staff and Public Counsel used the same 10 surrogate water companies in their DCF analysis; Company used 8 of the same surrogates. Both Staff and Public Counsel noted a downward trend in recent dividend growth rates among the surrogate companies. Staff's calculation in Exhibit 14 shows dividend growth rates as follows:

Year	Five Year Trend Line	Five Period Compound Int.	Ten Year Trend Line	Ten Period Compound Int.
1988	5.25	5.26	6.42	6.34
1989	4.69	4.62	5.97	5.91
1990	3.81	3.76	5.36	5.34

Total Average = 5.23%

The total average growth rate shown, 5.23%, is the figure Staff used in its DCF model.

In Exhibit 17, Public Counsel computed dividend growth rate as follows; deriving as an average a range of 4.6% to 5.9%:

Year	Five-Year Trend Line	Five Period Compound Int.	Ten-Year Trend Line	Ten Period Compound Int.
1988	5.25	5.26	6.42	6.34
1989	4.67	4.60	5.97	5.90
1990	3.81	3.76	5.36	5.34

Side-by-side, the rest of Staff's and Public Counsel's analyses appear thus:

Public Counsel's (Exhibit 17)				Staff's (Exhibit 14)			
Yield	+ Growth Rate	=	Cost of Equity	Yield	+ Growth Rate	=	Cost of Equity
7.68% +	4.6%	=	12.28%	7.50% +	5.23%	=	12.73%
7.68% +	5.9%	=	13.58%	8.02% +	5.23%	=	13.25%

The different equity ranges in Staff and Public Counsel's analyses are a result of a difference in their calculation of dividend yields. Public Counsel's calculation, performed when interest rates were falling, used six-week stock prices, more recent dividend figures, and employed a dividend growth adjustment. Staff adjusted its yield figure with a six month, forward looking, adjustment. At the time of hearing, interest rates were rising slightly.

Company's DCF analysis, although not presented in the same format as Staff's and Public Counsel's, nevertheless arrives (at least initially) at a similar result. As shown in Exhibit 3, Schedule 3, Company's eight surrogate companies produced the following average yields, dividend growth rate, and return on equity:

Company's Discounted Cash Flow Calculation

Sample group four year average yield	6.23%
Sample group four year average dividend growth rate	6.30%
Water Industry DCF indicated return of equity	12.53%

Company's witness Harrison did not feel that MCWC was comparable to his sample group of eight investor-owned water utilities. He stated that "Missouri Cities is more risky." Witness Harrison explained the differences by stating that (a) MCWC has higher debt ratios than the surrogates, (b) has no market for its stock, and (c) is smaller, and therefore less able to weather "unexpected events" than the surrogates. As a result, witness

Harrison did not think he could rely on the DCF model. Instead, he has relied on the "risk premium method." As Company's witness describes it in his testimony, the risk premium method establishes the cost of common equity as follows:

> A. The risk premium method assigns a return spread between either treasury bills or bonds and common equity securities. The spread represents the additional return that is required for the additional risk that is inherent in an equity security investment as compared to the other two. The return spread between the different securities is referred to as the risk premium.
>
> Q. How is the risk premium determined?
>
> A. Risk premium spreads have been compiled by the firm of Ibbotsin Associates, Chicago and are updated and published annually. Ibbotsin Associates is a widely accepted source of data for RPM analyses.
>
> Q. What cost of equity is indicated through application of the risk premium approach?
>
> A. The latest available Ibbotsin report shows that the historical spread between treasury bills and common stocks has been 860 basis points. The approximate current yield on treasury bills is 7.0%. Adding 860 basis points to the current yield indicates a 15.6% cost of equity.

The Commission finds that as described by Company's witness, the risk premium method is not as acceptable as the discounted cash flow method for arriving at an estimate of Company's cost of equity. The "spread" between either treasury bills or bonds and the common stocks of non-regulated enterprises may provide a reliable index to the costs of equity in a regulated monopoly, but the Commission does not find such to be the case in this instance. In addition, the amount of the "spread" can be dictated by one's choice of the time periods when either notes, bonds, or stocks are issued or examined, the nature of the enterprises whose stock is being used to establish the "spread," and by the reliance on purely historical data to establish a return for a future time period.

Company bulwarks its reliance on the risk premium method by stating that a 15 1/2% return is needed to increase Company's interest coverage ratios. Company states, and the Commission believes, that its interest coverage ratio has been declining. Whether this justifies Company's request for a 15.5% return is another matter.

Staff performed a pro-forma interest coverage calculation which reveals that a return of 12.73 to 13.25% to Company will result in a times interest coverage of 2.71 to 2.78 times. Such a coverage ratio compares favorably with the water industries composite average of 2.75 times interest coverage. Company reminds the Commission that Staff's calculation regarding interest coverage does not take Staff's proposed adjustments in this case into account. The Commission finds that even at the lowest end of any range herein proposed, Company will achieve a high enough return to both attract capital and meet the terms of its First Mortgage Bond Indenture, which requires 1.5 times, post-tax, interest coverage before Company may issue bonds.

Interest coverage ratios are driven in large part by management decisions over which this Commission has little or no control, at least in the first instance. Whether characterized as "prerogatives" of management or simply as a company's decision to, say, construct a new office building, these debt creating "events" cannot, in and of themselves, provide support for a company's estimate of its cost of equity or its revenue requirement. To do so would turn this or any other Commission into something other than a regulatory body inasmuch as Company management could determine rate of return simply by incurring debt. This Commission cannot, as suggested by Company, use interest coverages to arrive at Company's revenue requirement.

Both Staff and Public Counsel tested their DCF model by comparing the results thereof with the market-to-book ratios which their ranges of return would produce. Both concluded that the resulting market-to-book ratios in Company's case would be at least 1.0%, which the Commission finds adequate to permit Company to attract investors.

The Commission finds that Company's methods of determining its cost of common equity, and hence its required rate of return, are neither reasonable nor reliable. The Commission finds that notwithstanding witness Harrison's statement to the contrary, MCWC is not "more risky" than the surrogate companies selected for the DCF analyses. Nor does MCWC have meaningfully higher debt ratios than the averaged ratios of the surrogates. Nor is Company weaker or "less able" to weather unexpected events than the surrogates. As one of several operating utilities in a holding company structure, Company may enjoy more support than its publicly traded surrogates, not less. Company's stated reasons for not relying on its own DCF analysis are contrary to the evidence.

The Commission, therefore, finds that Company has failed to discharge its burden of proof on this issue. As stated in its brief, Company's approach on this issue is "novel and perhaps unprecedented."

The Commission finds that the DCF analyses performed by Staff and Office of Public Counsel are the most competent and substantial evidence on this record regarding Company's probable cost of equity. Of the two, the Commission finds that Staff's analysis is more persuasive, in that Staff's dividend yield calculation is less likely to include unusual or atypical shifts in stock prices, dividend payments and interest rate movement than Public Counsel's analysis.

The Commission finds that Company's rate of return should be slightly above the mid-point of the range herein proposed by Staff, 13.01%. The Commission also finds that said rate of return will enable Company to attract capital, to maintain its interest coverages, and to discharge its continuing obligations to its customers in each of its five operating divisions. The Commission also finds that Company's return on its net original cost rate base is 10.90%.

(5) Customer Deposits

Public Counsel proposes that Company's tariff provision regarding Security Deposits be changed to require Company to either (a) pay customers interest on their returned security deposits equal to Company's effective rate of return (stated by PC's witness as 13.76%), or (b) pay customers 9% interest, instead of the now approved 6%, on such returned deposits.

Public Counsel states that while the revenue effect of its proposal is negligible ($4,225 under [a], $1,242 under [b]), the principle is important. As stated, the principle underlying Public Counsel's proposal is that those who pay security deposits are subsidizing those who do not. Implementing Public Counsel's suggestion will, per their brief, prevent "an unjust benefit flowing to the other ratepayers who are not required to pay customer deposits."

Public Counsel reminds the Commission that it has increased interest payable on customer deposits to 9% in Case No. ER-82-52 (Union Electric), and that six of Missouri's investor-owned electric utilities also return 9% on such deposits, as do Southwestern Bell and Kansas Power & Light in their Joplin areas. Public Counsel does not identify any utility, here or elsewhere, which returns its <u>own</u> rate of return, as interest, on such deposits.

On this issue, Public Counsel has the burden of going forward with probative evidence and assumes the risk of not doing so.

Rule 9.2 of Company's present tariff contains the provisions which, in Public Counsel's view, creates the "subsidy." Public Counsel's witness frequently indicated that his recommendation had little or nothing to do with why deposits were required, or the amounts thereof. As a result, the exact provisions of Section 9.2 assume little importance from an evidentiary standpoint. Having examined said section, the Commission is satisfied that it complies with this Commission's present standards and policies regarding security deposits for water companies, and that it provide for the return of such deposits at 6% interest.

Public Counsel's sponsoring witness stated that he had no information or knowledge regarding: (a) the number of Company's customers who have made deposits, (b) the amount of deposits collected by Company, (c) whether any customers had to make initial deposits to receive service, (d) the amount of the "average" deposit collected or demanded by Company,[5] or (e) the deposit policies of Laclede Gas or Union Electric. When asked whether it was possible that Company had never before required a deposit under one particular section of its tariff, the witness responded in the affirmative.

Having given this issue the consideration it merits, the Commission finds that it would be imprudent to do as Public Counsel suggests. Permitting security depositors a return in excess of 13% might result in a veritable rush to make such deposits, a point made in Platte County Intervenors initial brief. Nor does the Commission believe that non-depositors are being

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[5]On cross-examination, Company's counsel suggested such deposits were 25 to 30 dollars, a figure the witness accepted.

"subsidized" by those who make deposits. Nor does the record made by Public Counsel suggest or indicate that any of Company's deposits are "involuntary," a touchstone in this Commission's past decisions regarding interest rates on deposits. Public Counsel had ample opportunity to secure evidence regarding the amounts, incidence, balances, and the conditions under which Company obtains security deposits. By choosing not to do, and presenting its case only on the dubious theory of "subsidy," Public Counsel has advanced an alleged "principle" shorn of any competent and substantial evidence in support thereof.

For these reasons, the Commission finds this issue in favor of Company.

(6) Advertising

This issue is contested only by Staff and Company. Company claims $23,173 in advertising expense in the test year period. Staff proposes to reduce this expense by $11,378. If permitted, in full, Staff's adjustment will reduce Company's revenue requirement by $11,872.

There are three components to Staff's adjustment: (a) direct costs which Staff permitted in full, (b) common costs to which Staff applied an "allocation factor" of 50.9%, and (c) direct costs which Staff completely disallowed. Staff indicates that its adjustment observes this Commission's proscription against spending ratepayer dollars for purely "image enhancing" corporate activities, citing case numbers EO-85-185 and EO-85-224 (Kansas City Power & Light) and ER-85-265 (Arkansas Power & Light). Staff also states that Company failed to properly document certain advertising expense.

Staff allowed 100% of Company's claimed direct expense for yellow page advertising and Company training programs. Staff completely disallowed

Company's claimed direct expense of $3,598.65 for a series of miscellaneous items including pencils and key chains given to students at open houses, rain cones, radio and newspaper ads of area events, etc.

Staff allowed only 50% of Company's printing expense for its newsletters, a number of which were attached to Company witness Bultman's rebuttal testimony. Staff's reason for so doing was that items which routinely appeared on <u>alternate</u> pages of the Company's various newsletters, [50%] did not, in Staff's view, provide a benefit to Company's ratepayers. Staff also states that Company did not document the benefits. Staff's witness admitted he did not know how much it would cost to print only 1/2 of the various pages in Company's newsletters, and when asked if one side had been left blank whether all Company's costs might have been included, he replied, "If the newsletter only included items which I allowed on the first page, then yes."

Some of the articles or items in Company's newsletter for which Staff found no benefit to customers included (a) an article on a planned water main, (b) a Company employee profile, and (c) a story on a retiring employee.

Staff's 50.9% allocation factor, by which it has adjusted away more than half of Company's claimed "common costs,"[6] derives from Staff's nearly equal allowances and disallowances of items of direct expense, which, when factored against Staff's assertion that only 50% of the cost of Company's newsletters should be allowed, provides the allocation of 50.9%.

Having considered Staff's proposed adjustment, and the reasons advanced therefore, the Commission rejects Staff's elimination of one-half of

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[6]In large part, Company's "common costs" consist of fees to Company's public relations vendor for Company's system-wide activities.

Company's newsletter expense and its elimination of 50.9% of Company common costs. Company is not claiming as expenses any dues or donations for corporate image building as occurred in the cases cited by Staff; indeed, the Commission can discern very little in Company's modest outlay which might reasonably be considered as "image building," corporate or otherwise. Staff's page-by-page dissection and disallowance of every other page of Company's newsletter expense is simply not reasonable. Moreover, some of the articles on the non-permitted pages do, in this Commission's view, provide a benefit to Company's customers.

With one exception, the Commission finds that Company's direct expenses for pencils, keyholders, "fun cups," and other similar items do not provide a benefit to Company's ratepayers and should be disallowed.

However, the Commission finds that Company's claimed direct expense of $829.20 for "rain cones," (Ex. 23, Sch. 1) which Staff also proposes to disallow, is a proper item of expense in that said item provides an index to water usage, which benefits Company's customers. The Commission, therefore, finds that Staff has properly disallowed those items of direct expense identified on Schedule 1 of Exhibit 23, with the exception of the $829.20 item identified above.

Staff's proposed 50.9% downward adjustment of Company's common costs seems to reflect only a percentage of Staff's previous adjustments to Company's direct and newsletter costs. The Commission can see no reason why Company's payments to its vendor should not be included in full. The Commission finds this issue in Company's favor in the particulars indicated, and in Staff's favor regarding $2,769.45 of Company's direct expenses. The net effect is to reduce Company's revenue requirement by the sum of $2,787.00, not by $11,872.00, as Staff suggests.

(7) and (8) Payroll Increase and Health Insurance

These issues, which are contested only between Staff and Company, have a total potential revenue effect of $30,399.00.

Company urges the Commission to consider as items of expense certain employee wage increases of $26,673 which became effective in July, 1991. Company also seeks to recoup $3,726 for an employee's health insurance premium which came due in July, 1991. Staff opposes both adjustments as falling outside the trued-up test year ending May 31, 1991, and points out that Company's proposed adjustments fail to match or identify any increments of revenue or plant to Company's added level of expense. Staff essentially maintains that Company is proposing an isolated adjustment which disturbs the match of test period revenues, expenses and rate base.

Company insists that since both items are "known and measurable," they should be included. In its initial brief, Company states:

> Interestingly, Staff admitted that the increase in the health insurance cost for the employee in Platte County did not cause any new customers to be attracted to the system or require the Company to add additional plant (Tr. 335). Similarly, Staff acknowledged that the payroll increase did not add new customers or add additional plant (Tr. 335).

Company cites *In Re: Kansas City Power & Light Company*, ER-81-42, 24 Mo.P.S.C. (N.S.) 386 (1981) for the proposition that test year data can be adjusted when the revenue - expense - plant relationship is maintained. The Commission agrees; however, the case cited did not authorize KCP&L to expense an item outside the test period, which is what Company proposes.

The Commission finds that the record on this issue does not lend evidentiary support to Company's claim that the items in question are both known and measurable. At hearing, it was apparent that Company evidence of its claimed known and measurable increase in labor expense consisted only of recently signed letters of agreement, not signed contracts. The Commission agrees that isolated out-of-period items of expense may sometimes be recovered in rates, irrespective of the "matching" which is normally required of expense revenue plant inside a test period. To do so, however, requires persuasive evidence that such claimed items are both known and measurable. The Commission finds that letters of agreement are not competent evidence that such expenses are known and measurable.

The Commission finds this issue in favor of Staff.

(9) Pension Expense

Company is claiming $50,653.00 in pension expense for the period ending May 31, 1991. Staff proposes to expense only $28,902 in pension expense. The impact on Company's revenue requirement is $20,704.

Company supports its figure by stating that it represents its actual booked pension expense required under generally accepted accounting principles (GAAP) and FAS 87, an accounting standard governing corporate accounting for pension expense.

Staff, while admitting that both GAAP and FAS 87 require Company to do as claimed, reminds the Commission that neither GAAP nor FAS 87 apply in ratemaking proceedings, especially when to do so might result in a distortion of a utility's cost of service. Staff's proposal to expense only $28,902 in pension costs is based on Staff's calculation of the 3 year average level of Company's pension contributions required by ERISA, a federal program which establishes minimum employer contribution levels to safeguard Company pension plans.

Company points out that its ERISA contribution levels have fluctuated far too much to produce a reliable or representative three year average. The record reveals the following (rounded) levels of Company's booked pension expense versus its ERISA contributions.

Booked Expense		ERISA Contributions
25,000	1988	22,000
59,000	1989	43,000
61,475	1990	31,000

The fluctuating levels shown above result from changes in certain accounting procedures as well as changes in Company's pension plan and payroll. Staff contends that Company's revenue requirement would be distorted upwards by permitting Company to expense only its most recent, and highest, booked pension expense. Staff also points out that its proposed adjustment has been recently approved by the Commission in St. Louis County Water, Case No. WR-89-246, and that Company itself has articulated its pension funding policy as follows:

> The funding policy is to contribute amounts to the plan sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974.

Testifying in rebuttal, Company's witness Cutshaw states:

> Under GAAP, the Company records net periodic pension cost as expense and the ERISA payment as a liability with the difference being recorded as a deferred credit. This treatment is similar to that of deferred income taxes which have long been recognized as a integral part of the cost of service. In the short run, the minimum ERISA payment will be both higher and lower than the net periodic pension cost because it is based on market conditions. Staff testimony states the components utilized to determine net periodic pension cost. Over time, the differences between the ERISA funding payment and the net periodic pension cost will balance out.

For the purpose of this case, the Commission finds this issue in favor of Staff, although not without misgivings. The record made by Company and Staff on this issue is not as illuminating as the Commission would prefer. It does not, for example, reveal (a) the actual source of the difference between Company's booked and ERISA expense, (b) whether or when Company's booked expense will be committed to the ERISA trust, (c) the extent to which Company's ERISA or booked expense reflects the actuarially determined level of risk of its pension plan.

Notwithstanding, the Commission finds that the "balancing out" referred to by Company witness Cutshaw can apparently be recognized by use of the 3-year average ERISA payment adjustment advocated by Staff.

(10) Rate Case Expense

This issue is disputed by Company, Staff, and Public Counsel. The only area of consensus is that each disputant agrees that Company should recover an appropriate level of rate case expense over a period of two years, the interval at which Company has regularly appeared before this Commission for rate increases. Company witness Harrison confirms the suggested interval by his on-the-record assertion that Company will make a rate filing late in 1992, which suggests scheduled hearings in 1993.

Company proposes to expense a total of $74,574 in rate case expense for the test year and for one additional year, and thereby recoup a total of $149,148. Public Counsel states that Company should recover only $30,179 in the test year, and a total of $60,358. Staff would allow Company to expense a total of $95,294, and to recover $47,647 in the test year.

The primary differences between Company and Staff arise from billings made to Company by the newly created regulatory affairs department of its service company, Consolidated Water Services, Inc. (CWSI). Staff also adjusted out a similar direct charge by AQUA, another of Company's service companies. Although Staff permitted direct rate expenses associated with Company personnel and its attorney through May 31, 1991, it disallowed the charged expenses of Consolidated and AQUA because they were estimated expenses. While excluding the cost estimates of CWSI/AQUA, Staff nevertheless took one-half of Company's other estimates of rate expenses and added that to Company's actual test year expense to reflect a normal annual level of rate case expense.

Public Counsel did not base its adjustment on any of Company's estimated, or billed, items of expense, although some actual costs were given consideration. Instead, Public Counsel took Company's actual rate expenses in its next preceding rate case ($85,779) and added that to $34,934 of Company's actual expense in the instant case, averaged the total, and arrived at its present recommendation. Unlike Staff, Public Counsel excluded Company's $30,000 legal expense associated with Company's rate design case, WR-90-236. Public Counsel states that said expense was a one-time non-recurring expense and that to recognize it in Company's rates would constitute retroactive ratemaking, in violation of *State ex rel. Utility Consumer's Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc 1979). (Also: *UCCM*).

Responding first to Public Counsel's proposed adjustment, the Commission finds that Company's legal costs associated with the rate design docket in WR-90-236 should be recognized as a legitimate item of expense in this case. Company's rate design is not a one-time or non-recurring matter, as this present case clearly indicates. Nor is the *UCCM,* cited above, controlling on the facts herein. In the case cited, the issue was whether the Commission had authority to approve a fuel adjustment clause, (FAC) through which a utility's fuel expense could be automatically included in rates. At page 49, the court said, "FAC is a radical departure from the usual practice of approval or disapproval of filed rates, in the context of a general rate case." The item of expense now under consideration is markedly different from a FAC.

The Commission finds that Public Counsel's proposed adjustment will not reimburse Company, through rates, for a reasonable level of rate case expense through May 31, 1991. The Commission also finds that Company's claim of a total rate case expense of $150,148.00 is not supported by competent and substantial evidence, and that expensing one-half of said sum does not represent a reasonable level of rate case expense. The Commission finds that Staff's proposed allowance of expense is the most reasonable of those presented and hereby approves same.

(11) Depreciation on Lapsing Advances

This issue, with a potential effect of $8,570 in Company's revenue requirement, is disputed only by Company and Staff.

The question presented has to do with depreciation expense on "lapsing advances." A lapsing advance is created as follows: When Company extends a main to serve some applicants (usually one at some distance from Company's existing facilities), it collects all or some of the construction money up front, in advance, from whomever applied for the service. For the next seven years the Company is required to refund the "advanced" money to the original applicant whenever other customers hook up to the main. The amount of the refund depends on the amount of revenue the Company realizes from the other customers. At the end of 7 years, all of the original customers' advance may have been returned; but if not, the Company no longer has to refund <u>any</u> of the originally advanced funds. This left-over balance of the first customer's advance, money which has not and will never be returned to the original customer, is said to be "lapsed."

Lapsed balances become part of Company's contributed plant, and Company cannot claim depreciation expense on such balances.

Staff proposes to eliminate Company's taking depreciation on advances that will eventually lapse. Staff studied 10 years of Company's records and found, on average, that 44.86% of Company's advances "lapsed." Staff proposes to eliminate from Company's present cost of service the depreciation it takes on these accounts. As stated, this would reduce Company's revenue requirement by $8,570.00.

Staff's adjustment has been employed, by agreement, in St. Louis County Water Company, Case No. WR-89-246, and Missouri American Water Company, Case No. WR-89-265. St. Louis County Water Company, Staff advises, had a lapse rate of 34%.

Company states that the years which Staff employed for its 10-year average are not representative, and that some years saw lapse rates of 10.84%, and others a lapse rate of 91.79%. Company says there was no lapse data available at all for a recent 10 year period. Company's chief lament is that implementing Staff's proposal would require additional record keeping, and that Company would need to maintain a "subsidiary ledger" to track the accumulated amortizations slated for transfer to the Company CIAC accounts after accounts lapse.

The Commission finds merit in Staff's proposed adjustment. The Commission also finds that additional record keeping of the sort feared by Company will not be required. Staff made its proposed adjustment on the basis of Company's presently available records, and Company is already required to keep records of each advance, by customer, and to record therein the amounts refunded and subject to refund. The Commission finds that Staff's proposed adjustment will more accurately reflect Company's actual depreciation expense regarding these accounts and, as a result, will better reflect Company's need to recover its expense through rates. For the reason stated, the Commission finds this issue in favor of Staff.

(12) Unamortized Deferred Maintenance

Company has included as part of its rate base the sum of $233,161 in unamortized deferred maintenance. By and large, this sum represents tank painting maintenance. Staff has removed it from rate base, citing for the Commission's consideration its recent decisions on this same issue in *Missouri American Water Company*, Case No. WR-89-265, and *Capital City Water Company*, Case No. WR-90-118. The revenue effect of this adjustment is $32,795.

Company claims this matter can be distinguished from the two cases above cited for the reason that in Company's last settled rate case, Case No. WR-89-178, Company was permitted to <u>reduce</u> rate base by an amount remaining in an unamortized maintenance accrual. Company suggests that because its maintenance reserve once received rate base recognition, albeit as a reduction, that Company should continue to receive the same treatment. Company also claims that a 1980 NARUC interpretation on this issue supports its position. Public Counsel urges the Commission to continue to treat this item as has been done in the two contested water cases cited above, as items of expense rather than investment.

The Commission finds nothing in Company's case or situation which distinguishes it from *Missouri American* and *Capital City*, supra. The fact that MCWC may have, in a settled case, somehow been accorded rate base treatment for an item which this Commission has stated is merely an item of expense is irrelevant.

The Commission finds that Company's inclusion of unamortized deferred maintenance in rate base is improper. As the Commission stated in

Missouri American, supra, these are items of expense, and do not rise to the level of an investment.

The Commission finds that Staff's adjustment is proper and that Company's revenue requirement should be reduced as stated, by the sum of $32,795.00.

(13) Amortization of Mexico Well

Sometime prior to 1982, Company's number 3 well in its Mexico division, which it purchased from a third party, suffered two pump failures in a 7-month period. In 1982, Company retired the well, but the well stayed in Company's rate base. Company discovered its error when it completed its automated continuing property record project (CPR), which is the next contested issue. In April, 1989, Company "reversed" the retirement and now proposes to amortize its loss in the remaining book value of the well ($75,000) over a ten-year period. Staff opposes the adjustment, and states that Company's faulty record keeping permitted the well to remain in Company's rate base from 1982 to 1989. The revenue effect of this issue on test year revenues is $7,595.

Staff's adjustment gives credence to the admitted fact that Mexico Well No. 3 was in Company's rate base, and improperly earned a return, for seven years. When asked whether this improper inclusion had permitted Company to recover "all" of the booked loss it now seeks to recover, Staff witness Rackers indicated that it had, adding that Company may have "recovered more than the $75,951."

The Commission finds that Company should have removed this well from rate base in 1982. Whatever their reasons for not being able to do so, and notwithstanding that Company reversed the retirement as a result of complying with this Commission's requirements regarding continuing property records, the

Commission finds that permitting Company to do as it requests will, as Staff claims, constitute a double recovery. The Commission finds this issue in favor of Staff.

(14) CPR Amortization

Company wants to amortize over three years the cost of computerizing its continuing property records (CPR) system. Staff opposes it, claiming that the total amount of $33,000 was essentially incurred for a one-time event and does not represent a continuing level of expense. The test year revenue effect of Staff's proposal is $11,113.

Company's position is as follows: The Commission first ordered Company to implement a form of continuous property record keeping in 1968, a directive which, over the years, has been modified and repeated through various rate cases. The Company states that Company and Staff have "worked closely" to achieve the stated goals and came to an agreement regarding the amortization of the sum needed to finish the project, $33,000. Staff's witness indicated there was no such agreement.

The Company's stated basis for employing a three-year amortization schedule for the computerization of Company's property records is that it took Company three years to do it. The evidence also indicates that Company's total costs connected with this process, which include constructing the records, has been, according to Staff's witness, "absorbed" by Company as part of its ongoing operations. The computerization of the property records, therefore, represents the last, or final, part of an ongoing process, one that began in 1968.

The Commission finds that Company's proposal to amortize this expense is supported in part by the length of time required to achieve compliance with the Commission's requirements, and by Company's reliance on representations by Staff that an amortization of such expenses would be, at least in this circumstance, proper. The Commission, therefore, finds this issue in Company's favor.

(15) Weather Normalization

Staff and Company disagree on how to normalize Company's test year residential water usage. Company obtained its estimate by totaling ten years of actual residential use, by division, and averaging the sums to present what, to Company, represents a "normal" year. (Ex. 13, Schs. 1-5). Staff employed a considerably more complicated method involving linear regression analysis which posits weather as one of its variables to establish "normal" water consumption. Adopting Staff's adjustment will have the net effect of decreasing Company's revenue requirement by $47,748. The Commission notes that both Staff and Company have concluded that water use in Company's test year was higher than "normal." The difficulty, of course, lies in defining normal.

Staff has attempted to define normal usage by employing an analysis in this particular case which, initially, separates water usage in winter months from water usage in summer months. Inasmuch as this winter/summer separation assumes some importance in Staff's calculation, it should be noted that Staff has characterized the months of May, June, July, August and September as "summer months." October through April, in Staff's analysis, are "winter months." Staff then averaged 12 years of Company's winter and summer usage, subtracted the winter usage from the summer usage and produced a "weather sensitive component" which, after additional calculations, Staff adjusted to reflect 73 actual years of weather experienced in each of Company's five divisions. Staff then added the result to Company's actual test usage in the winter months in order to determine Company's normalized test year usage.

Given the complexity of Staff's method, it is possible that this summarized characterization of it is flawed or incomplete, but the Commission has at least been made aware of certain basic assumptions which underlie Staff's approach, one of which is the relationship of weather to water usage. On this point, Company's sponsoring witness was asked on cross-examination why Company failed to explore the relationship of weather to usage in its study. Company's witness responded:

> "Because the intent of the company, in making this adjustment, is not to reflect solely weather as a factor that affects customer usage but to realize that there are also additional items which affect customer usage. And what we were trying to do was come up with an average of customer usage over the past ten years that would be a normal level and trying to adjust to that."

Staff's witness said that Staff sometimes uses different methodologies in different cases, depending on the nature and quality of available usage data. In Company's case, Staff found anomalies in certain of Company's usage data and, as a result, chose the method it proposes herein. Speaking to this issue, Staff's witness said: ". . . the best thing we can do really is separate the weather-sensitive component from the non-weather-sensitive component and treat them separately."

Staff's witness agreed that Staff's "separation" assumes that winter usage is not weather sensitive at all, while summer usage is entirely weather sensitive. As noted, Staff's method also assumes that May is a summer month, and that October and April are winter months.

On cross-examination, Staff's witness was asked if the following factors could affect water usage: (a) changes in the economy, (b) changes in the customer mix, (c) the price of water, (d) watering restrictions,

(e) technology changes, (f) water saving devices. The witness confirmed that each factor could affect water usage, but volunteered that Staff's regression methodology "included them" as well as the weather variables. Staff's witness was then asked:

> Q. The fact of the matter is that that analysis, your methodology, only takes that into consideration for the summer months?
>
> A: That's true, sir.
>
> Q. And not the winter months?
>
> A. Not the winter months.

The Commission finds that Staff's method, as employed in this case, should not be relied upon. It ignores the effect of weather on usage in those months which Staff characterizes as "winter," and only establishes a link between usage and weather in "summer" months. The Commission also finds that the "weather sensitive component" which Staff derived by the process above described should have been added to Company's historical average "winter" usage (12 years) instead of being added to Company's winter usage in the test year, which was admittedly abnormal and atypical.

The Commission finds that Company's proposed adjustment, which focuses on actual water usage, is not unreasonable. The Commission appreciates the time and effort which Staff's study represents. However, the Commission is not persuaded on this record that Staff's method is sufficiently reliable. The Commission finds this issue in favor of Company.

(16) Quality of Service

The issue here is the quality of service now being provided to Company's customers in its Platte City division.

In its reply brief, Company disputes the position taken by Platte County Intervenors regarding the quality of Company's service and product in its Platte City division. Company states that Staff witness Merciel's filed testimony reports "good water service" in each of Company's five operating divisions. Company also states that Staff witness Merciel's testimony was received "with the approval of all parties." While the Commission is aware that no party chose to cross-examine Staff witness Merciel, it doubts whether his testimony was received with their "approval." Mr. Merciel's written testimony was received at the end of the three-day hearing and, other than the true-up exhibit, was the last exhibit identified and admitted into evidence.

Company has advised the Commission in its direct filing that its Platte City division has for some years been operating at or near capacity with an aged plant and distribution system. At the public hearing in Platte City, the Commission heard public witnesses complain of poor water, smelly water, cloudy water, and low water pressure. One witness produced a container of fluid which the Hearing Examiner characterized for the record as "brown, viscous fluid." Other witnesses described their water as yellow, brown, or other unusual hues.

As Company will doubtlessly acknowledge, these and similar complaints are chiefly the by-product of an old and deteriorating system, and do not reflect any observed deficiencies in Company's management or personnel. The Company has stated in its direct case that it has conducted studies of its Parkville system in order to make improvements therein, and that Company has ongoing plans to do so. Company suggests that it will schedule improvements for this system in the near future. The Commission is of the opinion that for the Platte City division, the future is now. The Commission finds that inasmuch as Company has already initiated planning in this connection, that it should finalize such plans and submit them to the Commission Staff for its review and comment within 60 days of the effective date of this Report and Order.

(17) **Sewer Rates**

Company provides sewer service to 100 customers in its Platte County Division. Company's current monthly sewer charge is $29.62; Company proposes to increase it to $37.20, a percentage increase of 25.38%. None of the parties to this proceeding have designated this as a contested issue in Exhibit 1, the Hearing Memorandum. Nor has the issue been briefed.

In Company's original filing, Company states its net original cost rate base for its sewer plant is $65,143; Staff, in Exhibit 40, states that Company's net original cost rate base as of May 31, 1991, is $59,401. Company states its pro-forma adjusted revenue from sewer operations is $35,609. (Ex. 2, Section J, Sch. 1). Staff Exhibit 8, Schedule 10, identifies Company's total operating sewer revenue (as of May 31, 1991) as $35,766. Staff states that as of May 31, 1991, Company's net income requirement at 12.9% return on equity is $6,699. Staff also states that Company's available income is $6,542 for the same period, and that Company only requires an $82.00 increase to its annual sewer rates, an increase of less than 7 cents a month per customer. Company, by requesting a rate of return of 15.5% on its equity, requests an increase as above stated.

Having considered the evidence above referenced, the Commission finds that Company has not discharged its burden of proof on this issue and has not shown by competent and substantial evidence that its present revenue requirement for its sewer operation requires it to collect any additional sums from its present customers.

The Commission, therefore, rejects Company's proposed tariff and will herein order that said sewer rates remain the same as those presently on file, viz, $29.62 per month.

(18) Rate Design

Having determined that Company is entitled to an increase of $767,619 in revenues, the Commission must now determine how said increase is to be spread among Company's customers.

Company, Public Counsel, Warrensburg, and the City of St. Peters urge the Commission to stay with Company's "uniform" rate design, a design which this Commission approved in Company's revenue neutral rate design case, No. WR-90-236,[7] (hereafter, "Rate Design case").

Platte County Intervenors would have the Commission adopt "full" uniform rates, wherein customers in each of Company's five divisions pay the same water rates. Staff proposes that the Commission give limited approval to Company's present design, but requests that it be modified in certain particulars.

The aim of the parties in the rate design case, including Public Counsel, was to formulate a design which would eventually lead to uniform Company-wide rates and, according to Public Counsel, "single tariff" filings. The difficulties of so doing were, and remain, considerable; however, this is the first opportunity for the rate design approved in 1990 and revealed by Company's tariffs, to actually be implemented in rates. Foremost among these difficulties is the problem of recovering costs through rates. Each of Company's five divisions have embedded and ongoing costs which are uniquely

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[7]*In the matter of Missouri Cities Water Company, St. Charles, Missouri, for authority to file tariffs to implement uniform water rates for Company's four service areas in Missouri, filed March 16, 1990.*

their own. If all such costs are to be recovered in rates only on a division-by-division basis, can such rates ever be truly uniform? The answer is, of course, no. Yet Company has traditionally recovered its costs through rates designed on a "stand-alone" basis; that is, with rates designed as if each of Company's five divisions were separate companies. Company now proposes to recover its costs in the fashion approved in its rate design case and has filed proposed tariffs to achieve this end.

Company's approved rate design, although referred to in these proceedings as a "uniform" rate design, is not exactly uniform. This explains Platte County Intervenors' request that the Commission adopt a "full" or actual uniform rate design in this case. Company's approved rate design has resulted in Company filing proposed tariffs which, when examined, are helpful in explaining certain aspects of the rate design issue. For example, part of Company's proposed tariffs in each of its five divisions provides:

Brunswick

RATE - BILLING RATE IS EQUAL TO UNIFORM RATE PLUS EQUALIZATION RATE.

Water Usage Per Month	Rate per 1,000 Gallons		
	Billing	Uniform	Equalization
First 100,000	$3.8377	$2.0429	$1.7948
Over 100,000	4.2535	1.1579	3.0956

Monthly Minimum Charge Meter Size	Billing	Uniform	Equalization
5/8"	$ 9.07	$ 5.32	$ 3.75

Mexico

Cubic Feet Used Per Month	Rate per 100 Cubic Feet		
	Billing	Uniform	Equalization
First 13,400	$1.8889	$1.5281	$.3608
Over 13,400	1.1396	.8661	.2735

Monthly Minimum Charge Meter Size	Billing	Uniform	Equalization
5/8"	$ 6.00	$ 5.32	$ 0.68

St. Charles

Water Usage Per Month	Rate per 1,000 Gallons		
	Billing	Uniform	Equalization
First 100,000	$1.9585	$2.0429	$(.0844)
Over 100,000	1.2558	1.1579	.0979

Monthly Minimum Charge			
Meter Size	Billing	Uniform	Equalization
5/8"	$ 5.00	$ 5.32	$ (.32)

City of Warrensburg

Cubic Feet Used Per Month	Rate per 100 Cubic Feet		
	Billing	Uniform	Equalization
First 13,400	$1.3599	$1.5281	$(.1682)
Over 13,400	.5074	.8661	(.3587)

Monthly Minimum Charge			
Meter Size	Billing	Uniform	Equalization
5/8"	$ 5.27	$ 5.32	$ (.05)

Platte County, Missouri

Water Usage Per Month	Rate per 1,000 Gallons		
	Billing	Uniform	Equalization
First 100,000	$2.1731	$2.0429	$ .1302
Over 100,000	1.3054	1.1579	.1475

Monthly Minimum Charge			
Meter Size	Billing	Uniform	Equalization
5/8"	$ 5.60	$ 5.32	$ .28

The "equalization" component of the billing rate, shown above for each of Company's five divisions, reflects division specific costs unique to each division as established in the rate design case. St. Charles and Warrensburg, owing to favorable cost recoveries, have "negative" equalization rates. The remaining divisions have "positive" equalization rates. St. Charles and Warrensburg favor the present rate design. Platte County Intervenors oppose it.

The Platte County Intervenors point out that the proposed design enshrines already existing rate inequities and, over time, will make them worse. They ask the Commission to consider the effect of Company's design on both its present and proposed rates in the following example:

	1ST STEP		2ND STEP	
	Present	Proposed	Present	Proposed
Brunswick	$4.1386	$4.0513	$2.5438	$3.9986
Mexico	2.2291	2.2993	1.1770	1.3829
Platte County	1.7836	1.9051	1.0085	1.1712
Warrensburg	1.3679	1.5175	0.4524	0.5321
St. Charles	1.5319	1.6684	0.9997	1.1227

Platte County Intervenors urge the Commission to approve a truly uniform rate design, where future increases are spread evenly, irrespective of costs. Staff objects to this suggestion, pointing out that it would cause St. Charles and Warrensburg residents "rate shock." Staff recommends a partial phase-out of the equalization rate because it unduly favors St. Charles and Warrensburg, two areas in which Company has recently finished major construction projects. These projects have caused 65% of the costs which Company seeks to recover in this case. Staff also feels the present equalization rate is unfair to Brunswick, since Brunswick alone paid all costs of a large capital project finished before the advent of Company's uniform design. Staff also fears that the large increase in Brunswick's second tier, or "step" rate, will cause its largest user (who takes 40% of its water) to get off the system. Staff also proposes that Company's monthly minimum charge and private fire rates be set on a flat-rate, system-wide, basis.

At page 4 of the Commission's Report and Order approving Company's rate design, the Commission states:

> "These tariffs would not make everyone's water bill the same. This proposal would only make any future rate increases the same. That is, current differences in rates among the districts would remain the same, but the increases would be spread equally among all customers."

The Commission continues to support the concept of system-wide rates for Company, and in this respect is of the opinion that Staff's proposal to establish a system-wide flat rate for Company's minimum monthly charge and private fire charge is a step in the right direction.

Assuming a 9.47% overall increase in rates, the rate design proposed by Company, which incorporates the normalization and equalization ratios given approval in 1990, would produce the following increases at the consumption level shown below.

9.47% Across the Board Increase
Effect on Average Monthly Bill - 4,000 Gallons Consumed
Company Rate Design/Approved in 1990 Rate Design Case

Figure 1[8]

	Present Bill	Dollar Increase	Proposed Bill	% of Increase
Brunswick	$22.62	$1.32	$23.93	5.82%
Mexico	$13.78	$1.32	$15.09	9.56%
Platte County	$12.03	$1.32	$13.35	10.94%
Warrensburg	$10.45	$1.32	$11.77	12.60%
St. Charles	$10.67	$1.32	$11.98	12.34%

The same design, if the Commission partially eliminates the negative equalization factors for St. Charles and Warrensburg, as suggested by Staff, would produce increases in the approximate ranges shown below.

9.47% Across the Board Increase
Effect on Average Monthly Bill - 4,000 Gallons Consumed
Staff Proposed Rate Design

Figure 2[8]

	Present Bill	Dollar Increase	Proposed Bill	% of Increase
Brunswick	$18.24	$1.31	$19.55	7.18%
Mexico	$14.29	$1.31	$15.60	9.16%
Platte County	$12.65	$1.31	$13.96	10.35%
Warrensburg	$12.13	$1.31	$13.44	10.79%
St. Charles	$11.83	$1.31	$13.14	11.06%

Following the suggestion of Platte County Intervenors would produce increases as follows:

[8]A precise calculation of these estimated charges cannot be achieved on the basis of the cost evidence on the record.

9.47% Across the Board Increase
Effect on Average Monthly Bill - 4,000 Gallons Consumed
Platte County Proposed Rate Design
As Reflected in Present and Proposed Bills

Figure 3[8]

	Present Bill	Dollar Increase	Proposed Bill	% of Increase
Brunswick	$13.48	$1.28	$14.76	9.47%
Mexico	$13.48	$1.28	$14.76	9.47%
Platte County	$13.48	$1.28	$14.76	9.47%
Warrensburg	$13.48	$1.28	$14.76	9.47%
St. Charles	$13.48	$1.28	$14.76	9.47%

Having considered this matter, the Commission finds that the rate design proposed by Company and Public Counsel, represented by figure 1, above, is a reasonable, fair, and forward-looking design.

The Commission also finds that the proposal by Platte County Intervenors to go immediately to system-wide average rates, as depicted in figure 3, is premature. Over time, the rate structure herein approved will conduce to a leveling of rates throughout the Company's five divisions.

The Commission also finds that Staff's proposal to establish a system-wide flat rate for customer minimum monthly charges (service charge) and private fire charges is reasonable and herein adopts same. By so doing, the Commission finds that the equalization component of said minimum monthly and private fire charges should be eliminated. The Commission also finds that Company's proposal to eliminate the cost of 1,000 gallons of water (or the cost of 100 cubic feet) from said minimum charge is reasonable and should be adopted.

Conclusions of Law

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

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

Company's tariffs were suspended pursuant to Section 393.150, RSMo 1986, as amended, which puts the burden of proof on Company to show the proposed increase in rates is just and reasonable.

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

The Commission concludes that the Hearing Memorandum, Exhibit 1, executed by all parties, identifies all the contested issues other than True-up and Sewer Rates, discussed above. The Commission also concludes that late-filed Exhibit 40 properly states that Company's proposed revenue requirement, exclusive of the contested issues, is $1,379,482. It is this amount which, at hearing, was the starting point from which adjustments for the contested issues have been made.

Based on the revenue requirement found reasonable herein, the Commission concludes that applicant Missouri Cities Water Company shall be allowed to file revised tariffs designed to increase Company's revenues exclusive of gross receipts and franchise taxes in the amount of $767,619.00.

The Commission further concludes that Company has not discharged its burden of proof regarding its proposal to increase sewer rates in Company's Platte County Division. As stated in the Findings of Fact, these rates will remain at the present level.

The Commission also concludes that the rate design approved herein is reasonable and does not unjustly discriminate against any of Company's customers or divisions.

IT IS THEREFORE ORDERED:

1. That pursuant to the findings and conclusions in this Report and Order, the proposed tariffs for water service filed by Missouri Cities Water Company are hereby disapproved and Missouri Cities Water Company is authorized to file in lieu thereof, for this Commission's approval, tariffs designed to increase Company-wide annual gross revenues exclusive of gross receipts and franchise taxes by the amount of $767,619.00.

2. That pursuant to the findings and conclusions in this Report And Order, the proposed tariff for sewer service filed by Missouri Cities Water Company is hereby disapproved.

3. That Missouri Cities Water Company's tariffs for its water service in each of Company's five operating divisions shall reflect the rate design specified and approved in Section 18 of this Report and Order.

4. That Missouri Cities Water Company shall file plans for the upgrade of its Parkville District plant and distribution system, consistent with the findings of fact herein, within sixty (60) days of the effective date of this Report and Order.

5. That any objections or motions not heretofore ruled on are hereby overruled or denied.

6. That the tariffs to be filed pursuant to this Report and Order shall become effective for service rendered on and after October 3, 1991.

7. That this Report and Order shall become effective on the 3rd day of October, 1991.

BY THE COMMISSION

Brent Stewart

Brent Stewart
Executive Secretary

(S E A L)

Steinmeier, Chm., Mueller, Rauch, McClure and Perkins, CC., concur and certify compliance with the provisions of Section 536.080, RSMo 1986.

Dated at Jefferson City, Missouri, on this 20th day of September, 1991.