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March 26, 2002

**FILED**<sup>3</sup>

MAR 26 2002

Missouri Public  
Service Commission

Mr. Dale Hardy Roberts  
Public Service Commission  
P. O. Box 360  
Jefferson City, MO 65102

**RE: Missouri-American Water Company - Case No. WR-2001-281**

Dear Mr. Roberts:

Enclosed for filing in the above-referenced proceeding please find an original and eight copies of MAWC's Suggestions in Response to Order Directing Filing. Please stamp the enclosed extra copy "filed" and return same to me.

If you have any questions concerning this matter, then please do not hesitate to contact me.  
Thank you for your attention to this matter.

Sincerely,

BRYDON, SWEARENGEN & ENGLAND P.C.

By: *Dean L. Cooper*  
Dean L. Cooper *ugRg*

DLC/rhg  
Enclosures

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Mr. Joseph W. Moreland  
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FILED<sup>3</sup>

**BEFORE THE PUBLIC SERVICE COMMISSION  
STATE OF MISSOURI**

MAR 26 2002

Missouri Public  
Service Commission

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

Case No. WR-2000-281

**MAWC'S SUGGESTIONS IN RESPONSE  
TO ORDER DIRECTING FILING**

Comes Now Missouri-American Water Company ("MAWC") and, in response to the Missouri Public Service Commission's ("Commission") Order Setting Prehearing Conference and Directing Filing, states as follows to the Commission:

**I. BACKGROUND**

1. On March 7, 2002, the Commission issued its Order Setting Prehearing Conference and Directing Filing (the "Order") which, among other things, directed that each party prepare and file "a pleading setting out its suggestions as to the course of action that the Commission should follow with respect to the remanded issues." The Commission directed that each such pleading be divided into sections corresponding to the issues in question and should indicate, with respect to each issue, whether or not the existing record is sufficient to support the necessary findings of fact."

2. The "remanded issues," as set forth in the Commission's Order, are as follows:

- Phase-in;
- Level of rates for the Joplin district;
- Treatment of larger and smaller distribution mains; and,

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- Premature retirement.

3. The first three issues – phase-in, rates for Joplin and distribution mains – are all issues where the Circuit Court determined that the Commission’s Report and Order lacked sufficient findings of fact and conclusions of law. These issues were remanded with instructions that the Commission make findings of fact and conclusions of law sufficient to support a resolution of the issues and sufficient to permit the Court to determine whether such resolution is based upon, and supported by, the competent and substantial evidence on the whole record and is otherwise reasonable and lawful.

4. The premature retirement issue is different in that it has been remanded after findings on the merits that “[i]f no consideration is made for the net depreciation related to the old St. Joseph treatment plant, MAWC will suffer a taking or confiscation of its property” and that the “record does not support the Commission’s finding/ conclusion that the old St. Joseph treatment plant was the victim of extraordinary supersession.” This issue was, therefore, “remanded to the Public Service Commission for further proceedings consistent with [the court’s opinion].” MAWC will suggest alternative courses of action to the Commission in Section VII of this pleading.

## **II. DIFFERENT FROM A “GENERAL REMAND”**

5. The Commission states that “[b]y statute, all remands to the Commission are general remands” and cites as support Section 386.510, RSMo 2000 and *State ex rel. GTE North v. Public Service Commission*, 835 S.W.2d 356, 363 (Mo.App. W.D. 1992). However, it should be considered that Section 386.510, RSMo 2000, and by extension, *GTE North*, only refer to situations when a “judgment” or final order has been issued by a circuit court. Therefore, they do not apply in this case. Their inapplicability

was established when the Court of Appeals found that the Circuit Court's decision in this case was not final and appealable and dismissed the cases that were pending before it.

6. Section 386.510, RSMo 2000 (emphasis added) states in part as follows:

Upon the hearing the circuit court shall *enter judgment* either affirming or setting aside the order of the commission under review. In case the order is reversed by reason of the commission failing to receive testimony properly proffered, the court shall remand the cause to the commission, with instructions to receive the testimony so proffered and rejected, and enter a new order based upon the evidence theretofore taken, and such as it is directed to receive. The court may, in its discretion, remand any cause which is reversed by it to the commission for further action.

This statute refers to a circuit court "judgment." A "judgment" "includes a decree and any order from which an appeal lies."<sup>1</sup> In this case, the order issued by the circuit court is not a "judgment" as the Court of Appeals has determined that the Circuit Court's order is not final and no appeal lies from it.<sup>2</sup>

7. Similar language to that found in Section 386.510, RSMo 2000 can be found in Section 386.540.1, RSMo 2000, which governs appeals from circuit court orders. Section 386.540.1 states that "[t]he commission and any party, including the public counsel, who has participated in the commission proceeding which produced the order or decision may, *after the entry of judgment in the circuit court* in any action in review, prosecute an appeal to a court having appellate jurisdiction in this state." Both Sections 386.510 and 386.540.1 refer to a situation where there is a circuit court

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<sup>1</sup> Mo.R.Civ.P. 74.01(a).

<sup>2</sup> See *State ex re. Missouri-American Water Company, et al. v. Public Service Commission*, Order, WD60080 (December 13, 2001).

“judgment,” or, in other words, a final and appealable decision of the circuit court. The “general remand” referred to by the Commission only exists after a circuit court “judgment.”

8. Likewise, the case referred to by the Commission, *State ex rel. GTE North v. Public Service Commission*, 835 S.W.2d 356, 363 (Mo.App. W.D. 1992), is inapplicable to the case at hand. In *GTE North*, the Court of Appeals was presented with a final order, or judgment, and addressed what the circuit court could do in that context. Here, the Circuit Court has not entered a judgement. It has presented the Commission with specific instructions directing that the Commission take the steps that are necessary to allow the Circuit Court to know the basis for the decision and perform its review function.<sup>3</sup> Only after this is done will the Circuit Court be in a position to complete its review and, presumably, issue a judgement to which Section 386.510, RSMo 2000 will apply.

### **III. EXISTING RECORD**

9. In regard to the Commission’s question as to whether or not the existing record is sufficient to support the “necessary findings of fact,” MAWC believes that as to all three issues that were deemed to lack sufficient findings and conclusions, the Circuit Court has provided specific instructions to the Commission. These instructions do not include the taking of additional evidence and, therefore, the Commission cannot do so.

10. Even if it could take additional evidence, there is no reason to do so. This record is more than adequate for the Commission to reach findings and conclusions

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<sup>3</sup> See *Iron County v. State Tax Commission*, 480 S.W.2d S.W.2d 65, 70 (Mo. 1972).

that will support decisions on the issues in question. The evidentiary record in this matter is extremely lengthy and very well developed by the numerous parties. While there were difficult decisions to be made in this case, the difficulty was not the result of a lack of evidence. There is no reason to add to this already voluminous record by taking additional evidence.

11. What will be required is that, if the two new commissioners participate in this decision, they will need to certify that they have either: (a) "read the full record including all of the evidence," or (b) "personally consider[ed] the portions of the record cited or referred to in the arguments or briefs" before issuing a new report and order.<sup>4</sup> The Commission should also consider additional findings in conjunction with the conclusions of law to be made.<sup>5</sup> These things can and should be done within the context of the existing evidentiary record.

#### **IV. PHASE-IN**

12. In the subject Report and Order, the Commission stated that "as the Company requested, no phase-in of rate increases shall be permitted." (Report and Order, p. 58). As to this issue, the record provides a basis to reach this determination on either a factual or legal basis. For example, the following Conclusions of Law would be sufficient to reach this result without further findings of fact:

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<sup>4</sup> Section 536.080 RSMo 2000; *State ex rel. Jackson County v. Public Service Commission*, 532 S.W.2d 20, 30[8] (Mo.banc 1975) ("[W]e do emphasize that it is a basic and fundamental rule of law that one making a decision be aware by some means of what he is deciding.").

<sup>5</sup> See *Stephen and Stephen Properties, Inc. v. State Tax Commission*, 499 S.W.2d 798, 804[9] (Mo 1973).

The Commission concludes that it does not have the ability to implement a rate phase-in plan for a utility, other than electric utility, where that utility does not agree to such a phase-in plan. The Commission notes that it is a creature of statute and possesses only those powers and duties specified in its enabling legislation "and also all powers necessary or proper to enable it to carry out fully and effectually all the purposes of (the) chapter" Section 386.040, RSMo 2000; *See also State ex rel. Kansas City Transit Inc. v. Public Service Commission*, 406 S.W.2d 5 (Mo. Banc 1966). In that regard, the Commission notes that Section 393.155, RSMo 2000 specifically permits it to implement a phase-in of rates for an electrical corporation where the increase is "primarily due to an unusually large increase in the corporation's rate base..." The express authorization for a phase-in of rates for electrical corporations implies the exclusion of such authority for other utilities. *See Harrison v. MFA Mutual Insurance Corporation* 607 S.W.2d 137 (Mo. Banc 1980). *See also Bridges v. Van Enterprises*, 992 S.W.2d 322 (Mo. App. SD 1999). Thus, the Commission is without the specific authority to require a phase-in of rates due to an unusually large increase in a water company's rate base, without the agreement of the water company. Therefore, as the Company has not agreed to a phase-in, no phase-in of a rate increase shall be permitted.

13. In the alternative (or in addition), this result can also be reached with a more factual approach based on the existing record. The following provides an example of such findings:

The Commission finds that FAS 71 and 90 preclude the Company from including any deferred revenues resulting from a rate phase-in plan in its financial statements. (Hamilton Sur., Ex. 3, pp. 8-9). This will preclude the Company from having a reasonable opportunity to earn the return on equity authorized herein and thus adversely affect its ability to raise capital on reasonable terms. (Jenkins Reb., Ex. 4, pp. 5-6). The Commission also finds that the deferral of revenues associated with any rate phase-in plan will include carrying costs that also must be recovered from customers. Such carrying costs, depending upon the amount of the deferral and the length of the phase-in can have a substantial, negative impact upon the ultimate rates to be paid by the customers. (Tr. 1984-1985; 2042). For these reasons the Commission does not believe it is appropriate to implement a phase-in of rates.

14. Thus, the Commission not only has a sufficient record to reach its phase-in decision, it has at least two approaches by which it can do so.

## **V. RATES FOR JOPLIN**

15. The cost of service studies performed in this case indicated that the City of Joplin's rates were approximately \$600,000 greater than its district cost of service. Joplin argued that it should not pay more than its cost of service. The Commission's decision in this case addressed this issue by stating that "In moving toward [district specific pricing], however, the Commission will adhere to the principle that no district will receive a rate decrease." (Report and Order, p. 58).

16. As the Commission cited in its Report and Order (p. 59), the Missouri Supreme Court has stated previously that there is "no legitimate reason or basis for the view that a utility must operate exclusively either under a systemwide rate structure or a local unit rate structure. . . ." *State ex rel. City of West Plains v. Public Service Commission*, 310 S.W.2d 925, 933 (Mo. banc 1958). It is the "province and duty of the commission, in determining the questions of reasonable rates, to allocate and treat costs (including taxes) in the way in which, in the commission's judgment, the most just and sound result is reached." *Id.*

17. Thus, while the Commission's discretion in this area is quite broad, it must explain its reasoning in a way that is sufficient to allow the courts to determine the reasonableness of that decision.

18. The impact of the Commission's decision on this issue as to the rates in Joplin and, correspondingly, as to the rates in the other operating districts, is sufficiently developed in the evidentiary record along with expert opinions concerning the policy implications of the decision. Therefore, MAWC suggests that the Commission consider the record before it and reach a decision which includes findings and conclusions



sufficient to explain the Commission's reasoning.

## **VI. DISTRIBUTION MAINS**

19. This issue arises based upon the St. Joseph Industrial Intervenors challenge to the Staff's execution of the Base-extra Capacity ("BXC") method. The St. Joseph Industrial Intervenors alleged that the Staff class cost of service study was flawed because Staff "failed to recognize that customers who are provided service through mains that are 12" or larger in diameter make minimal use of the distribution system."

20. The Commission, while concluding that the "Staff's class cost of service study, developed using the BXC method, is the appropriate method by which to allocate costs among customer classes in each district and to design rates by which to recover appropriate revenues," failed to address this specific argument. (Report and Order, p. 60-61).

21. The St. Joseph Industrial Intervenors have alleged in the past that sufficient evidence existed in the record to place this matter before the Commission. Thus, it must still be sufficient for the Commission to reach a decision. The St. Joseph Industrial Intervenors have pointed to the direct and rebuttal testimony of Ernest Harwig (Ex. 57, 61), as well as the cross-examination of Staff witness Hubbs found at Tr. 956-963, for the development of this issue.

22. MAWC suggests that the Commission should take this information into consideration and issue a decision which expressly addresses the St. Joseph Industrial Intervenors' challenge to the Staff's application of the BXC method to its class cost of service study.

## **VII. PREMATURE RETIREMENT**

23. Unlike the other subjects which have been remanded to the Commission, the premature retirement issue concerns a decision on the merits. The Commission was found to have erred when it denied MAWC's recovery of depreciation amounts associated with the retirement of the old St. Joseph treatment plant and directed that the remaining plant balance of \$2,832,906 be written off. Additionally, the Commission found that any amount expended by MAWC to retire the old plant would not be recoverable in rates.

24. The Circuit Court found that "[i]f no consideration is made for the net depreciation related to the old St. Joseph treatment plant, MAWC will suffer a taking or confiscation of its property" and that the "record does not support the Commission's finding/ conclusion that the old St. Joseph treatment plant was the victim of extraordinary supersession."

25. The following findings and conclusions based upon the existing record should be used to correct the Commission's error in regard to this issue:

### **FINDINGS**

The "premature retirement" issue concerns how to address the remaining book value of the old St. Joseph treatment plant in light of the construction of the new treatment plant and related facilities. It is a "depreciation" issue in that depreciation rates have failed to match the actual life of the old plant.

"As applied to utility plants, depreciation means the loss in service value not restored by current maintenance, incurred with the consumption or prospective retirement of utility plants in the course of service from causes which are known to be in the current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and

requirements of public authorities, etc." (Bolin Dir., Ex 21, p. 3).

In this case, the past depreciation analysis has proved incorrect and the depreciation rates have failed to match capital recovery with capital consumption. The old St. Joseph treatment plant consisted of structures that predate 1900 and filters that predate World War I (Young Reb., Ex. 17, p. 20) which is a reasonable length of service. However, the old treatment plant was not fully depreciated before its retirement leaving a net plant investment or net original cost. Thus, a depreciation reserve deficiency of \$3,332,906 exists (which includes the net salvage or cost to disable the old treatment plant). (Salser Dir., Ex. 6, p. 12; Bolin Dir., Ex. 21, p. 3).

These amounts are associated with a plant that was used and useful for over one hundred years. They are merely depreciation that would have been taken previously, if recovery had matched consumption. (Salser Sur., Ex. 8, p. 4).

## CONCLUSIONS

It is recognized that plant depreciates in value and, thus, depreciation expense is included in a utility's cost of service. See *State ex rel. City of St. Louis*, 47 S.W.2d at 111 ("A public utility is entitled to earn a reasonable sum for depreciation of its property, including necessary retirements, ordinary obsolescence and diminishing usefulness which cannot be arrested by repairs . . ."). Depreciation rates for ratemaking purposes are set by the Commission, not the utility (Section 393.240, RSMo 2000) in an attempt to match capital recovery with capital consumption. See *Re: Depreciation*, 25 Mo.P.S.C. (N.S.) 331, 334, (1982). This process necessarily involves an analysis of expected future events such as useful life, salvage value and cost of removal. See *In the Matter of St. Louis County Water Company's tariff revisions designed to increase rates*, 4 Mo.P.S.C.3d 94, 102-103 (1995).

Because of the estimates and unknowns involved with this analysis, depreciation rates can, and do, miss their goal. The question is what to do with this failure to match recovery with consumption. Commonly, a piece of property, such as a water plant, is fully depreciated before the end of its life. In that situation, depreciation stops. The utility does not get to over-depreciate. Because a utility does not get to benefit from excess depreciation in the case of a plant, it should not be penalized by under depreciation.

Recovery of investment is not universally guaranteed. *State ex rel. City of St. Louis v. Public Service Commission*, 47 S.W.2d 102, 111 (Mo

banc. 1931) (the "abandonment of property which is never replaced, but is superseded by another instrumentality, as gas lamps by electric lights, or by another agency or company, is an extraordinary supersession.") is an example of a situation where a utilities' loss is "one of the hazards of the game," just as the extraordinary increase in values following the war was an unexpected gain . . . ."

However, *State ex rel. City of St. Louis* does not further the Public Counsel's proposal to deny recovery in this case. First, *State ex rel. City of St. Louis* is based upon the "abandonment of property which is never replaced . . . ." Such is not the case at hand. The old St. Joseph surface water treatment plant was replaced with a new ground water treatment plant.

Second, it is an economic truth that public utility appliance will wear out. By the Public Service Commission statutes, the state undertakes to protect utility companies against loss on that account by allowance of depreciation reserves. Only when an appliance becomes obsolete by reason of scientific discoveries and inventions, is there a risk which investors in such utilities must take. *State ex rel. City of St. Louis v. Public Service Commission*, 47 S.W.2d 102, 111 (Mo banc. 1931).

The old St. Joseph treatment plant was not "obsolete by reason of scientific discoveries and inventions." Water was not replaced by some other substance. The plant had substantial length of service consisting of structures that predate 1900 and filters that predate World War I. (Young Reb., Ex. 17, p. 20). This treatment plant needed to be replaced for a variety of reasons. However, these reasons were not based on "scientific discoveries and inventions."

Thus, the question for the Commission is not whether the reserve deficiency should be recovered, as suggested by the Public Counsel, but rather how it should be recovered. In the past the Commission has provided for the recovery of premature retirements through an amortization. *In the matter of United Telephone of Missouri*, 2 Mo. P.S.C. 3d 403, Case No. TR-93-181 (1993) and *In the matter of GTE North Incorporated*, 30 Mo. P.S.C. (N.S.) 88 (1990).

An amortization is necessary to avoid a taking. The net depreciation in this case is the result of insufficient depreciation rates set by the Commission. If no provision is made for the net depreciation related to the old St. Joseph treatment plant, MAWC will suffer a taking or confiscation of its property.

Therefore, MAWC shall be allowed to return to its books the plant's

net original cost of \$2,832,906. The Commission will further direct that the amounts be amortized (to include actual net salvage) over twenty years, resulting in an adjustment of \$166,645, consistent with MAWC's original amortization proposal in this case. (Gutowski Dir., Ex. 2, Sch. LJG-2.27).

### VIII. CONCLUSION

26. It is appropriate for the Commission, based upon the existing record, to issue a report and order on remand which addresses the issues remanded by the Circuit Court. Specifically, MAWC suggests that the phase-in and premature retirement issues can be addressed through the use of the findings of fact and conclusions of law provided herein. In addressing the Joplin rate question and the distribution mains question, MAWC suggests that the Commission reach its decision while being mindful of the fact that any changes to its approach will necessarily impact other rate payers.

WHEREFORE, MAWC prays the Commission consider these suggestions in proceeding with this case and issue such orders as are reasonable in the circumstances and consistent with the above.

Respectfully submitted,



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Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, or hand-delivered on this 26<sup>th</sup> day of March, 2002, to the following:

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