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August 12, 2000

FEDERAL EXPRESS

Mr. Dale H. Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
301 West High R530
Jefferson City, Missouri 65102

Re: **Missouri-American Water Company**
Case No. WR-2000-281

Dear Mr. Roberts:

Enclosed are the original and eight (8) conformed copies of **SUBMISSION OF PROPOSED FINDINGS OF FACT AND CONCLUSIONS**, which please file in the above matter and call to the attention of appropraite Commission personnel.

An additional copy of the material to be filed is enclosed, which kindly mark as received and return to me in the enclosed envelope as proof of filing.

Thank you for your attention to this important matter. If you have any questions, please call.

Sincerely yours,

FINNEGAN, CONRAD & PETERSON, L.C.

By: Stuart W. Conrad

SWC:s
Enclosures
cc: All Parties

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STATE OF MISSOURI
MISSOURI PUBLIC SERVICE COMMISSION AUG 1 4 2000

Missouri Public
Service Commission

In the Matter of Missouri-American Water Company's Tariff Sheets Designed to Implement General Rate Increases for Water and Sewer Service provided to Customers in the Missouri Service Area of the Company	))))))	**WR-2000-281** **SR-2000-282** **(Consolidated)**

SUBMISSION OF PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

COME NOW Intervenors AG PROCESSING INC, A COOPERATIVE ("AGP"), FRISKIES PETCARE, A DIVISION OF NESTLE USA ("Friskies") and WIRE ROPE CORPORATION OF AMERICA INC. ("Wire Rope") (collectively herein "St. Joseph Industrial Intervenors") joined by City of Parkville ("Parkville") and submit Proposed Findings of Fact and Conclusions of Law, attached hereto as an Appendix. Inasmuch as these parties have taken positions only on selected issues, only selected issues are included in the attached appendix.

Respectfully submitted,

FINNEGAN, CONRAD & PETERSON, L.C.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by hand delivery or U.S. mail, postage prepaid addressed to the following persons:

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Dated: August 11, 2000

Stuart W. Conrad

Although a number of issues are presented in this case for decision, there are two significant issues that tend to determine other smaller issues in the case. These are the controversy regarding whether District Specific or System wide Pricing shall be used and the rate base valuation of the new St. Joseph district treatment plant. The Commission will address these two issues first, since their determination may affect the handling of other issues in the case.

I. DISTRICT SPECIFIC OR SINGLE TARIFF (SYSTEM WIDE) PRICING.

A. Evidence.

Single Tariff (STP) or System wide pricing describes a rate methodology wherein all districts of the company are charged under the same tariff. At its extreme, STP rates would treat the several service districts of the company as though they were one and all customers throughout the several districts would pay the same rate for the same volume of water taken. District Specific Pricing, or DSP approaches the question from the opposite perspective. DSP identifies those costs that are specific to each district and assigns and recovers costs only from the customers in that individual district. Under DSP, joint and common costs such as financing costs, debt service costs and management costs are allocated to the various districts proportionate to the district's share of the corresponding assigned cost item.

The parties are deeply divided on this issue. The Company and the Water Districts in the St. Joseph District

advocate what they term as "retention" of the "existing" STP approach. Staff, which has previously advocated STP in prior Company rate cases, has determined that STP was not appropriate for the rate design in this case, because of the particular facts surrounding this case. Staff is recommending DSP with a five-year phase-in for the districts that receive significant rate increases. Public Counsel also agrees with Staff that STP is not appropriate for application to Company in seven distinct, diverse and non-interconnected districts. Public Counsel believes that DSP is more just and reasonable for this Company under the circumstances and also because a significant movement toward DSP and towards cost of service rates in each of the districts and proposes a phase-in approach to minimize rate shock. St. Joseph Industrial Intervenors (SJII) and Riverside, and Municipal Intervenors including the City of Joplin argue that STP should be rejected and that DSP is the only lawful approach.

Company's principal witness was Mr. Stout. He testified that there were numerous administrative advantages to preserving the existing STP system and that otherwise company would be required to submit (currently) seven separate sets of tariffs each time new tariffs were filed. Mr. Stout testified that in his opinion STP was preferred because it provided rate stability in that cost increases were spread over a much larger number of customers and that accordingly the impact of rate changes was lessened. He also argued that differences in costs between districts were temporal in nature in that, at any one

time, a capital improvement project may be coming on line in a particular district, but other districts will be receiving capital improvements at a later time thus eventually evening out capital-related costs among the districts.

Water Districts offered the testimony of Dr. Janice Beecher, a recognized academic authority on water rates and water rate-making in the United States. Dr. Beecher testified that more jurisdictions had adopted STP in some form, although in some cases with limitations. She characterized STP favorably, and provided a multi-part analysis addressed to several of the important criteria she identified in her study. This study was developed through a survey that she had performed of many regulatory commissions throughout the United States. Among other things, the regulators were asked whether STP had been approved, the circumstances of its approval, and the extent of satisfaction with the approach. She then collated and further analyzed the results of this survey. The Water Districts, essentially customers served from the St. Joseph district, also argue that STP has been approved by the Commission in prior cases and it would be particularly unfair and unjust to, as they put it, "change horses" at this "late date" and revert to a district-specific pricing system. The Water Districts note that they would face significant price increases if STP were abandoned in favor of DSP.

Proponents of STP also note the situation of the Brunswick district. Brunswick is the Company's smallest district

with roughly 500 customers. All parties who have performed district specific cost studies have identified that the Brunswick district is being served at considerably less than what its costs would be if DSP were adopted. Quantification of the amount of differential varies, but is generally in the range of $250,000. This would represent a substantial increase to the Brunswick district with its small customer base simply to adjust for a transition from STP to DSP without taking into account the costs of the new treatment plant in St. Joseph.

Company's original proposal under STP, which of course included the entire costs of the new treatment plant in St. Joseph, was roughly an increase of 53% for all districts and rate classifications within those districts. Reversing STP from the current rates in Brunswick would have its own effect, but combined with the new treatment plant costs as proposed by Company, the effect would be over 200% to this district.

The parties opposing STP offered several witnesses. Mr. Ernest Harwig, a rate consultant, was jointly sponsored by the Municipal Intervenors. Mr. Harwig has also had long experience in water rate cases and has participated in several of the same cases as has Dr. Beecher. Mr. Harwig's basic contention is that STP was subject to numerous flaws and did not provide the benefits claimed for it. In addition, Mr. Harwig testified that STP resulted in inter-district cost shifting and resulted in charging the costs that were unique to one district to the customers in the other districts. Mr. Harwig also testified that

the temporal argument referenced by Mr. Stout should be rejected since all it proved was that one district might be overcharged then later undercharged its costs.

In addition, STP opponents also offered testimony from the City Manager of Warrensburg, Mr. Landon. He testified that the citizens of Warrensburg were willing to pay the costs of their own water treatment system, but were unwilling to pay the costs associated with other districts' systems and specifically, in this case, the new treatment plant in St. Joseph.

Although not specifically offered by any of these parties directly, the members of the public who testified at public hearings in several of the districts generally testified in opposition to STP. Particularly the hearings that were held in Joplin, St. Charles, and Warrensburg indicated substantial opposition by customers in those districts to being charged costs associated with the new treatment plant in St. Joseph.

The various parties briefed the issue of whether STP is lawful under Missouri law. At significant issue is the language of Section 393.130 RSMo 1994 which provides in relevant part

> 1 ....All charges made or demanded by any... water corporation... for water... service rendered or to be rendered shall be just and reasonable... Every unjust or unreasonable charge made or demanded for... water... service, or in connection therewith... is prohibited.
>
> 3. No... water corporation... shall make or grant any undue or unreasonable preference or advantage to any... locality, or to any particular description of service in any respect whatsoever, or subject any... locality or any particular description of service to any

undue or unreasonable prejudice or disadvantage in any respect whatsoever. [Emphasis Added]

B. Discussion.

STP appears to have been a creature given some life for this Company by this Commission in prior orders. Without identifying those prior orders as a mistake, based on the evidence in this case and the circumstances of this case, the Commission has been convinced that STP must be ended for this Company. In reaching this conclusion, we note several factors.

First, STP was "approved" to the extent that it was as an experimental rate system. One of the principal arguments in favor of STP, as noted by its proponents, is the benefit that is claimed for smaller districts whose systems require expensive improvements. In those cases, STP, it is argued, allows the cost of the improvements to be spread to a large number of customers where the impact is diluted, thereby permitting what may be needed improvements to go forward in circumstances that would otherwise be cost prohibitive. In this case, however, the evidence is extremely persuasive that the very opposite is the case. For example, the smallest district of Brunswick is the recipient of costs shifted from the largest district, St. Joseph. This would appear to be a perversion of the claimed benefit, if benefit it be. Further, the Joplin district, where the evidence was persuasive, was currently paying rates which exceeded its district specific costs by roughly $600,000 according to Staff's evidence, would be required to increase the amount of this

subsidy by well over $1 million to recover the costs of the new treatment plant that would be allocated to Joplin under STP as proposed by Company.

We are convinced that this result is, in a word, wrong. Ultimately, public acceptance of utility charges must be supported by basic perceptions of fairness and equity, otherwise the very underpinnings of the system of regulation become suspect in the view of the public for whose benefit regulation exists. Based on the clear public perception as voiced by numerous public witnesses, including several legislators, it is inequitable to charge the costs that are incurred to provide service exclusively to one district to other districts. What appears to have been a misguided attempt to achieve equity has been revealed as a means of creating inequity that this Commission will not perpetuate nor further foist upon the ratepaying public. In this regard we specifically take note of the testimony of numerous public witnesses who expressed the otherwise unexceptional thought that they were willing to pay their own costs but not those belonging to someone else.

Second, we are convinced that the legal basis for STP is questionable under Missouri law. This Commission does not pretend to be a court and readily defers to the courts to construe the statutes of the state, just as we would hope that the courts would defer to our judgment on matters of fact and mixed questions that are particularly within our realm of expertise. Nevertheless in the absence of judicial construction of the

particular language of Section 393.130 RSMo, we conclude that the plain meaning of this statute precludes charges that grant a preference to one locality of the state over another. Rather clearly, STP does this. Costs incurred to provide service in one district are explicitly shifted to another. The locality from which the costs are shifted is preferred; the recipient locality is burdened. Regulatory expertise is not needed to discern this effect.

The courts of this state have indicated that statutes are to be given their plain meaning. The mechanism of STP has not been judicially examined against this standard, but we are convinced that if it were, given the evidence in this case, it would fail under this statute. Thus, although we have concluded that STP as a general policy does not meet its stated objectives, we also conclude that there is significant question regarding its legality.

Third, we are convinced based on the evidence of record in this case that the policy of STP simply does not fit the facts of this case. Proponents have argued that the several districts of the Company are like the telephone system where uniform tariffs are commonly employed. They also point to examples of natural gas and electric companies where similar uniform tariffs are common. These examples are inapposite. Electric utilities are obviously interconnected, not only within their own networks, but to a larger "grid" or network that unifies often several electric utilities together within a control or reliability area.

Electrical energy may be generated at a generating station tens, or even hundreds of miles away from the load it serves and thus electric utilities dispatch their generation to serve their load for the most part on a unified basis. The power received by one locality or community does not differ from that delivered to another community or locality. Indeed, several "localities" may receive power that is generated from one central location. The several districts of MAWC however, are not interconnected. Water treated in St. Joseph cannot be delivered in Joplin, nor any other district and vice versa.

The analogy to natural gas systems is also inapposite and rejected. While natural gas distribution systems may appear charge **distribution** rates that are uniform within that particular company, they are distinguished in several instances in this state by different PGA structures representing different delivering interstate pipelines and different cost structures pertaining to the cost of purchased gas supplies. An example recently familiar to the Commission, is Union Electric (Ameren) distribution system in Jefferson City. One portion of Ameren's distribution system is served from Panhandle Eastern; another portion is served by another pipeline and presents different rates to the ratepayers in the two **noninterconnected** service areas. Finally the comparison to the telephone system, where any caller connected to the telephone network may call any other telephone customer, even though they are not customers of the same telephone provider, is obviously flawed.

Nor are we persuaded by the argument that the service, the provision of safe and palatable water, is the same, therefore the service is identical. This argument is amusingly simplistic and is similar to an argument that a Budweiser Clydesdale is the same as a Shetland pony because both are horses. In fact, as the evidence herein demonstrated amply, costs of water treatment vary considerably from one district to another. Depending on the source of the water, raw water is treated using significantly different methods from one district to another. The quality of the water sources also varies, requiring different treatment to make the water more palatable, remove "hardness" or the like. In the case of St. Charles, treated water is purchased from another processor and redistributed to meet part of the Company's public service obligation. The respective costs differ markedly from district to district. Further, even the quality and palatability of the finished water product differs from one district to another. Joplin's groundwater supply did not appear to draw significant comment at the public hearing regarding taste and odor; Warrensburg's and St. Joseph's did.

One of the largest differences between the districts is the rate base installations in each district. Some are older and more fully depreciated; others are newer and represent newer technologies. The new St. Joseph treatment plant obviously makes a significant difference in the cost of treatment in St. Joseph (without regard to other issues dealt with, infra). These costs

and other differences simply cannot be squared with arguments that the same product is supplied.

In reaching our decision we have given due consideration to the argument of the Water Districts who assert that STP was adopted in past cases and that this represents a shift that results in a significant impact to them. While acknowledging the impact potential, closely analyzed, this argument proceeds upon a false assumption, namely that this Commission "adopted" STP. The Water Districts have, unfortunately, misread our prior decisions on this topic. For example, in the last rate case for this Company, WR-97-237, there was no sufficient evidence on which to construct an alternative approach and thus we were forced to approve the rate structure proposed by the Company. However, we made it clear in our decision in that case that we were not adopting STP as a policy and would continue to review the matter. Indeed, in the same Report and Order, we authorized the WO-98-204 cost of service docket as a "spin off" docket from that case, in which the Water Districts participated. In that case, evidence was gathered to identify and quantify the amount of the inter-districts shifts that had resulted from our experimental implementation of STP. Based on the evidence in this case, we are persuaded that STP is the wrong direction for regulatory water policy in this state. While the change in direction may cause some initial discomfiture, it would be poor public policy to continue in the wrong direction just to avoid the trouble of turning around. Indeed, we are convinced that it would ill serve

the public in these districts to continue on a course that we have concluded on the basis of the record in this case is unwise public policy.

In sum, we are convinced that single tariff pricing or STP must be rejected and district specific pricing must be implemented in the rates that result from this case and we will so order. The specifics and implications of this decision on various districts will be dealt with in another part of this Report and Order.

II. THE VALUATION OF THE ST. JOSEPH TREATMENT PLANT FOR RATEMAKING PURPOSES.

A. Introduction.

The other major issue in this case was the value that should be attached for ratemaking purposes to the company's investment in the new St. Joseph water treatment plant. At the closing of the true-up portion of the case, Staff witnesses testified that the full value of that investment should be roughly $70.1 million.

There is substantial disagreement between the parties regarding the proper value to be attached to this plant for ratemaking purposes. Staff and Company assert that the full value should be included in rate base; Public Counsel and SJII assert that the construction of the new plant was imprudent and that the prudent and economical choice was for the Company to have renovated the existing surface water plant. They assert that choice could have been completed for roughly one-half the cost of the new treatment plant.

B. Was Prudence Determined in the Certificate Case, WA-97-46?

1. Arguments.

Staff and Company both assert that the Commission has already decided this issue and that the Public Counsel and SJII are collaterally attacking that earlier decision. Just prior to the hearing, Company moved to strike the testimony of the expert

witnesses offered by the Public Counsel and SJII and also sought summary determination of the issue. Staff joined in this motion. The Company's motion was taken with the case. Although some responses had been tendered regarding the motion, the parties were asked to brief the issue. The Commission will now address this issue, since if it is ruled in favor of Company, issues regarding the prudence of the Company's choice are not reached. The issue essentially boils down to whether in the prior certificate case, the Commission had already determined that the Company's selection of the alternative chosen was prudent.

Understandably, Company makes the strongest argument. Company contends that it would not have gone forward with construction had it not thought the plant had been approved by the Commission.

Case No. WA-97-46 was filed by Company to seek a certificate of public convenience and necessity for the construction of a new treatment plant, two new raw water lines, a well field, and two distribution lines. The treatment plant was to be constructed on property located within the St. Joseph district and thus no certificate was required for that portion of the project. The Commission granted a certificate for the well field and raw water lines which were located outside of the then-certificated service area. In filing its application, the Company had sought advance approval of the project from the Commission, which portion of the request was opposed by Public Counsel among others.

The Company relies on the following language from the Report and Order in that proceeding as support for its position that the Commission has already determined the question of prudence:

> . . . based on the extensive evidence presented, the Commission finds that proposed project, consisting of the facilities for a new ground water source of supply and treatment of a remote site, **is a reasonable alternative.**

The Company lays great stress on the bolded portion of the WA-97-46 Report and Order. Staff joins in these arguments of Company. Staff draws an equivalence between the word "prudent" and the word "reasonable" employed in the above language. However, both parties gloss over the explicit language that follows:

> 5. **That nothing in this Report and Order shall be considered a finding by the Commission of the prudence of *either* the proposed construction project** or financial transaction, or the value of this transaction for ratemaking purposes, **and the Commission reserves the right to consider the ratemaking treatment to be afforded the proposed construction project** and financial transaction and their results **in cost of capital in any future proceeding.** (Emphasis added.)

Company and Staff also raise a further related legal issue of estoppel. Company asserts that several of the parties to this case participated in the certificate case and either were silent or took no position on the prudence of the selection of alternatives. The Company asserts that those parties are now estopped to assert that its selection between alternatives was imprudent. Additionally, the Company asserts that the Commission

itself is estopped citing the case of *Lick Creek Sewer Systems, Inc. v. Bank of Bourbon*, 747 S.W.2d 317 (Mo.App 1988). That assertion essentially sounds in more basic fairness, in that the agency should not be permitted to induce the utility to make an investment, then reverse course and deny recovery.

Public Counsel, SJII and other parties argue the contrary. They argue that review of the Report and Order in WA-97-46 is dispositive of this argument. There MAWC asked for pre-approval of the treatment plant project. Issues 1 and 2 identified in the WA-97-46 hearing were: "Is it appropriate for the Commission to determine the prudence of this project and, if so, is the MAWC proposed project a prudent alternative?" Report and Order, WA-97-46, pp. 8-9. These parties also observe that the Commission noted that "authority exists supporting the position that the Commission may **not** legally take any further action regarding the pre-approval of the proposed project" citing both *State ex rel. Capital City Water Co. v. Public Service Commission*, 850 S.W.2d 903 (Mo.App. 1993) and *Union Electric Company (Callaway Nuclear Plant)*, 27 Mo. PSC (N.S.) 183, indicating that the proper time for prudence to be considered is when a rate case is filed in which a utility attempts to recover the associated costs of such a project. Report and Order, WA-97-46, pp. 12-14. Thus, they argue, the Commission clearly rejected MAWC's request to pre-approve the prudence of its project. They assert that neither they nor the Commission are estopped, noting the prior Commission decision nearly two decades ago in the Callaway

Nuclear Power case, wherein a similar argument was raised. They respond to the argument about the language in the certificate case by noting that the Commission rejected Company's request for preapproval and that the language chosen did no more than indicate that the selection made was "a" reasonable choice, but not "the" reasonable choice.

Public Counsel and other parties also argue that the Commission lacks legal authority to predetermine such a question in the context of a certificate case. Essentially this argument asserts that the questions in a certificate case are different than those in a rate case and the Commission would violate *State ex rel. Util. Consumers Council v. Public Service Commission*, 585 S.W. 41 (Mo. banc 1979) ("UCCM") and other cases cited if it were to commence a policy of determining such questions in advance of the time they were presented for decision and properly noticed for that purpose. They note that the Callaway Nuclear case presented an argument that a prior certificate determination had determined the prudence of the selection made by Union Electric to construct a nuclear fueled generating station rather than a fossil fueled generating station. In the Callaway case, the conclusion was that the Commission could not lawfully reach out, in that case several years into the future, to rule rate issues before they were presented.

2. Discussion.

In general, estoppel is an aspect of the doctrine of issue preclusion that prevents a party from relitigating an issue that has been previously litigated and resolved, either by a court or an administrative agency. Similarly, the assertion by Company that the Commission itself is estopped to reconsider this issue is similarly a variation of the same general concept, but framed in the context of finality that the administrative body cannot thereafter disturb. We believe both questions ultimately turn on whether in the certificate case the Commission ruled that the Company's selection to construct a new treatment plant over several other alternatives was prudent.

The language cited and relied on by Company, and to a lesser extent, Staff, is only a portion of the Commission's Report and Order in the certificate case. A significant portion of that Report and Order, quoted above, discussed the argument whether preapproval was lawful and, if lawful, wise. Indeed, Company openly requested preapproval of its construction plan. The Commission's Report and Order in the certificate case clearly rejected that request.

We read our prior decision much less expansively than does Company and do not consider this question at all doubtful. First of all, the decision in the certificate case was, under the law, limited to the question of whether a certificate should be issued to only a portion of the project, since only a small portion of the project was outside the Company's existing service

territory and no certificate at all was needed for the larger portion already within the Company's certificated service area. Had the entire project been within the Company's service territory, no certificate case would have been required or needed. Second, the question in a certificate case is whether public convenience and necessity for the **service** have been shown. This is a much different, and necessarily narrower, question than a question of prudent utility management and decision-making that is involved in a rate case proceeding, where the public utility seeks to include recovery of and on the investment through its rates.

We agree with Public Counsel and SJII that in issuing its Report and Order in the certificate case, the Commission clearly rejected Company's request for preapproval. In our view, that decision is made more clear by the fact that the Company had explicitly sought that preapproval and the decision clearly denied its request. Artful construction and interpretation of the words that were used to indicate that the Company's selection was a reasonable choice do not equate to a preapproval and a determination in advance of prudence, particularly in the face of the Commission's chosen language that all issues pertaining to the valuation of the project for ratemaking purposes were reserved to "any future proceeding." We do not believe our language at Paragraph 5 that is quoted above could have been more clear.

In reaching this conclusion, we note that as a part of the certificate case, Company had also sought approval of a special financing mechanism which, MAWC asserted, would allow a lower-cost financing of the project compared to traditional rate base financing. In its Report and Order, the Commission voiced concerns about that approach, and did not approve it. Rather, the opportunity was left open for the proposal to be presented at a later time. During the hearing in this case, Company witnesses, particularly Mr. Salser, indicated that the decision had been made not to go forward with that financing vehicle because it had not been approved outright. From this we discern that the Company is able to understand our certificate decision, but in other contexts.

In sum, we conclude that this Commission's prior decision in the Certificate case, WA-97-46, did not determine the issue of prudence of the selection by the Company between competing alternatives, but rather ruled only the narrower question of the public convenience and necessity and then only as to that portion of the construction project that was outside the Company's existing service territory. Since we find that the question of prudence in the selection of alternatives was not determined in the certificate case, it follows that no party that participated in that certificate case is estopped to raise the

issue of prudence in this rate proceeding,[1/] nor is the Commission itself precluded by its prior certificate decision.

Likewise, for the foregoing reasons, the examination of the prudence issue in this case is not a collateral attack on the Report and Order issued in WA-97-46 in violation of Section 386.550 RSMo. as claimed by MAWC.

C. The Prudence of the Alternative Selection.

Perhaps the most controversial issue in the case, this issue presents whether the Company's decision to construct a new water treatment plant with a different source of supply was a prudent choice compared to the alternative of renovating and flood protecting the existing treatment plant. Company asserts that this decision was prudent and Staff joins in this assertion. Public Counsel, SJII and other parties join in asserting that the Company was imprudent in making this decision and that safe and adequate service could have been maintained for St. Joseph by renovation of the existing plant at a much lower cost. This alternative, though not inexpensive in its own right, is asserted to be little more than half as costly as the new plant.

[1/]It bears note that there is not an identity of parties in any event. Even if we were to conclude, which we do not, that collateral estoppel applied, it would be inapplicable to bar parties to this proceeding such as Wire Rope Corporation of America and Friskies, Inc. who were not parties in the prior proceeding.

1. The Evidence.

In July, 1993, an unprecedented flood, identified to be the level of a "500 year flood" rolled throughout the midwest and the drainage areas of the Missouri and Mississippi Rivers. Fed from upstream by record precipitation, Missouri's namesake river rose not only out of its normal banks, but well into flood plains that had not seen river water for perhaps hundreds of years.

The St. Joseph treatment plant at that time was located on the lower flood plain of the Missouri River just north of St. Joseph and immediately adjacent to the river itself. Evidence was not disputed that during the Flood of 1993, the plant was rendered inoperative by this flood, interestingly, however, not by reason of the flood waters overtopping or undermining the levees that were constructed as flood protection around the existing plant, but rather by flood waters that in effect did an "end run" around those protections, entering the plant from its rear side by infiltrating an adjacent railroad right of way and ballast bed and then entering the plant from the rear. This area, while not directly flood protected itself because of its elevation, was nevertheless the source of the infiltrating water.

Once the flood waters bypassed the existing levee system, the efforts of Company personnel to stave off the infiltration with sandbags and other means proved unavailing. The plant was off line for approximately four days. Similar problems and unprecedented pressure on the flood protection systems of Missouri were tested all across the State. On our own motion, we

take administrative notice that when the Missouri's flood crest reached the similarly and already swollen Mississippi River above St. Louis, the resulting flood created a catastrophic event for Missouri and virtual havoc in affected portions of this state for many days. Many thousands of acres of valuable farm land, homes and businesses and other developed areas were flooded or outright swept away with resulting damage in the billions of dollars. We were all reminded that "man proposes, but nature disposes."

Company offered the testimony of its principal design engineer, Mr. John Young. Mr. Young testified that he had been directly involved in and had supervised others in the selection process essentially throughout. It appeared from the evidence that in advance of the 1993 Flood, the Company had for some months been planning a renovation of the St. Joseph plant. This project, which Mr. Young characterized as a "filter improvement" project, had been developed, received Department of Natural Resources (DNR) approval, and had been let for design bidding. The evidence demonstrated that project, although not yet in active construction, was in progress at the time of the flood.

Following the recession of the flood waters, Company's efforts turned to recovering from the flood and damage assessment. The approved project appeared to have been shelved at that point, but was replaced with a project conceptualized in 1994 which included the earlier approved project but added additional items and flood protection. This project continued to evolve and grow. At about this time the company began to review the

construction of a new plant that was on higher ground and away from the river. This process continued through various iterations until a cost comparison began to indicate that the difference in cost between renovation and enhanced flood protection of the existing plant approached the cost of the new plant complete with a well field and raw and finished water lines. Company's evidence through Mr. Young was to the effect that these various comparisons were of little or no relevance because the 1996 comparison report was the point of decision for the Company.

Company's position asserts that this process was an evolving process and continued to change in scope until the definitive comparison was made in 1996. This voluminous document, which was submitted to the Commission in connection with the certificate case, was the point of decision for the Company. This document, according to Mr. Young, compared a cost of $63.3 million for the renovation and flood protection work at the existing site with a cost of $63.7 million for the construction of the new plant. Although admittedly slightly less expensive at that time, Mr. Young, joined by Mr. Merciel of Commission Staff, testified that in their opinion the intangible values of a groundwater source of supply were sufficient to tip the scales in favor of the new plant construction selection for the Company.

Public Counsel presented the testimony and analysis of Mr. Biddy. Mr. Biddy is a professional engineer with some thirty-odd years of experience in design of water treatment facilities in Florida. Mr. Biddy reviewed the documents provided

to the Public Counsel by discovery processes and concluded that the Company's estimates of the cost of renovation were substantially higher than his experience would indicate were appropriate. Mr. Biddy was highly critical of the procedures employed by Company in making its estimates and comparisons. He testified that many of the estimates made by Company were, in his view as a professional engineer, "incompetent".

Mr. Biddy testified that a 1993 engineering cost estimate prepared and submitted to the Company by Gannett Fleming represented the most detailed cost estimate that was presented. Other later internal estimates by the Company were criticized as being "lump sum" and not sufficiently detailed as to withstand analysis of their constituent components. Mr. Biddy provided his own estimate of what the cost of renovation and additional flood protection for the existing plant would have been at roughly $38 million. Mr. Biddy also prepared a comparative chart indicating the various estimates for the renovation project, marked and admitted as Exhibit 86, which the Commission has found helpful in grasping the myriad of numbers and estimates that appear to have been involved.

SJII offered the testimony of Dr. Charles Morris. Dr. Morris is an Assistant Professor of Engineering at the University of Missouri-Rolla where he has taught since 1978, working in the field of hydrology and hydraulics and water resources, including design of water and wastewater treatment plants. Dr. Morris testified that he had significant experience in the construction

and design of water treatment facilities, recently in Boonville on the Missouri.

Like Mr. Biddy, Dr. Morris also reviewed the Company's materials provided pursuant to data requests. He complained of some difficulty in obtaining materials from Company, but indicated that he was ultimately able to obtain those materials from the Commission's own files following review of Mr. Young's rebuttal testimony which appeared to refer to materials that had not been provided to Dr. Morris previously. While not as sharp as the criticism leveled against Company by Mr. Biddy, Dr. Morris also was critical of the lack of documentation and detail that had been provided by the Company in support of its decision. He also noted that the Gannett Fleming 1993 estimate was the only detailed component-specific document that he had identified in the Company's materials, and shared Mr. Biddy's criticism that other estimates were "lump sum" and were not broken out by component or structure so that their development could be traced and underlying support examined.

Dr. Morris also developed an estimate of the costs of renovation of the existing facility, examined the facility itself, and included additional amounts for enhancement of the flood protection at the plant including the construction of a flood wall at the rear of the property to guard against a repeat of the infiltration from the railroad right of way. Dr. Morris also included the estimated costs of a reconstruction of the intake facility and proposed a phased renovation program that

would take into account the problems of continuing to operate the plant while the renovation program was ongoing.

Dr. Morris also allowed $2.7 million for additional land acquisition by the Company, noting that this land could be used initially for a construction staging area and possibly later as an additional source of supply through alluvial wells that could be used in blending raw supplies for temperature control or other treatment purposes, included $3 million for reconstruction of the existing intake structure at the facility, and $2.5 million for additional grading, flood proofing and associated road work. Dr. Morris derived his estimate of $40.3 million, which also included a contingency allowance of $2 million, through a different methodology than did Mr. Biddy. Nevertheless, the two engineers produced estimates that were remarkably close in ultimate number. When Dr. Morris' contingency allowance is removed, the two numbers derived by the engineers were virtually identical, with Mr. Biddy's estimate at $38.8 and Dr. Morris' estimate at 40.3.[2/] Dr. Morris concluded that at an early date the Company appeared to have made a decision to construct a new facility and thereafter inflated its estimates

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[2/]In a minor skirmish on the side of this issue, Company accused these two witnesses of "collusion," citing to a portion of the transcript where SJII counsel was discussing the difficulties their witness had in obtaining documentation from the Company. We have examined the transcript cited by Company and find there no support for its charge. Additionally, Dr. Morris testified that he had not had contact with Mr. Biddy prior to the hearing. Moreover, Company's charge, even if validated, would pertain to events that occurred after the initial testimony in which the respective witnesses' recommendations were set forth.

and added components to them that he believed were presently unnecessary in order to drive the comparison in the direction of the new construction.

2. Discussion.

a. Initial Comments.

This is a troubling issue for the Commission. We begin our discussion by setting frame of reference. First, Section 393.150.2 RSMo. 1994 specifies that the burden of proof shall be on the utility in any proceeding such as this. As was indicated by SJII counsel in opening statement, the concept of burden of proof we take to mean that if the scales of evidence are figuratively balanced, the party with the burden of proof loses the issue because they have the obligation to tip the scales in their direction.

Second, not only is the burden of proof part of the framework for this decision, but the recognition must be given that hindsight is perfect. We are constrained not to evaluate the utility's decision not by what is known presently, but rather what was known at the time.

Third, we also approach this issue from the perspective that the utility has access to all the information and knows or understands (or should know or understand) that it will, if challenged, have to justify its decisions and internal processes and amply document its internal decision-making processes.

b. Analysis of the Evidence.

We find it to be undisputed in this record that the Company had in place and moving forward a renovation plan for the St. Joseph facility at the time of the flood. It was also undisputed that project had received DNR approval to proceed. We note that approval, somewhat in passing, because in our view it disposes of the argument that the DNR had ruled that the plant must be moved from the river to a higher location. Were that the case, approval would not have been granted by the DNR to any renovation plan at the old location. Moreover, it appears as undisputed that Commission Staff had also reviewed this renovation plan and given approval or acquiescence to it, which is again inconsistent with the present assertion that DNR would not approve such a plan for a river side plant. This is, however, far from complete as a discussion of this issue.

Mr. Young testified that renovation plan was intended to address new filters at the existing plant and was thus far narrower in scope that what was ultimately compared. It cannot be gainsaid that the scope of the 1996 project which Company would compare was substantially larger than this project. However, review of those materials indicates that the scope of this project, while certainly far less comprehensive than the 1996 plan, went somewhat beyond a filtration project as characterized by Mr. Young. Importantly, it is apparent from this project and its status at the time of the flood that **at the time of the flood** Company appeared to have every intention of remain-

ing at the existing location and simply going forward with a long range renovation project or projects at that location. This is completely understandable since the age of the St. Joseph facility was over 100 years and it had originally been built in stages as need for expanded capability arose.

The 1993 Gannett Fleming estimate, which both Mr. Biddy and Dr. Morris noted was a detailed component engineering cost estimate, included several additional items beyond filtration adjustments and included, for example, the Gannett Fleming 1993 estimate included $4.335 million for a new chemical building and $4.493 million for a new clearwell. Associated electrical and HVAC work was also included. Obviously, the Gannett Fleming estimate did not include enhanced flood protection, since it predated the flood. It appears from the evidence that was the course on which the Company had embarked up until the flood occurrence.

Following the flood and an understandable period of reconsolidation and assessment, this appeared to change. The time of some events is either not clear or is disputed, but it does appear from the evidence that a 1994 post-flood estimate appeared to include not only enhanced flood protection for the existing plant, but also added projects and components that had not appeared in the pre-flood detailed Gannett Fleming estimate. In cross-examination, Mr. Young was not able to describe or trace the development of these additional components. They clearly appeared to have been added to the estimate with the result that

the cost of the renovation project increased substantially over that which would have occurred had the only adjustment been to add the additional flood protection that would have been needed.

At this point in our discussion we would note an additional point that causes us concern. Although we certainly agree that Company's evaluation should as much as possible be evaluated without the benefit of hindsight, it does not flow from that principle that the Company should be permitted to make its decisions without foresight. Recognizing that its decisions would quite likely be subjected to scrutiny at a later date by experienced personnel, it follows that the Company should be certain that its decision-making process is well documented and easily traced. As noted by SJII in their brief, such documentation assures not only a rigorous internal process and the incumbent protections, but also demonstrates integrity in that process and helps to assure public confidence in the ultimate outcome of that process. In this regard, it is not and will not become the obligation of this Commission, nor we hope any other, to interpolate estimates and documentation for regulated utilities when such documentation does either does not exist or has not been produced. While we are inclined to give the benefit of the doubt to the Company on day-to-day decisions that have marginal impact on ultimate rates, we are constrained by law and our own processes to expect the Company to be prepared to meet its burden of proof with respect to such significant plant additions as this.

With respect to foresight on the part of the Company, we also believe that foresight must include the most serious consideration by the Company as to the ultimate rate impact that its choices would have on its captive ratepayers. Commissioner Schemenauer queried several Company witnesses regarding this consideration as well as that regarding a related issue of phase-in and it appeared that the Company was more concerned about its own circumstances than those of its ratepayers.

In apparent recognition of its responsibility, the Company noted its Citizen's Advisory Council in St. Joseph. However, one of the members of that committee testified at the public hearing in St. Joseph and his comments indicated considerable disparity between the use that the Company actually made of the Council and what it might have been. The City Manager from Warrensburg who testified in the main hearing described a more collaborative process that had been used satisfactorily in that city with respect to the remediation of taste and odor issues in the water supply. We are not convinced based on this record that the Company did an effective job of communicating to the residents of St. Joseph the significance and the implications of its choice. Moreover, based on the CAC participant who testified, the Council may have been used more as a public relations tool than a real public sounding board.

It is also at this point that we are impelled to discuss again the implications of Single Tariff Pricing. The evidence in this case from several of the witnesses and documents

indicated that the Company portrayed the rate implications of the new treatment plant to residents in St. Joseph as being in the range of a 32-35 percent increase. Again, if Company's estimates regarding the cost of the **new** plant are considered in this context, the only way in which such a low increase figure could be developed was on the assumption that STP would continue and be implemented in this proceeding. Nevertheless, Company's original proposal, even with STP, still represented a 53% increase.

This Commission stands as the surrogate for competition and competitive forces in a market that is obviously a monopoly. Thus, the foresight that we believe are entitled to expect to see demonstrated by a regulated utility views not only the impact of its decision on its shareholders, but in addition the impact on its ratepayers who have no other choice for provision of necessary services, which services must be provided at just and reasonable, and which services must be priced at a hypothetical competitive level.

The Company, through Mr. Young, based its comparison on its 1996 study. Both engineers however, testified that study contained no detail regarding the components of the construction project that was being compared at all. The nearest that either of them could identify to a cost-component separation, or indeed appear to support the Company's $63.3 million estimate for the renovation project was a cash flow document which Mr. Young subsequently testified could not be used to identify components of the estimated project nor could it tie projections for costs

to particular components. He was highly critical of Dr. Morris for using a portion of this sheet in his workpapers because Mr. Young suggested that Dr. Morris was using the material without understanding that it represented only periodic cash flow amounts. However, Mr. Young was never able to identify any document in the package that was represented to be the 1996 comparative study that added to $63.3 million **other** than this cash flow document. Thus we are left with a $63.3 million comparative figure which, based on Company's own evidence, is not useful for evaluating the cost components of that number or its derivation. Importantly, we are unable, as were the two engineers who independently reviewed this documentary package, to find any detailed cost estimates that are broken down to components that support the Company's number that it wishes to use for the comparison. Given this state of the evidence, and in consideration of the principles that we have enunciated previously, we conclude and find that the Company has failed to meet its burden of proof to demonstrate that its own stated basis of comparison is substantiated. Indeed, in its attack on Dr. Morris, the Company actually impeached its own document.

Another point that was an apparent issue between the parties was the characterization of the source of supply for the new plant. Dr. Morris testified that he believed that the source of supply was properly characterized as "ground water under the direct influence of surface water." Both Company and Staff vehemently disagreed. Dr. Morris provided copies of the Interim

Clean Water Act regulations from the Federal government and the DNR Guidelines for making these determinations. It appears that the decision is a close case, but one that this Commission need not make. As noted in their brief, SJII brought this point forward in order to note that the source of supply for the new plant is not pristine and, though true groundwater supplies may have certain advantages over surface water, the source in question here, drawn from a series of alluvial wells that are indisputably "recharged 90 percent from the river" rather clearly will have some aspects that more resemble surface water than true groundwater supplies. SJII noted this to discount the intangible benefits claimed by both Company and Staff to overcome the cost disparity.

As to this issue, the DNR is more aptly suited to make this determination than is this Commission. We are concerned that the finished water be of acceptable quality under State DNR regulations. Were the cost differential comparatively insignificant between the alternatives, the touted benefits of groundwater over surface water might tip the balance. However, given the multiple millions of dollars dividing the alternatives, and the acceptable nature of the surface water supplies for St. Joseph for a large number of years, we are not persuaded that the stated advantages of ground water are sufficient to overcome this significant cost disparity.

Since the implications of this decision are certainly likely to be subjected to judicial review, we take the additional

step of noting that the Company through the course of this proceeding had ample opportunity to come forward with detailed estimates substantiating and validating its selection of alternative and its selection process. That process was initiated by the filing of Mr. Biddy's and Dr. Morris' direct testimony in this proceeding and certainly at that point, Company should have well known that its decision-making process was being challenged and that, if it had complete documentation of that process and the underlying components of the lump sum estimates it should come forward with that material. It did not. We must therefore presume that such evidence does not exist, but in any event it was not produced in this proceeding.

We also take the additional step of noting that, although Mr. Young seemed generally able to respond to particular questions from the stand, his explanations of numerous items were incomplete or broadbrush. An example we would note was his explanation of the approximately $1.698 million that appeared to have been added to the Gannett Fleming estimate and labeled "water company expenses." Similarly, we note the addition of $1.020 included for "community relations" as well as an unspecified construction review by American Waterworks Services Company, an affiliate of Company, of $274,000. There was no further analysis of these amounts, nor was Mr. Young able to supply any. Even with these (and other) additions to the Gannett Fleming estimate (including a $3 million contingency discussed below),

the estimate totaled to $44.1 million which is still far below the level for which recovery is sought.

These failings bespeak either an internal decision-making process that is flawed or is driven by factors other than those revealed in the materials supplied to the parties. In any event, they fall short of meeting the Company's burden of proof.

Since appeal is likely we also would note for the benefit of any court that would review this record that our conclusion turns not on the characterization of a particular set of numbers as an "engineering cost estimate," a "preliminary cost estimate," or a "project cost estimate," nor does it turn on whether AFUDC was included or excluded. It turns upon the virtually complete absence of detailed data that supports not only the estimate on which Company states it based its decision but the inability of Company through Mr. Young to demonstrate the development of those estimates so as to rebut the inferences that the estimates were inflated and designed to skew the comparison in favor of constructing the new plant.

Yet an additional example from the record will demonstrate our point and further support our decision. The Gannett Fleming estimate was presented as including a covering letter from Gannett Fleming that indicated that the estimate had been "conservative" and a full errors and omissions allowance was not needed. Mr. Young testified that he had contacted Gannett Fleming but his testimony was vague regarding the amount of contingency that was included. He appeared to testify that

Gannett had told him that only a ten percent errors and omissions factor should be added. He however explained why he had, in fact, added fifteen percent, then increased it by another $3.037 million (10%) his own estimate, resulting in a combined value of 25% error and omissions buffer in the resulting $44.1 million revised estimate. While we recognize that Company urges us to understand that this Gannett Fleming estimate was not the estimate that was used to make its construction decision, the Gannett Fleming estimate was nevertheless the only detailed estimate document indicating any sort of an objective buildup of costs to an estimate that either Mr. Biddy or Dr. Morris had been able to locate, and it appears to have been inflated with excessive contingencies and unidentified lump sum costs added by MAWC even to reach the $44.1 million total.

3. Value of the Plant for Ratemaking Purposes.

Given that we have determined that Company has failed in its burden of proof to demonstrate that its estimates are reasonable, we conclude that the decision to construct a new plant in St. Joseph was necessarily imprudent. This does not, however, resolve the question of how much of the value of the new plant that has been constructed should be the responsibility of the ratepayers.

Both Dr. Morris and Mr. Biddy's estimates were aggressively by Company and, surprisingly, by Staff. Company did not choose to put in a detailed estimate regarding its position on

what the renovation costs would have been but was satisfied by attacking the estimates of its challengers. With regard to Company's concerns, we have discussed the absence of Company's contrary proof and would observe that a burden of proof is not met by attacking the challengers' evidence but rather by coming forward with convincing materials and evidence on the part of the party bearing that burden. We then turn to those estimates as being the best evidence of the construction costs that would have been incurred to renovate the existing plant and additionally install adequate flood protection to protect it adequately against the flood of record, which had become the 1993 Flood.

Mr. Biddy developed his estimate by working from the Gannett Fleming estimate and adjusting the costs of those portions of the project upward to account for inflation. Dr. Morris started from one of the earlier estimates, but actually used the summary numbers from the Gannett Fleming estimate believing they were from another document because of a shuffling in the materials that had been supplied to him by the Company. Both engineers were careful to indicate in their testimony that their estimates were in the class of preliminary cost estimates, but nevertheless they were better estimates than those proffered by the Company.

Accordingly, on the basis of the evidence of record in this case, we conclude that the Company should be allowed to increase its rate base by the amount of $38.2 million that being the amount of the estimate provided by Dr. Morris confirmed by the estimate of Mr. Biddy.

III. RATE DESIGN.

The parties were in disagreement regarding the proper calculation of the resulting rates. SJII through Mr. Harwig joined with the Company in advocating the continued use of the Base-Extra methodology. Staff also supported that method but had come to a different result for larger customers than had either Mr. Harwig or Company Witness Stout. Public Counsel, through Ms. Hong Hu proposed a methodology that purportedly recognized certain economies of scale. Additionally, with respect to the remediation of the STP/DSP issue, Public Counsel through Mr. Bush proposed that all districts save Brunswick be brought to cost and that Joplin receive neither a decrease nor an increase, with the subsidy from Joplin even at that level being used to subsidize Brunswick and several other districts. We will first address the interdistrict issues, then the class cost of service allocation issues.

A. Interdistrict Issues and Revenue Shifts.

1. The Evidence.

Staff, SJII and the Municipal Intervenors asserted the position that STP had not worked and should be eliminated, a decision that the Commission has confirmed, supra. However, this necessitates address of the interdistrict revenue shifts that are caused by moving back to DSP. Indeed, absent increases in revenue that are necessitated by expenditures that are specific to the district concerned, or are represent some portion of

increased joint and common administrative costs that are allocated to that district, several of the districts' rates would be reduced by reason of moving from STP to DSP. It is only because of the elimination of the subsidy from other districts that these shifts occur. For example, the Warrensburg district is currently a subsidizing district whose rates would be reduced because of the elimination of the STP-related cost shifts from other districts. However, Warrensburg also received some additional capital investment during the test period in order to address the water palatability issues. As a result, Warrensburg's rates as a district would increase even though STP is eliminated because of these district-specific charges. Each of the districts will have different revenue effects as these cost shifts are eliminated and district-specific costs are identified and properly assigned as directed by this decision.

2. Discussion.

It appeared that Staff and Public Counsel had come to the same essential figures regarding these shifts since they had essentially used the same data. Company's district specific studies also appeared to confirm the necessity for these shifts. With one exception which we will discuss infra, Staff's approach appeared to be the most thorough on this point, although the differences between Staff's results and Public Counsel's results on the DSP shifts are insignificant. Moreover, Staff had apparently sought to calculated ultimate rates that would result from its shifts.

However, Staff also proposed an initial phase-in in the St. Joseph district of the full costs associated with the new treatment plant which is an option that has been rejected in this decision. Accordingly, all studies will need to be redone, but Public Counsel's district specific cost study, because it was based on Mr. Biddy's proposed rate base allowance, appears to be the closest indicator to the result that will obtain. For other reasons discussed infra we are not persuaded that Public Counsel's overall approach is best. Staff will be directed to rerun its studies based on the rate base decisions represented by this decision.

There are at least two aspects of Public Counsel's studies that we find not supported. The first of these is the perception that the ratepayers in Joplin should be held in a "no change" position. This is characterized as a "hold harmless" result, but it appears to us that if a ratepayer is intentionally and knowingly charged in excess of their proper cost of service, that rate is not just and reasonable and the ratepayer is harmed. Accordingly, we will direct that the rates in Joplin be reduced to their cost of service levels indicated by Staff and Public Counsel's basic studies. In rough numbers this means that the district rates in Joplin should be reduced roughly $600,000 as more specifically calculated in Staff's district specific cost study.

Similarly, and for the same reason, we reject that portion of Staff's recommendation that would shift a part of the

costs of Brunswick's operations to Joplin. We will address Brunswick separately, but, as noted above, the intentional overcharging of one group of customers or district in order to provide below cost service to other customers or another district is directed to be ended.

B. What Rate Design Method Shall be Used to Design the Increase.

We now turn to the issue of the proper rate methodology to use to develop class costs and rates within each district once the district-specific revenues have been determined.

1. The Evidence.

Company, Staff, SJII and the municipal intervenors support the continuation of the Base-Extra methodology. The Water Districts also appear to support this methodology, although their position is obscured by their position on STP. Only Public Counsel appears to propose a different methodology.

Through its witness Ms. Hu, Public Counsel proposed a complicated method of identifying peak usage then increasing a series of ratios by an "rth" power to supposedly recognize what are termed "economies of scale." These scale factors is said to represent recognition that a water main's throughput capability increases at a greater rate than linearly as the diameter increase. Conversely, Public Counsel argues, a 4" pipe does not cost twice as much to install as a 2" pipe and carries more than twice as much. The result of this scale factor is to assign more

cost to larger customers, in theory because to do otherwise would undercharge these customers who make greater use of larger lines.

2. Discussion.

While we appreciate the efforts of Ms. Hu to defend her method, the evidence was conclusive that the Base-Extra methodology already recognizes economies of scale. Base-Extra employs several different allocators that reflect not only the usage of the system on peak day and peak hour, but also on an annual basis. Company, Staff and SJII witnesses all confirmed through their testimony that the method is virtually universally used in the water industry because it represents a balanced approach between what might otherwise be competing interests.

Ms. Hu asserted that she had discovered that the Base-Excess method produced the same results as the Coincident Peak method. She then offered an exhibit to demonstrate that. However, SJII offered a series of exhibits modeled after Ms. Hu's exhibit that demonstrated that Ms. Hu had identified a particular set of allocators that produced identical results, but other situations produced divergent results. Mr. Stout confirmed that the circumstance that occurred in the example noted by Ms. Hu had never been seen.

Ms. Hu acknowledged that her proposal had never been approved by any regulatory commission or agency and she also acknowledged that the study had been limited to the distribution system rather than the treatment plant piping. In this case it is the treatment plant costs that are driving this increase.

Finally, Ms. Hu's method, by dramatically increasing the assignment of costs to larger users, ironically impacts the residential users who are served by the public behind supply districts who are themselves often the largest customers of the Company in particular districts.

We are not persuaded that this is the proper time to make major shifts in rate design policy, nor subject Missouri ratepayers to experimental procedures such as STP. Accordingly, we reject Public Counsel's approach and find that the Base-Excess method is supported by the weight of the evidence in this proceeding.

While using the Base-Extra method, Staff's cost analyst Mr. Hubbs did not recognize a separate cost category for larger mains as suggested by Mr. Harwig. As a result, Mr. Hubbs' results also resulted in a significant increase to larger users including the Water Districts. Mr. Harwig suggested that recognition of the larger main distinction would bring this increase back in line. Because of the following discussion, the Commission will defer decision on this issue in this case. However, we do believe that the evidence does support one aspect of Mr. Harwig's recommendation that also appears supported by the testimony of Water Districts second witness, Ms. Price. Mr. Harwig noted that because of the size of some of the shifts that would occur from district to district to eliminate STP, coupled with the increase that will result from the new St. Joseph treatment plant even taking into account the disallowance that we

have determined, a simple equal percentage increase or decrease among and within all rate blocks and charges will help to mitigate those shifts. This approach is persuasive in the circumstances of this case. Accordingly, after the district-specific revenue requirements have been determined, we will order an equal percentage increase or decrease among and within all rate categories within each district. In doing so we expressly reserve our collective judgment on the issue that divides Mr. Hubbs and Mr. Harwig, and will postpone resolution of that issue for a future proceeding.

This leaves the question of the rate impact on Brunswick. Because of its small size that impact will be substantial, even with the mitigation measures such as equal percentage increase that we are adopting on this record. The issue of Brunswick has been characterized by some (without intending any disrespect to the ratepayers and good people of Brunswick) as a case of the "tail wagging the dog." While significant for the small numbers of ratepayers in Brunswick, the aggregate revenue difference needed to bring the Brunswick district to cost of service is not that large viewed from the perspective of the total Company.

After careful evaluation of the evidence concerning the treatment of Brunswick, we are persuaded to direct that in the rates which result from this decision, Brunswick district will be moved **gradually** to full cost of service levels. Company will be and is directed to submit for our evaluation a series of annual

tariffs for Brunswick, the initial one of which will (consistent with earlier discussions) increase the district rates for Brunswick by 25 percent. Company will be allowed to defer the revenue differential between those rates and full cost of service rates for Brunswick, but will not be permitted to earn a return on the amount of that deferral. We take this step because of the undisputed fact that Company chose to acquire or to retain the Brunswick district through its acquisition policy and in this manner some responsibility for that decision will be shared by the shareholders. We believe this to be a fair allocation of responsibility for the Brunswick district. In subsequent years, year two and following, each annual rate increase to Brunswick, which will not exceed the 25% level, will be implemented until the Brunswick district revenue levels have been returned to a cost of service level and the deferred revenues have been recovered. Thus, it may be necessary for the final set of tariffs in this package to represent a slight decrease to Brunswick as the deferred revenues are removed from the collections. We will also direct Company to work in coordination with Public Counsel to develop a public information mailing to the customers in Brunswick informing them of the implications of this decision so that they may be better able to plan for it.

IV. OTHER ISSUES.

A. Recommendation for Public Consultation.

The City Manager of the City of Warrensburg testified in this proceeding. He asserted that the Company had engaged in a meaningful dialogue with proper members of his community government regarding the measures that should be implemented to ameliorate the water palatability problems that had been experienced in Warrensburg. He testified that this process worked well. In comparison, the Customer Advisory Council in St. Joseph did not appear to work as well nor was it perceived as useful.

We believe that the experience of Warrensburg is instructive and desirable for future Company operations. Accordingly, we will direct that Company submit a tariff providing that it will engage in a procedure of meaningful community involvement and consultation in any future cases in which rate base additions in that particular district are projected to increase more than 15% above their current levels. To enforce this procedure, and upon approval of this tariff, we will direct Company to publish a copy of the tariff in each newspaper of general circulation within each district and to include a copy of the tariff (or an accurate summary) with its billings at least once each year. Additionally, the tariff will provide that Company will include a copy or summary of the tariff provision with its billings in any district in which any such capital improvement is planned or contemplated.

V. CONCLUSIONS OF LAW.

Based upon the foregoing discussion and analysis and upon the competent evidence that is of record in this proceeding, the Commission reaches the following Conclusions of Law:

1. It is reasonable to reject the tariffs proposed by the Company.

2. It is reasonable to adopt District Specific Pricing in this proceeding and to direct rate adjustments to various districts accordingly.

3. It is reasonable to disallow all costs in excess of $38.2 million for the new St. Joseph Water Treatment Facility on the basis that the Company failed to meet its burden to show that costs in excess of that level were reasonable.

4. It is reasonable to disallow all costs in excess of $38.2 million for the new St. Joseph Water Treatment Facility on the basis of imprudence.

5. It is reasonable to direct that all districts of the Company be brought to district specific cost levels, with the exception of Brunswick.

6. It is reasonable to direct that the rates of Brunswick be gradually brought to cost of service levels as discussed in the body of this Order.

7. It is reasonable to permit Company to defer and accumulate the difference in revenue between what the Brunswick district specific rates would produce and the mitigigation measures directed in this order.

8. It is reasonable to deny Company the ability to earn a rate of return on the amount of the Brunswick revenue deferrals.

9. It is reasonable to direct that, within each district, any increase or decrease be spread on an equal percentage basis corresponding to the percentage increase or decrease resulting to that district.

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