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August 7, 1992

Mr. Brent Stewart  
Executive Secretary  
Missouri Public Service Commission  
301 West High Street  
P.O. Box 360  
Jefferson City, Missouri 65102

**FILED**

AUG 10 1992

PUBLIC SERVICE COMMISSION

RE: Case No. WR-92-85, In the Matter of The Raytown Water Company's  
Tariffs to Provide for a Permanent Increase in Rates for Water  
Service

Dear Mr. Stewart:

Please find enclosed for filing in the above-captioned case an original and fifteen (15) copies of the Initial Brief of the City of Raytown. We would appreciate your assistance in filing this Brief, and acknowledge such filing by return mail.

Thank you for your attention to this matter.

Very truly yours,

  
Jeremiah D. Finnegan

JDF:dj  
enclosures

cc: William K. Haas, Esq.  
John B. Coffman, Esq.  
Jay D. Haden, Esq.  
Derron D. Gunderman, Esq.

**FILED**

BEFORE THE PUBLIC SERVICE COMMISSION AUG 10 1992

OF THE STATE OF MISSOURI PUBLIC SERVICE COMMISSION

In the Matter of the Raytown Water )  
Company's tariffs to provide for a ) Case No. WR-92-85  
permanent increase in rates for )  
service. )

INITIAL BRIEF OF THE CITY OF RAYTOWN

I. INTRODUCTION

This case, while somewhat more confusing than one's typical rate case because of its proposal to establish regular rates and a surcharge, is not complex. Boiled down to its essence, it is about nepotism, greed and subterfuge. Not content with providing well-compensated employment for at least seven members of the Clevenger clan, including its 84 year old matriarch, the Company also wants an additional \$495,347 a year in revenues from its ratepayers, which would result in an unprecedented 22% return on equity (Tr. 190).

The confusion comes about partially by the subterfuge of attempting to hide a request for the heretofore unprecedented 22% return on equity (Tr. 190) in the guise of a surcharge on top of base rates to provide debt service coverage and, since that didn't produce enough money, cash flow coverage.

The other confusing part of the case is the Staff's unyielding belief that the company should get a \$418,000 increase as Staff had agreed to in the Nonunanimous Stipulation (Tr. 146-148), despite the fact that as time went by its recommended surcharge amount, included in such figure, was substantially reduced by continuing collections of the interim surcharge. Thus, instead of a mix of \$258,355 in base rates and \$160,000 in surcharges, which comprised

76.

✓ X

Staff's original \$418,000 figure, the Staff revised its base rates upward to produce \$304,056, while its surcharge recommendation fell to \$114,000 to maintain a level of \$418,000 increase. It did this mainly by abandoning its pre-filed condemnation of the company's rate case expenses as being excessive for a company the size of Raytown Water Company (Ex. 39, p. 14) and increasing its recommendation by \$44,847 per year (Tr. 147) to offset its \$46,000 decrease in the surcharge.

It is ironic that after such nimble gymnastics by the Staff with the ratepayers' money in an effort to keep the Nonunanimous Stipulation alive, its efforts were rebuffed by the Company, which at the 11th hour left the Staff with egg on its face by announcing it would not be bound by the Nonunanimous Stipulation after all, and now wanted \$495,347 instead of \$418,000 (Ex.4). After having said that the additional \$45,000 in rate case expenses were reasonable (Ex. 25, p.2), what was the Staff to do but suck it in and defend its new position, right or wrong.

## II. TRADITIONAL RATE-MAKING ISSUES

In general, the City goes along with the majority of the Staff's positions and adjustments made with the respect to what has been termed the traditional rate-making issues (Ex. 3), with the following exceptions: Staff's revised rate case expense, rate of return, additional field employee, and the 11th hour company management payroll issue.

### 1. Rate Case Expense

City would advocate a return to the Staff's original

recommendation of \$28,556 per year as a reasonable rate case expense to be recovered in rates charged the Company's 6,600 customers, rather than its \$73,403 later recommended to keep its overall level of additional base rates and surcharge revenues at \$418,000. The additional \$44,847 in rate case expenses was obviously done for one purpose only, i.e., to offset the \$46,000 reduction in surcharge requirement due to additional collections of interim surcharges in order to keep the Staff's overall recommendation at \$418,000.

While such financial gyrations keep the Staff's overall figure at \$418,000, they end up costing each customer over \$11 a year or almost \$7 a year more than Staff's original proposal. This is an expensive price to ask the ratepayers to pay merely for the purpose of keeping a Nonunanimous Stipulation and Agreement intact, especially when the Company spurned it at the 11th hour and asked for an additional \$77,000 on top of the \$418,000.

It is, therefore, up to the Commission to consider what is a reasonable amount of rate case expense for a company of this size and not only save the customers from paying prices that would finance a Southwestern Bell rate case, but also to rescue its Staff from its gaffe.

Mr. Williams of the Staff was correct when he stated on April 24th: "The Staff believes that the amount of rate case expenditures to date and the Company's estimated additional rate case costs are excessive for a normal rate case for a company the size of Raytown Water Company." (Ex. 39, p. 14) Nothing has changed since that

date. Never in my 27 years before the PSC have I seen the Staff reduce its rate case expense adjustment because a case settled nor have I seen them increase it (before this case) because the case went to hearing. Three days of prehearing and 4 days of hearing are not abnormal events for a rate case. Staff was correct in its original recommendation of \$29,556. A company the size of Raytown Water Company does not need its accounting work done by a Big 3 accounting firm.

2. Rate of Return

The Staff's recommendation of a \$304,056 base rate increase is based on the low end of its rate of return figures or 11.98%. This 11.98% is in turn based on a 12.73% return on a common equity.

There are two problems with Staff's rate of return: 1) from a traditional rate-making perspective, it is excessive for a company with as much equity as Raytown Water Company; and 2) because of the surcharge of \$114,000 also recommended by the Staff on top of the \$304,056, it grossly understates what return on equity the Company would actually be receiving. It is not 12.73%, but rather more like 23% on a 73% equity ratio. (Tr. 257).

a. Traditional Rate-Making

Staff's recommended rate of return, even at its low end, is excessive even without the consideration of a \$114,000 surcharge to be earned by the Company on top of the \$304,056 increase recommended by the Staff in base rates.

The reason the rate of return is excessive is because the return on equity recommended is excessive. The reason the return



on equity is excessive is because it has factored in it the "risk" related to the EI ERA bond issue even though such bond issue is not in the capital structure utilized for the traditional rate-making part of this case (Ex. 11, p. 20), and even though Mr. Caplinger recognized that a surcharge mechanism was to be utilized which would alleviate any "risk" of the EI ERA bond issue. In other words, the risk of the EI ERA bond issue has been double counted.

The return of equity for Raytown Water Company recommended by the Staff was 12.73%. This was based on average equity returns on 10 other water companies. Such average was not adjusted for Raytown Water Company despite the fact that the average equity ratios of such companies was around 50%, while Raytown's common equity ratio was 73.15% (Ex. 11, pp. 30-32). The difference results in a higher weighted cost of capital, hence, a higher rate of return for Raytown Water Company than for the average of the 10 water companies. Such is shown as follows:

Raytown Water Company—	73.15%	x	12.73%	=	9.31%
Average 10 companies —	50%	x	12.73%	=	<u>6.37%</u>
Difference					2.94%

By deducting 2.94% from the 11.98% rate of return recommended by Mr. Caplinger, the reasonable rate of return for Raytown Water Company would be 9.04% on a traditional basis. Base rates should be reduced accordingly.

Inasmuch as Mr. Caplinger admits in his testimony that he made no adjustment to the return on equity derived from companies with significantly lower equity ratios in the traditional rate-making portion of this case, it is up to the Commission to make such an

adjustment. It is not bound by anyone's recommendations in this case. It has the duty to set just and reasonable rates based on all the evidence.

Of course, the additional \$8,455 being requested by the Company in rate of return only compounds the excessiveness. The Company's request would result in a 14.8% return on equity before the surcharge is added in (Tr. 189-190).

b. Surcharge Impact on Rate of Return.

In addition to the \$304,056 in base rates recommended, the Staff is recommending an additional \$114,000 a year be collected in surcharges. The total is a \$418,056 increase and not merely a \$304,056 increase.

When utilizing \$418,056 in revenues, the return on equity actually results in a 23% return on a 73% equity ratio (Tr. 257). If 12.73% is excessive, 23% is downright confiscatory.

The Company figures that based on its adjustments, its \$495,000 increase would result in a 22% return on common equity with an overall rate of return of 16.2%.

Surely, this Commission is not going to allow such equity returns.

2. Additional Field Employee

The PSC Staff has recommended that the Company hire an additional field employee to carry out additional tasks it would like to see the Company do. Aside from the fact that the Company has an excess of employees named Clevenger (about whom the City wonders what they are doing besides drawing salaries), this is not

a good time to hire a new employee. The Company is allegedly in an emergency situation and the ratepayers are already being asked to finance too much of the Company's operations. An additional \$23,914 expense a year at this time is asking too much of the ratepayers. This is over \$3.62 per customer per year.

Furthermore, from a pure utility accounting standpoint, this additional employee expense must be rejected. The employee has not been hired (Tr. 663) and the expense is well outside the accounting period. (Ex. 14, p. 2-3)

3. Management Payroll Issue.

The Company's 11th hour action to seek more money after agreeing to take less is, of course, a typical reaction for a company where greed and family appear to be the sole motivating factors. Not satisfied with a cash cow that keeps at least seven members of the Clevenger clan gainfully employed during times of high unemployment, the Company rejected everyone else's contention that three managers were too many for a company of this size and insisted that the Commission allow \$36,288 (Ex. 4, pp. 3-4) to keep three Clevengers (the matriarch, Virginia, and her two sons, Neal and Mark) in charge of operating a small (6,600 customer) water company that purchases all of its water from an outside source and, therefore, is dissimilar to companies which obtain and treat their own water. It is hardly necessary to go further than Neal Clevenger's own direct testimony (Ex. 17, Sch. 1) to find that three managers is not only one too many but two too many. The exhibit shows that the neighboring PWSD #2 served 6,400 customers



with only one manager with a total management payroll of \$60,000 as compared to the Raytown Water Company triumvirate's payroll of \$141,342.

Inasmuch as the Staff's adjustment only eliminates \$36,288 in management payroll expenses, instead of \$81,342, which higher amount is easily justified merely by looking next door to PWS#2, the staff's adjustment is very conservative. One would think the Company would have been well advised to leave sleeping dogs lie. The Commission can, of course, adjust this item further based on the evidence in this record.

The City strongly recommends that before the next rate case in 18 months, that the Commission order a management audit of this Company and find out just how many Clevengers its takes to screw in a light bulb (or work for and run a water company).

### III. THE SURCHARGE SUBTERFUGE

In the first place, City believes a spade should be called a spade. What is termed a surcharge is in reality an additional base rate because both the surcharge and the base rates would be in effect for the next 18 months until the next rate case is decided. Calling the \$114,000.00 in revenues agreed to by the Staff and Company a surcharge instead of base rates is done for one purpose only, to obfuscate the fact a \$418,056.00 increase would produce a 23% return on equity per the Staff Case and that a \$495,347.00 increase would produce a 22% return on equity per the Company Case.

As stated hereinabove, the return on equity recommended under the so called traditional rate-making is already excessive. The

the so called traditional rate-making is already excessive. The 22% to 23% actually to be produced on a 73% equity ratio by the revenue requirements of the Staff and the Company are confiscatory and obscene. Yet, that is what this commission is being asked to approve.

The City is flat-out opposed to both the excessive rates of return recommended under traditional rate-making and the obscene, confiscatory rate of return, which these rates would actually produce.

Raytown Water Company is supposed to be a privately owned utility. As such, it is supposed to finance its own operations through debt and equity. However, when faced with the need to raise substantial capital for debt service and cash flow needs after going to the debt market, it turned not to the equity market but to its ratepayers.

The Commission has allowed it to collect from its ratepayers an interim surcharge of \$425,000.00 per year and now it wants \$114,000.00 a year for another 18 months. The question must be asked is: What benefit do the ratepayers, who are being asked to finance the company's need for debt service coverage and cash flow, receive? The answer is nothing. They receive no stock in the company nor any evidence of indebtedness of the company to them, nor do they receive any return on their investment. In fact, those ratepayers, who are not on the system when the new water tower is finally included in rate base, will not even receive the potential benefits such project is supposed to offer down the line.

This may be the first case of its kind, but make no mistake, it will not be the last. If the Commission deviates from traditional rate of return rate-making and begins to set rates based on debt service coverage and cash flow requirements as the \$114,000.00 additional revenues over traditional rate-making revenues is intended, then Katie bar the door. Every future case will see such issue raised. In fact, Missouri Cities Water Company has already filed such a case seeking debt service coverage, WR-92-207. Rates will then be set by the financial institutions and not the regulators.

a. The Issuance of Stock to Ratepayers for Surcharge Revenues

The City's proposal that the company issue ratepayers stock for their investment via the surcharge is novel, but then so is debt service/cash flow coverage novel. Whatever the Commission does in this case will no doubt be reviewed by the Courts as to its reasonableness, lawfulness and constitutionality. The granting of rates which would result in a 22% to 23% return on a 73% equity ratio should shock the conscience of the Court, especially in these times of low interest rates.

Furthermore, this 22% to 23% return is based on a capital structure with 73% common equity, the equity ratios prior to the EIERA financing. (Ex. 11, Sch. 18). At a 30% equity ratio (Ex. 11, Sch. 22), the ratio after the financing, the return on equity is really about 40% or double your money in 2½ years. (Ex. 14, P. 6). This should doubly shock the conscience of the Court.

City's proposal is that if the ratepayers are forced to

over and above what revenue requirement is found reasonable under traditional, lawful, rate of return regulation, then such money should continue to be the ratepayers' money and not become the company's money.

Public Counsel's proposal is superior to that of the Staff's and the Company's because under Public Counsel's proposal to treat the surcharge revenues as CIAC such customer capital will never become part of an unreasonable return for the shareholders (Ex. 14, P. 10). However, since CIAC has become taxable only .65¢ of every dollar contributed is available. To avoid taxation on the customer's capital contributions and, consequently, reducing the amount needed from customers, we are proposing that surcharge revenues be treated as payments for a junior series of no cost or low cost, non-voting, preferred or common stock. The amount would become part of the capital structure and treated as such in future rate proceedings (Ex. 14, P. 11), and until paid back by the Company.

b. Debt Service and Cash Flow Coverage Calculations


While in vehement disagreement with the concept of a surcharge for cash flow requirements, City also takes issue with the calculations utilized in arriving at the \$114,000.00 figure. While the Staff determined that \$27,384.00 in income taxes on the interest earned on loan deposits should be provided in the cash flow requirement, it failed to include the \$66,958.00 in interest on loan deposits in the unrestricted sources of cash flow (Ex. 27, Sch. 1). The result is that the Staff's \$114,000.00 in surcharge

revenues allegedly needed under its cash flow calculation has been overstated by \$39,574.00. (TR.636-640, 655-660). This alone would reduce Staff's recommended surcharge to \$74,426.00.

CONCLUSION

This is a case of first impression. One thing is sure, if the Commission begins regulation of company's on debt service coverage requirements or cash flow requirements, it will not be the last case of its kind. To allow a 22% or 23% return on a 73% equity ratio under the guise of traditional base rates and surcharge rates is both unreasonable and unlawful. It is not what was intended that matters, but what resulted. To authorize \$304,056.00 in base rates and \$114,000.00 in surcharges results in an increase in rates by \$418,056.00 to the ratepayers and \$418,056.00 in revenues to the company and this produces a 22% to 23% return on an equity ratio of 73%. When the actual equity ratio of 30% is considered such return is closer to 40%. City does not believe the Courts will let such a result stand.

Respectfully submitted,

  
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