

REPORTS
OF THE
PUBLIC SERVICE COMMISSION
OF
THE STATE OF MISSOURI

Volume 15 MPSC 3d
September 14, 2006 – May 22, 2007

Morris Woodruff
Reporter of Opinions

JEFFERSON CITY, MISSOURI
(2011)

PREFACE

This volume of the *Reports of the Public Service Commission of the State of Missouri* contains selected Reports and Orders issued by this Commission during the period beginning September 14, 2006 through May 22, 2007. It is published pursuant to the provisions of Section 386.170, et seq., Revised Statutes of Missouri, 2000, as amended.

The syllabi or headnotes appended to the Reports and Orders are not a part of the findings and conclusions of the Commission, but are prepared for the purpose of facilitating reference to the opinions. In preparing the various syllabi for a particular case an effort has been made to include therein every point taken by the Commission essential to the decision.

The *Digest of Reports* found at the end of this volume has been prepared to assist in the finding of cases. Each of the syllabi found at the beginning of the cases has been catalogued under specific topics which in turn have been classified under more general topics. Case citations, including page numbers, follow each syllabi contained in the Digest.

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

The Staff of the Missouri Public Service Commission, Complainant, v. Hurricane Deck Holding Company, Chelsea Rose Land Owners Association, Inc., Gregory D. Williams, Debra J. Williams, and Charles H. Williams, Respondents.*

Case No. WC-2006-0303

Sewer §4. The Commission granted without prejudice Staff's recommendation to dismiss the complaint alleging that Hurricane Deck Holding Company violated §393.190.1 by transferring the water and sewer systems serving the Chelsea Rose Service Area from Hurricane Deck Holding Company to Chelsea Rose Land Owners Association without having obtained authorization from the Commission.

Water §4. The Commission granted without prejudice Staff's recommendation to dismiss the complaint alleging that Hurricane Deck Holding Company violated §393.190.1 by transferring the water and sewer systems serving the Chelsea Rose Service Area from Hurricane Deck Holding Company to Chelsea Rose Land Owners Association without having obtained authorization from the Commission.

**ORDER DISMISSING RESPONDENTS CHELSEA ROSE LAND
OWNERS ASSOCIATION, INC., GREGORY D. WILLIAMS, DEBRA J.
WILLIAMS, AND CHARLES H. WILLIAMS, AND DISMISSING COUNT
IV OF STAFF'S COMPLAINT**

Issue Date: September 14, 2006

Effective Date: September 20, 2006

The Staff of the Commission filed a complaint against Hurricane Deck Holding Company, Chelsea Rose Land Owners Association, Inc., Gregory D. Williams, Debra J. Williams, and Charles H. Williams on January 23, 2006. On August 31, the Commission issued an order granting in part and denying in part Staff's motion for summary determination. That order granted Staff's motion for summary determination regarding Counts I, II, III, and V of its complaint, as applied to Hurricane Deck Holding Company. The order denied summary determination regarding Counts I, II, III, and V of Staff's complaint as applied to Chelsea Rose Land Owners Association, Gregory D. Williams, Debra J. Williams, and Charles H. Williams. The Commission also denied summary determination regarding Count IV of Staff's complaint as applied to all respondents.

Because the denial of summary determination did not entirely resolve Staff's complaint, the Commission ordered Staff to file a pleading by September 11, indicating whether it intended to present evidence to prove the allegations against the respondents for which summary determination was denied. Staff responded on

*This case was appealed to the Missouri Court of Appeals (WD70299) and affirmed. See 302 S.W.3d 786 (Mo. App. W.D. 2010).

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September 7 with a motion asking leave to dismiss its complaint as to Chelsea Rose Land Owners Association, Gregory D. Williams, Debra J. Williams, and Charles H. Williams, and to dismiss Count IV of its complaint as to all respondents.

Commission rule 4 CSR 240-2.116(1) provides that a complainant may dismiss its complaint by leave of the Commission. The Commission's leave and Staff's motion to dismiss will be granted.

With the dismissal of the remaining complainants and the unresolved count, the Commission's August 31 Order Granting in Part and Denying In Part Staff's Motion for Summary Determination becomes a final resolution of Staff's complaint. As a result, that order is no longer interlocutory and may be appealed. Staff may proceed to file a petition in Circuit Court as authorized by that order.

IT IS ORDERED THAT:

1. Staff's complaint against Chelsea Rose Land Owners Association, Gregory D. Williams, Debra J. Williams, or Charles H. Williams is dismissed without prejudice.
2. Count IV of Staff's complaint is dismissed without prejudice.
3. This order shall become effective on September 20, 2006.

Davis, Chm., Murray, Gaw,
Clayton and Appling, CC., concur

Woodruff, Deputy Chief Regulatory Law Judge

***NOTE:** The Commission, in an order issued on September 19, 2006, denied a motion for rehearing in this case. See page 582, Volume 14, MPSC 3d for another order in this case.

NORTHWEST MISSOURI CELLULAR LIMITED PARTNERSHIP

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In the Matter of the Application of Northwest Missouri Cellular Limited Partnership for Designation as a Telecommunications Company Carrier Eligible for Federal Universal Service Support Pursuant to §254 of the Telecommunications Act of 1996.

Case No. TO-2005-0466

Telecommunications. §14.1. The Commission designated Northwest Missouri Cellular Limited Partnership as a Telecommunications Company Carrier Eligible for Federal Universal Service Fund purposes pursuant to § 254 of the Telecommunications Act of 1996.

APPEARANCES

Paul S. DeFord, Lathrop & Gage L.C., 2345 Grand Boulevard, Kansas City, Missouri 64108, for Northwest Missouri Cellular Limited Partnership.

Charles Brent Stewart, Stewart & Keevil, L.L.C., 4603 John Garry Drive, Suite 11, Columbia, Missouri 65203, for Spectra Communications Group, LLC, d/b/a CenturyTel, and CenturyTel of Missouri, LLC, d/b/a CenturyTel.

W.R. England, III, and **Sondra B. Morgan**, Brydon, Swearingen & England, 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri 65102-0456, for Holway Telephone Company.

Robert J. Gryzmala, Deputy Counsel, Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri, One AT&T Center, Room 3516, St. Louis, Missouri 63101, for Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri.

Michael F. Dandino, Deputy Public Counsel, Office of the Public Counsel, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

William K. Haas, Deputy General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE:Nancy Dippell, Deputy Chief Regulatory Law Judge.

REPORT AND ORDER

Issue Date: September 21, 2006

Effective Date: October 1, 2006

Syllabus:This order grants Northeast Missouri Cellular Limited Partnership's (NWMC) application for status as an eligible telecommunications carrier (ETC) for federal universal service fund (USF) purposes.

Procedural History

On June 3, 2005, NWMC filed an application for designation as an eligible telecommunications carrier for federal universal service fund purposes under Section 254 of the Telecommunications Act of 1996. NWMC sought ETC

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designation throughout its FCC-licensed service area¹ in Missouri with respect to all local exchange carrier wire centers in NWMC's FCC-licensed service area with the exception of the Pattonsburg wire center.²

NWMC seeks ETC designation in the entire study areas of the rural telephone companies: Rock Port Telephone Company, Holway Telephone Company, IAMO Telephone Company, Iowa Telecom Services, d/b/a Iowa Telecom – North, and Oregon Farmers Mutual Telephone Company. In addition, NWMC seeks ETC designation in portions of the rural study areas of the rural telephone companies: Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, and Sprint Missouri, Inc. NWMC also seeks ETC designation in the non-rural telephone company area served by Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri, with respect to the Stanberry wire center.

Grand River initially intervened, but later withdrew from the case. Spectra Communications Group, LLC, d/b/a CenturyTel, and CenturyTel of Missouri, LLC (collectively referred to as "CenturyTel"), Holway, and AT&T Missouri intervened in opposition to NWMC's request for ETC designation. The Office of the Public Counsel and the Staff of the Missouri Public Service Commission also oppose the application.

The parties filed prehearing briefs on May 24, 2006. An evidentiary hearing was held on May 31, 2006. On July 11, 2006, the parties, with the exception of the Office of the Public Counsel, filed post-hearing briefs. Exhibit 14, containing NWMC's privacy policy, was filed after the hearing. There was no objection to the exhibit and it is hereby admitted into the record.

Overview

Under Section 214(e)(1) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996, a telecommunications carrier may be designated as an eligible telecommunications carrier and thereby receive universal service support so long as the carrier, throughout its service areas: (a) offers the services that are supported by Federal universal service support mechanisms under Section 254(c) of the Act, either using its own facilities or a combination of its own facilities and resale of another carrier's services (including services offered by another ETC); and (b) advertises the availability of and charges for such services using media of general distribution.

Section 54.201(b) of the Code of Federal Regulations states that the Commission shall, on its own motion or upon request, designate a common carrier an ETC so long as the carrier meets the requirements of Section 54.201(d), which restates the requirements found in Section 214(e)(1) of the Act. Section 214(e)(2) of the Act and Section 54.201(c) of the Federal Communication Commission's rules state that the Commission may, in the case of an area served by a rural telephone company, and shall, in the case of all other areas, designate more than one common carrier as an ETC for a service area the Commission designates, provided each additional requesting carrier satisfies Section 214(e)(1) of the Act and

¹ Also known as a Cellular Geographic Service Area (CGSA).

² Exhibit 5, Direct Testimony of Jonathon D. Reeves, Appendix C.

Section 54.201(d) of the FCC's rules. Before designating an additional ETC for an area served by a rural telephone company, the Commission shall find that such designation is in the public interest.

The FCC set out additional requirements for the ETC designation process in its *Designation Order*.³ The requirements are that the applicant must:

(1) Provide a five-year plan demonstrating how high-cost universal service support will be used to improve its coverage, service quality or capacity in every wire center for which it seeks designation and expects universal service support;

(2) Demonstrate its ability to remain functional in emergency situations;

(3) Demonstrate that it will satisfy consumer protection and service quality standards;

(4) Offer local usage plans comparable to those offered by the incumbent local exchange carrier in the areas for which it seeks designation; and

(5) Acknowledge that it may be required to provide equal access if all other ETCs in the designated area relinquish their designations pursuant to section 214(e)(4) of the Act.⁴

The FCC also set out the analytical framework that the FCC will use to determine whether the public interest would be served by granting the applicant an ETC designation. The state utility commissions were encouraged by the FCC to apply the same type of fact-specific analysis when determining whether the public interest would be served. The state commissions were encouraged to consider the benefits of increased consumer choice, and the unique advantages and disadvantages of the competitor's service offering.⁵

In addition, the Commission has set out its own rule regarding applications for ETC designation at 4 CSR 240-3.570. The Commission's rule adopts the minimum requirements and the analytical framework suggested by the FCC in its *Designation Order* with a few additional requirements. The Commission's rule also only requires a two-year build-out plan.⁶ Thus, by analyzing NWMC's compliance with the Commission's ETC rule, the Commission is assured that the applicant has met all the necessary qualifications for ETC designation. This case is the first time the Commission has decided an ETC designation case under this new rule.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The Commission in making this decision has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the

³ In the Matter of Federal-State Joint Board on Universal Service, Report and Order, CC Docket No. 96-45, (March 17, 2005).

⁴ Designation Order, para. 2.

⁵ Designation Order, para. 41.

⁶ 4 CSR 240-3.570(2)(A)2.

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Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Northwest Missouri Cellular

NWMC is licensed by the FCC to provide commercial mobile radio service in the rural counties of Atchison, Gentry, Holt, Nodaway, and Worth within the state of Missouri, under FCC Call Sign KNKN816.⁷ NWMC is a Missouri partnership. NWMC is not certificated to provide telecommunications services in Missouri by this Commission.

NWMC has requested ETC designation for the following wire centers: Stanberry, Albany, Grant City, Allendale, Barnard, Conception Junction, Denver, Darlington, Gentry, Graham, New Hampton, Parnell, Ravenwood, Sheridan, South Hamburg Missouri, Watson, Rock Port, Fairfax, Westboro, Tarkio, Craig, Mound City, Elmo, Burlington Junction, Skidmore, Maitland, Oregon, Maryville, Pickering, Hopkins, Clearmont, South Bradyville Missouri, and King City.

The Intervenors

All of the intervenor companies are incumbent local exchange companies (ILEC) that provide basic local and other telecommunications services in their respective service areas, as certificated by the Commission and pursuant to Commission approved tariffs. Each is a carrier of last resort and is an ETC providing service to the public throughout its respective service area. In addition, five other wireless carriers currently provide service in the area for which NWMC seeks ETC designation.⁸ No evidence was presented to show that any residents in the service areas of the incumbents are being denied access to the public switched network or service in the incumbents' service areas.

Service Offerings of NWMC

NWMC produced the testimony of three witnesses regarding its service offerings. NWMC alleges that it provides, or will provide, all the required service offerings and no party contested that NWMC provides: voice-grade access to the public switched network; local usage; dual tone multi-frequency signaling or its functional equivalent; single-party service or its functional equivalent; access to emergency services; access to operator services; access to interexchange service; access to directory assistance; and toll limitation for qualifying low-income consumers. With regard to these services, the Commission finds that NWMC offers or will offer the core services and functions required by an ETC.

In addition, NWMC will advertise the availability of and charges for these core services, using media of general distribution. NWMC will also advertise the availability of Lifeline and Link-Up services to qualifying customers and take steps to comply with the advertising requirement in 47 U.S.C. § 254(c).⁹

⁷ Ex. 5, p. 3, Ins. 8-12.

⁸ Exhibit 10, Rebuttal Testimony of William J. Warinner, p. 45.

⁹ Ex. 2, p. 5-6.

Compliance with 4 CSR 240-3.570 – Uncontested Items

NWMC provided testimony showing that it complied with certain provisions of the Commission's ETC rule. No party contested the fact that NWMC provided the populations affected by construction plans, its existing tower locations, and an estimated budget.¹⁰ There was also no contest to NWMC's allegations that it will: advertise the availability of its services and the charges for those services;¹¹ provide Lifeline and Link-Up discounts and that it will advertise those discounts appropriately;¹² provide equal access if necessary;¹³ and follow the Cellular Telecommunications and Internet Association's (CTIA) customer code.¹⁴ There was also no contest to the fact that NWMC has provided a plan outlining the method for handling unusual construction or installation charges.¹⁵ NWMC will also abide by the consumer privacy protection standards and applicable service quality standards as provided by the federal rules.¹⁶ Therefore, the Commission finds that NWMC provides, or will provide if granted ETC status, these uncontested items as set out in 4 CSR 240-3.570.

4 CSR 240-3.570(2)(A)1 – Intended Use of High-Cost Support

NWMC provided both written and oral testimony regarding the upgrades it intends to make to its system over the next five years. Included in its written testimony were Appendices F,¹⁷ G,¹⁸ H,¹⁹ M,²⁰ O,²¹ and P,²² which were intended to comply with the requirements of 4 CSR 240-3.570(2)(A)1 for showing the intended use of high-cost support, including detailed descriptions of construction plans with start and end dates, populations affected by construction plans, existing tower site locations, and estimated budgets. Appendices M and P include budget information and year-by-year proposals for spending the USF support if ETC designation is granted. Appendices F, G, H, and O show the current coverage and the proposed

¹⁰ 4 CSR 240-3.570(2)(A)1.

¹¹ 4 CSR 240-3.570(2)(A)6.

¹² 4 CSR 240-3.570(2)(A)7.

¹³ 4 CSR 240-3.570(2)(A)9.

¹⁴ 4 CSR 240-3.570(2)(B).

¹⁵ 4 CSR 240-3.570(2)(C).

¹⁶ 4 CSR 240-3.570(A)8; 47 C.F.R. 64 Subpart U.

¹⁷ Ex. 5, Appendix F (Revised).

¹⁸ Ex. 5, Appendix G (Revised).

¹⁹ Ex. 5, Appendix H.

²⁰ Ex. 3, Appendix M.

²¹ Ex. 6, Appendix O.

²² Ex. 4, Appendix E.

coverage after the implementation of a five-year plan. Appendices D and E show the population densities and changes.²³

NWMC first filed its application while the Commission was in the process of promulgating its ETC rule. It later supplemented its testimony in order to try to comply with the provisions of the new rule. Because the Commission's rule differs slightly from the FCC's requirements, NWMC submitted a five-year build-out plan, the FCC requirement, instead of the two-year plan required by the Commission's rules. The submission of the five-year plan has caused some problems with NWMC presenting its case. Holway argues that NWMC has failed to provide sufficient details of its build-out plan and has failed to state starting and ending dates for the construction. While the Commission prefers to receive as much detail as possible, NWMC provides sufficient details for the Commission to make its decision.

The Appendices state the proposed plans' beginning and ending dates as "Year 1," "Year 2," etc., this is sufficiently specific for the Commission. The Commission encourages any future applications or compliance filings to include as specific information as possible, but given that NWMC could not know when, or if, its ETC status would be granted, the general dates are sufficient. In addition, Staff did not indicate that it had any difficulty in determining the proposed start and end dates of the proposed upgrades in its review of the application. Furthermore, the Commission will not punish NWMC for providing a five-year plan, which is technically more detail than the rule requires.

4 CSR 240-3.570(2)(A)2 – Only USF Supportable Services

As stated above, NWMC filed a five-year plan instead of a two-year plan. The plan is supposed to show how the USF support will be spent and that it will only be used for USF supportable services. NWMC estimates receiving \$1,468,614 in USF support annually if its application is granted.²⁴ Appendices M and P²⁵ are intended to show how these funds will be spent.

Included in Year 1 figures is an expenditure for EVDO (Evolution Data Only).²⁶ EVDO is a data service.²⁷ NWMC agrees that EVDO is not a USF supportable service.²⁸ Mr. Bundridge on behalf of NWMC testifies that USF support will "be used to deploy and extend advanced wireless services including high-speed wireless data through EVDO technology . . . to rural areas that would otherwise remain unserved from this technology."²⁹ This statement seems clear on its face that NWMC intends to use USF monies to deploy EVDO, an unsupportable service. During cross-

²³ Appendix E also shows by implication (*i.e.*, "24 months after support") the ending dates of the proposed new cell site locations.

²⁴ Exhibit 1, Direct Testimony of Kathryn G. Zentgraf, p. 15, Ins. 22-23.

²⁵ Ex. 3 and Ex. 4, respectively.

²⁶ Ex. 3, Appendix M; Ex. 4, Appendix P.

²⁷ Tr. p. 50; Ex. 4, p. 5.

²⁸ Tr. p. 50, Ins. 1-7.

²⁹ Ex. 4, p. 5, Ins. 8-11.

examination and redirect examination at the hearing, however, Mr. Bundridge attempted to clarify the company's position.

Mr. Bundridge testified that the five-year budget submitted was a "rolling plan."³⁰ Because of the lack of certainty with the timing of matters, such as permits from the Department of Natural Resources, NWMC has presented a plan for building new cell sites and upgrading its facilities that could occur over the next five years, or, if the USF money is available, some of those new sites and upgrades will be made in the next 18 months to two years. NWMC committed to spending the USF monies only on supportable services and understands that it will have to report those numbers to the Commission on an annual basis under the new ETC rule.³¹

The Commission finds that NWMC's presentation of its five-year plan was extremely confusing. However, the Commission recognizes that this is a new process and that it may take several applications to get some clarity in the filings. The Commission finds Mr. Bundridge's explanation of why unsupported EVDO was included in the budget to be credible. The Commission finds that NWMC intends to spend its USF support only on supportable services in the next two years. At its annual certification, NWMC shall provide a budget which is clear and does not contain items which are not supportable, or which would have been made regardless of the USF support.

4 CSR 240-3.570(2)(A)(3) – Expenses Would Not Otherwise Occur

NWMC provided maps of the geographic coverage areas before and after its proposed improvements. The maps were broken down on a wire center basis. The appendices to the various testimony included projected dates for the improvements as discussed above. NWMC also provided estimated budgets for the projects and the estimated populations affected by the improvements.

AT&T Missouri argued that NWMC did not demonstrate any meaningful improvement in signal coverage in the Stanberry wire center, or otherwise demonstrate how funding will be used to further the provision of supported services in that area.³² Thus, AT&T Missouri argues that this exchange should be excluded from ETC designation.

NWMC provided the testimony of Jonathan D. Reeves to sponsor the maps showing its current signal coverage³³ and the signal coverage after the implementation of its proposed upgrades.³⁴ The coverage maps show current "minimum signal coverage"³⁵ in green, and a lack of signal in white.³⁶ A "minimum signal coverage" was defined by the witness during the *in camera* portion of the

³⁰ Tr. p. 140.

³¹ Tr. p. 165-166.

³² AT&T Missouri's Post-Trial Brief, p. 1 (filed July 10, 2006).

³³ Ex. 6, Supplemental Direct Testimony of Jonathan D. Reeves, Appendix O.

³⁴ Ex. 5, Direct Testimony of Jonathan D. Reeves, Appendix H.

³⁵ Tr. pp. 42, 206.

³⁶ Tr. p. 192-194.

hearing.³⁷ NWMC admitted that the maps are designed to be simplistic.³⁸ The coverage maps could have been provided in more detail as demonstrated by the Rebuttal Testimony of Glenn H. Brown.³⁹ The Commission, however, finds the evidence provided by NWMC to be sufficient to demonstrate how each of the wire centers will benefit from added coverage.

Mr. Reeves testified during the *in camera* portion of the hearing as to two reasons why an area which already has signal may benefit from the proposed additional signal coverage.⁴⁰ In comparing the coverage before and after improvements, the coverage maps indicate that each of the wire centers for which NWMC seeks ETC designation will benefit from the proposed upgrades. Thus, the Commission finds that NWMC has shown that it will provide improved coverage, service quality, or capacity in each of the wire centers where ETC designation is requested, including the Stanberry wire center.

Another significant issue is whether NWMC will be spending USF support on improvements that it would not have made without receiving such support. As NWMC admits, Appendices M and P⁴¹ include maintenance on existing cell sites that it will spend even if ETC designation is not granted.⁴² As set out above, however, Mr. Bundridge testified that NWMC will condense its five-year plan as necessary to be certain that it spends all of the USF monies it receives on supportable items.⁴³ The Commission finds Mr. Bundridge's clarification to be credible. Based on that clarification, the Commission determines that NWMC has provided sufficient evidence showing how it intends to spend its expected USF support on expenditures other than those it would have made without USF support.

Mr. Bundridge also provided testimony that improvements, including the seven additional cell sites, could only be made with USF support.⁴⁴ Mr. Bundridge testified that if NWMC received more money than estimated, then NWMC would speed up the implementation of some items in order to spend that money on supportable services.⁴⁵ The Commission finds that NWMC intends to spend all its USF support on supportable services in the next two years and that the improvements would not be made without USF support.

³⁷ Tr. pp. 190-206.

³⁸ Tr. p. 204.

³⁹ Ex. 9, Schedule GHB-4HC.

⁴⁰ Tr. p. 219.

⁴¹ Ex. 4 and Ex. 5, respectively.

⁴² Tr. p. 147.

⁴³ Tr. p. 140, 147-149.

⁴⁴ Ex. 3, p. 5; Ex. 4, p. 7.

⁴⁵ Ex. 4, pp. 5-6; Tr. p. 140.

4 CSR 240-3.570(2)(A)4 – Ability to Remain Functional in an Emergency

Mr. Bundridge testified about NWMC's ability to remain functional in the event of an emergency.⁴⁶ NWMC has a fully redundant network, with extensive battery backup and three emergency generators.⁴⁷ NWMC's system is also configured to automatically reroute traffic around damaged facilities.⁴⁸ In addition, NWMC's switch is designed for additional overhead traffic to accommodate traffic spikes, and the code division multiple access (CDMA) technology allows for increased volume with a reduced "overall footprint and quality."⁴⁹

Only AT&T Missouri suggests that NWMC's testimony on this point is insufficient.⁵⁰ Mr. Stidham suggests that NWMC has not provided sufficient detail about how the system is designed for the Commission to make a determination about emergency capabilities.⁵¹ Neither the Commission's Staff nor any other party objected to the sufficiency of this testimony. The Commission finds that the information provided is sufficiently detailed for it to make a decision regarding this element. The Commission further finds that NWMC has demonstrated its ability to remain functional in an emergency.

4 CSR 240-3.570(2)(A)5 – Public Interest

Granting NWMC an ETC designation will benefit the public by enabling NWMC to bring wireless service, including E911 and CDMA, to many remote locales and by increasing competition for primary telephone service in remote areas. In addition, Lifeline and Link-Up customers will have access to service that would otherwise be unavailable to them.⁵²

An ETC grant to NWMC will bring the benefits of advanced technologies to the remote areas of NWMC's service area.⁵³ These advancements in technology include an enhanced CDMA coverage⁵⁴ and EVDO. Although EVDO is not a supported service, by upgrading the network it becomes more likely that advanced technologies, such as EVDO, will be rolled out in the rural areas. Thus rural areas will become more in line with the types of services offered in urban areas.

In addition, NWMC will provide additional enhanced 911 (E911) coverage in the most rural areas. The ILECs argue that NWMC did not provide evidence that the other wireless carriers serving in NWMC's service area do not already provide E911 service and, therefore, the Commission cannot determine that E911 service will be

⁴⁶ Ex. 2, pp. 21-22; Ex. 3, pp. 5-6.

⁴⁷ Ex. 2, pp. 21-22; Ex. 3, pp. 5-6.

⁴⁸ Ex. 3, p. 6.

⁴⁹ Ex. 3, p. 6.

⁵⁰ AT&T Missouri's Post-Trial Brief, pp. 4-5; Exhibit 11, Rebuttal Testimony of James E. Stidham, Jr., pp. 6-8.

⁵¹ Ex. 11, pp. 6-8.

⁵² Tr. p. 76.

⁵³ Ex. 2, pp. 10-12.

⁵⁴ Tr. pp. 135-136.

enhanced. However, NWMC is the only wireless provider offering service in Worth County.⁵⁵ Therefore, at least with regard to that county, 911 service will be enhanced.

The ETC designation will also bring the benefits of wireless service to the current Lifeline subscribers of the various ILECs. Without ETC status, NWMC will not be able to offer Lifeline discounts. NWMC's Lifeline plan would give qualifying consumers a \$1.75 monthly discount. However, to benefit from a \$1.75 discount, a low-income customer seeking only the Lifeline plan would need to pay for a handset and pay an activation fee of up to \$30 (a discount is offered to Link-Up customers). These costs could be paid out over a period not to exceed one year without interest. Even though the service is more expensive than the ILEC's plan, the service received has additional features and benefits.

An additional benefit to some Lifeline subscribers is an increased local calling scope. Another benefit of granting the ETC designation is the mobility that wireless service provides. Finally, the addition of local calling plans similar to traditional landline basic service will enhance and increase competition for basic local service in these rural areas.

The grant of ETC status to NWMC would result in USF support in the amount of \$1,468,614 annually. That represents approximately .0357% of the total high-cost support received by all carriers from the USF.⁵⁶

The Commission finds that benefits to the public outweigh the potential detriments of granting ETC status.

4 CSR 240-3.570(2)(A)10 – Local Usage Plan Comparable to ILEC's Plan

NWMC currently offers several different calling plans. NWMC will continue to offer a wide selection of plans.⁵⁷ In addition, if designated as an ETC, NWMC intends to offer two local usage plans available only to Lifeline customers and one "ILEC-equivalent" plan available to any customer. These plans are designed to be comparable to that of the ILEC.⁵⁸

The first of those plans will offer unlimited local calling and mobility in the area served by the subscriber's home cell site at a fixed monthly price of \$17.95 (\$9.70 per month after applying the local exchange service discount of \$1.75 and the federal line charge discount of \$6.50⁵⁹). The subscriber's outbound local calling area will correspond to the traditional ILEC calling area for that subscriber's address. Calls could be originated by the NWMC Lifeline subscriber to any numbers within the ILEC exchange from any location within the subscriber's home cell site serving area. Calls could also be received within this area. The home cell site area will be

⁵⁵ Tr. p. 165.

⁵⁶ Ex. 1, pp. 15-16.

⁵⁷ Ex. 2, p.6; Appendix J.

⁵⁸ EX. 2, pp. 6-8; Ex. 3, pp. 11-12; Tr. pp. 104-106.

⁵⁹ In the Stanberry exchange, the subscriber line charge should be \$5.25. Mr. Bundridge testified, however, that NWMC would offer the service at the same overall price as offered in the other exchanges in order to avoid customer confusion. (Tr. p. 121-122.)

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defined to include coverage from all NWMC cell sites necessary to encompass the subscriber's entire corresponding ILEC exchange area. The plan would also include several vertical features, including call waiting, call forwarding, 3-way calling, caller ID, and voice mail, for no additional charge.⁶⁰

The second Lifeline-only plan will allow for unlimited inbound and outbound local calling and mobility through out the entire service area for which NWMC is designated as an ETC, for a flat \$21.95⁶¹ (\$13.70 per month after applying the local exchange service discount of \$1.75 and the federal line charge discount of \$6.50⁶²). Subscribers of this plan will receive toll-free calling within the geographic area encompassing multiple telephone exchanges served by all local exchange carrier wire centers for which ETC designation is being sought. The plan will also include the same vertical features as listed above at no additional charge.⁶³

The first Lifeline-only plan will not allow roaming on other carriers' networks for routine calls. Both the plans will, however, allow for ubiquitous access to 911 for the NWMC Lifeline subscriber even in a roaming situation. NWMC is unable to provide either of these two plans without USF support.⁶⁴

NWMC will also offer discounts of 50% off of its \$35 activation fee to Link-Up subscribers along with a deferred schedule for payment of the charges accessed for commencing service. The consumer will not pay interest for a period of up to one year.⁶⁵

In addition, in order to initiate service a new Lifeline-only customer would have to pay the discounted activation fee and would need to purchase a wireless handset.⁶⁶ NWMC will provide information to the customer regarding the lowest cost handset available and even has a program for the purchase of used handsets.⁶⁷

NWMC is committed to continuing to offer its local usage plans and will attest to those plans being offered when it seeks its annual ETC certification with the Commission as required in 4 CSR 240-3.570(4).⁶⁸

The "ILEC-equivalent" plan will offer the same features and services as the first Lifeline plan discussed above, but will be available to all NWMC subscribers at a price of \$17.95 per month.⁶⁹

NWMC provided Appendix K⁷⁰ to show how its local calling plan rate will compare with the rates of the ILECs. The total monthly charges for the ILECs,

⁶⁰ Ex. 2, p. 7.

⁶¹ Ex. 4, p. 2.

⁶² The subscriber line charge is \$5.25 in the Stanberry exchange.

⁶³ Ex. 2, p. 8.

⁶⁴ Ex. 2, p. 8.

⁶⁵ Ex. 2, p. 8.

⁶⁶ Ex. 4, p. 3.

⁶⁷ Tr. p. 95.

⁶⁸ Tr. pp. 105-106.

⁶⁹ Ex. 2, p. 9.

⁷⁰ Ex. 2, Appendix K.

including the various surcharges and E911 taxes, range from \$12.03 for Rock Port Telephone Company to \$20.98 for Iowa Telecom Rate Group 4. Appendix K, however, does not show the ILEC charges after the applicable Lifeline discounts are applied. For instance, AT&T Missouri's rates in the Stanberry exchange, Rate Group A rates, are only \$.15 before the applicable 911 and Relay Missouri charges, not \$13.65 as shown on Appendix K. Thus, NWMC's Lifeline customers in the Stanberry exchange under its first option would pay \$9.70 as compared to \$.15 for AT&T customers. NWMC's customers purchasing the ILEC-equivalent plan would pay \$17.95 compared to \$13.60 for basic service from AT&T's Stanberry customers.

While the NWMC rates are greater than those charged by the ILECs, the levels of services are not identical. Each of the current NWMC plans includes multiple vertical services. Adding the tariff rates for those features to the rates charged by the ILECs would result in substantially greater monthly rates. In addition, one of NWMC's Lifeline plans will offer a larger calling scope than the ILEC. Furthermore, NWMC's customers will have limited mobility, though there may be dead spots and the possibility of dropped calls⁷¹ which is not expected with traditional landline service.

Both ILEC basic local subscribers and NWMC Lifeline and Link-Up subscribers will have unlimited local calling.⁷² Furthermore, NWMC will abide by any local usage requirements set by the FCC.

With regard to credit checks of Lifeline customers, NWMC intends to require a credit check where the Lifeline customer chooses the second option and thus has the ability to incur roaming charges. NWMC does not have the ability to limit roaming charges. Under the first Lifeline plan, the company will not require a credit check.⁷³ Public Counsel argues that Lifeline customers should not be subject to credit checks unless they have a past unpaid account with the company.⁷⁴

Conclusions of Law

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

AT&T Missouri, Holway Telephone Company, Iamo Telephone Company – Missouri, Iowa Telecom – North, Oregon Farmers Mutual Telephone Company, Rock Port Telephone Company, Alltel Missouri, Inc., Sprint Missouri, Inc., and Grand River Mutual Telephone Company, are each a “telecommunications company” and a “public utility” as those terms are defined in Section 386.020, RSMo 2000, and are therefore fully subject to the regulatory jurisdiction of the Commission. Each of the companies is an incumbent local exchange carrier and has been designated as an ETC for purposes of receiving federal USF support.

⁷¹ Tr. p. 110.

⁷² Tr. p. 71.

⁷³ Tr. p. 97.

⁷⁴ Exhibit 7, Rebuttal Testimony of Barbara Meisenheimer, p. 17.

Each of these companies, with the exception of AT&T Missouri, is a rural telephone company as defined by the Federal Telecommunications Act of 1996. AT&T Missouri is a non-rural telephone company.

The commercial mobile radio service provided by NWMC is specifically excluded from the statutory definition of "telecommunications service."⁷⁵ Thus, NWMC is not subject to the general regulatory jurisdiction of the Commission. Under the authority granted to the Commission by the FCC, NWMC has requested that the Commission designate it as an ETC for purposes of receiving federal universal service support.

Under the Commission's ETC rule, by applying for designation as an ETC, NWMC voluntarily subjects itself to the Commission's jurisdiction regarding ETC "status and USF funding and the acceptance of any additional rules made applicable to" ETCs.⁷⁶ NWMC admits that the Commission's rule should be applied in this case⁷⁷ and, therefore, NWMC is subject to the Commission's jurisdiction as set out in the ETC rule.

The purpose of the Universal Service Fund is to provide financial support to carriers that use the support to advance universal service principles. Before a carrier can receive support from the USF, the carrier must be designated as an ETC by the state commission with jurisdiction over the service area where the carrier seeks to apply its USF support.⁷⁸

The state commission must first confirm that the petitioning carrier offers the services that are supported by federal universal service support mechanisms under Section 254(c) of the Act.⁷⁹ Second, the state commission must confirm that the petitioning carrier advertises the availability of such services and charges using media of general distribution.⁸⁰ After making those determinations, the Commission must determine if the request is in the public interest.⁸¹

The FCC issued an order setting forth additional guidance to be used in conjunction with a public interest finding for competitive ETC designations in areas served by rural telephone companies.⁸² In addition, the FCC has issued an order in the *Highland* case⁸³ that helps define the public interest standard.

⁷⁵ Section 386.020(53)(c), RSMo.

⁷⁶ 4 CSR 240-3.570(4)(G).

⁷⁷ See, Issues List.

⁷⁸ 47 U.S.C. § 214(e).

⁷⁹ 47 C.F.R. § 54.101.

⁸⁰ 47 U.S.C. § 214(e).

⁸¹ 47 U.S.C. § 214(e)(2).

⁸² In the Matter of Federal-State Joint Board on Universal Service, Highland Cellular, Inc., Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia, CC Docket No. 96-45, FCC 03-338 (rel. April 12, 2004).

⁸³ In the Matter of Federal-State Joint Board on Universal Service, Highland Cellular, Inc., Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia, CC Docket No. 96-45, FCC 03-338 (rel. April 12, 2004).

On March 17, 2005, the FCC issued a decision⁸⁴ regarding how it will evaluate applications for ETC status, and recommending that the states use similar guidelines. Paragraph 41 of the *Report and Order* states:

41. In instances where the Commission has jurisdiction over an ETC applicant, the Commission in this Report and Order adopts the fact specific public interest analysis it has developed in prior orders. First, the Commission will consider a variety of factors in the overall ETC determination, including the benefits of increased consumer choice, and the unique advantages and disadvantages of the competitor's service offering. Second, in areas where an ETC applicant seeks designation below the study area level of a rural telephone company, the Commission also will conduct a cream skimming analysis that compares the population density of each wire center in which the ETC applicant seeks designation against that of the wire centers in the study area in which the ETC applicant does not seek designation. Based on this analysis, the Commission will deny designation if it concludes that the potential for cream skimming is contrary to the public interest. The Commission plans to use this analysis to review future ETC applications and strongly encourages state commissions to consider the same factors in their public interest reviews. (footnotes omitted)

The footnote to the "prior orders" the FCC references in the above paragraph refers to both the *Virginia Cellular Order*⁸⁵ and the *Highland Cellular Order*.⁸⁶ The FCC wrote in paragraph 28 of the Virginia Cellular Order:

In considering whether designation of Virginia Cellular as an ETC will serve the public interest, we have considered whether the benefits of an additional ETC in the wire centers for which Virginia Cellular seeks designation outweigh any potential harms. We note that this balancing of benefits and costs is a fact-specific exercise. *In determining whether designation of a competitive ETC in a rural telephone company's service area is in the public interest, we weigh the benefits of increased competitive choice, the impact of the designation on the universal service fund, the unique advantages and disadvantages of the competitor's service offering, any commitments made regarding quality of telephone service, and the competitive ETC's ability to satisfy its obligation*

⁸⁴ 1 Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC-05-46. Rel. March 17, 2005. ("*Report & Order*")

⁸⁵ FCC 03-338, CC Docket 96-45, Released January 22, 2004.

⁸⁶ FCC 04-37, CC Docket 96-45, Released April 12, 2004.

to serve the designated service areas within a reasonable time frame. (italics added)

The same italicized phrase is contained in paragraph 22 of the *Highland Cellular Order*.

In addition, the carrier must meet the requirements of the Commission's rule governing ETC designations.⁸⁷ The Commission's rule largely incorporates the requirements set out by the FCC.

The Commission has found that NWMC offers the services that are supported by federal universal service support. The Commission has also found that NWMC advertises the availability of those services using media of general distribution. Thus, the Commission concludes that NWMC has met the requirements set out in Section 214(e)(1)(A) and (B).

4 CSR 240-3.570 – Uncontested Items

No party contested the fact that NWMC complied with portions of the ETC rule. Therefore, based on the uncontested facts, the Commission concludes that NWMC has complied with the following portions of the ETC rule: (1) providing the populations affected by construction plans, its existing tower locations, and an estimated budget;⁸⁸ (2) advertising the availability of its services and the charges for those services;⁸⁹ (3) providing Lifeline and Link-Up discounts and advertising those discounts appropriately;⁹⁰ (4) providing equal access if necessary;⁹¹ (5) following the CTIA's customer code;⁹² (6) providing a plan outlining the method for handling unusual construction or installation charges;⁹³ and (7) abiding by the consumer privacy protection standards and applicable service quality standards as provided by the federal rules.⁹⁴ Therefore, the Commission concludes that NWMC provides, or will provide if granted ETC status, these uncontested items as set out in 4 CSR 240-3.570.

4 CSR 240-3.570(2)(A)1 – Intended Use of High-Cost Support

The Commission found that NWMC provided a sufficiently detailed plan for the Commission to make its decision. The start and end dates included in the plan were less than clear, but were sufficient for the Commission to make its decision. The Commission concludes that NWMC has provided a statement of intended use of its high-cost support including a detailed description of construction plans with start and end dates and estimated budget amounts. The Commission further concludes that

⁸⁷ 4 CSR 240-3.570.

⁸⁸ 4 CSR 240-3.570(2)(A)1.

⁸⁹ 4 CSR 240-3.570(2)(A)6.

⁹⁰ 4 CSR 240-3.570(2)(A)7.

⁹¹ 4 CSR 240-3.570(2)(A)9.

⁹² 4 CSR 240-3.570(2)(B).

⁹³ 4 CSR 240-3.570(2)(C).

⁹⁴ 4 CSR 240-3.570(A)8; 47 C.F.R. 64 Subpart U.

NWMC shall, as a condition of its grant of ETC status, file a plan outlining more specifically the proposed starting and ending dates of proposed USF supportable upgrades for the first two years of USF support. The revised budget and build-out plan shall condense the five-year plan to include only those items for which USF is intended as set out in 4 CSR 240-3.570(2)(A)2.A.⁹⁵ This condition is reasonable in that it will allow the Commission to more easily review the certification filings that NWMC will need to make on an annual basis.

4 CSR 240-3.570(2)(A)2 – Only USF Supportable Services

The Commission previously found that NWMC's five-year budget in conjunction with Mr. Bundridge's testimony was sufficient for the Commission to make a decision regarding what services NWMC will provide using USF support. The Commission also found that the services would only be provided in Missouri. The Commission, therefore, concludes that NWMC has met the requirement to show that high-cost support shall only be used for the provision, maintenance, and upgrading of facilities and services for which the support is intended in the Missouri service area for which it was granted. In addition, the Commission concludes that it is reasonable to require NWMC, as a condition of the grant of ETC status, to provide a revised estimated budget showing only the USF supportable items for which it proposes to spend USF funds in the next two years. This condition will help facilitate the Commission's future review and ensure that USF monies were spent only on supportable services.

Furthermore, the Commission concludes that under the ETC rule, failure to demonstrate "that high-cost support was used to improve coverage, service quality or capacity in the Missouri service area in which ETC designation was granted and that support was used in addition to any expenses the ETC would normally incur,"⁹⁶ shall result in the Commission refusing to certify NWMC for USF support.⁹⁷

4 CSR 240-3.570(2)(A)3 – Expenses Would Not Otherwise Occur

AT&T argued that NWMC did not demonstrate any meaningful improvement in signal coverage in the Stanberry wire center, or otherwise demonstrate how funding will be used to further the provision of supported services in that area.⁹⁸ Thus, AT&T argues that this exchange should be excluded from ETC designation. The Commission has found that the coverage maps provided by NWMC show sufficient detail for it to reach its decision in this matter. The maps were broken down on a wire center basis and the appendices to the various testimony included projected dates for the improvements as discussed above.

⁹⁵ The Commission has found in Case No. TO-2006-0172, Report and Order (issued September 21, 2006), that expenses for income tax and depreciation are not USF supportable items.

⁹⁶ 4 CSR 240-3.570(4)(D).

⁹⁷ 4 CSR 240-3.570(5)(E).

⁹⁸ AT&T Missouri's Post-Trial Brief, p. 1 (filed July 10, 2006).

The Commission concludes that the evidence provided by NWMC demonstrates how each of the wire centers will benefit. The Commission also concludes that NWMC will provide improved coverage, service quality or capacity in each of the wire centers where ETC designation is requested, including the Stanberry wire center.

The Commission also found that NWMC will be spending USF support only on improvements that it would not have made without receiving such support. NWMC's Appendices M and P⁹⁹ included budgets for unsupportable items and expenses that it would make regardless of the ETC designation. When those items are removed, the remaining amounts in the first two years of the budget do not add up to the expected \$1,468,614 in USF support. However, the testimony clarified that NWMC will make the USF supportable improvements as laid out in the five-year plan as necessary so that it spends funds on cell towers and services that it would not have otherwise spent without the USF funds. The Commission concludes, based on the five-year plan and the testimony, that NWMC intends to spend all its USF support on supportable services in the next two years and that the improvements would not be made without USF support.

As a condition of its ETC designation, the Commission will require NWMC to provide a new two-year budget which excludes the improvements and upgrades the company would have made regardless of USF support and in compliance with 4 CSR 240-3.570(2)(A)2.A as specified above.

4 CSR 240-3.570(2)(A)4 – Ability to Remain Functional in an Emergency

Only AT&T suggests that NWMC's has not provided sufficient detail about how the system is designed for the Commission to make a determination about emergency capabilities. Neither the Commission's Staff nor any other party objected to the sufficiency of this testimony. Based on the evidence provided, including rerouting calls, redundant networks, the system not operating at capacity, and back-up generators, the Commission concludes that NWMC has demonstrated its ability to remain functional in an emergency.

4 CSR 240-3.570(2)(A)10 – Local Usage Plan Comparable to ILEC's Plan

NWMC will offer local calling plans that are designed to be comparable to that of the ILEC. Although the NWMC rates are more than those charged by the ILECs, the level of services is also increased. Each of the current NWMC plans includes multiple vertical services and some will offer a larger calling scope than the ILEC. Furthermore, NWMC's customers will have limited mobility. While the offerings are not identical, the Commission concludes that NWMC offers a local usage plan that is comparable to those offered by the ILECs.

The Commission further concludes that requiring a credit check of Lifeline customers who do not have unpaid accounts with the company is not a reasonable requirement. In order to protect Lifeline customers, the Commission finds that it is reasonable to condition the grant of ETC designation upon NWMC offering service to Lifeline customers without requiring a credit check.

⁹⁹ Ex. 4 and Ex. 5, respectively.

4 CSR 240-3.570(2)(A)5 – Public Interest

Section 214(e)(2)¹⁰⁰ of the Act, as well as the FCC regulations,¹⁰¹ and the Commission's rule¹⁰² govern the designation of ETC status. Section 214(e)(2) of the Act states, in relevant part:

Upon request and consistent with the public interest, convenience and necessity, the State commission may, in the case of an area served by a rural telephone company, and shall, in the case of all other areas, designate more than one common carrier as an eligible telecom-munications carrier for a service area designated by the State commission, so long as each additional requesting carrier meets the requirements of paragraph (1). Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission shall find that the designation is in the public interest.

The Commission's ETC rule also requires that the applicant for ETC designation demonstrate that the designation is in the public interest.¹⁰³ Thus, the Commission must determine if the designation of an additional ETC is in the public interest.

The FCC has held that an increase in competition is in the public interest. This is based on the fact that one of the main goals of the Telecommunications Act of 1996 was to increase competition. Thus, under the FCC's analysis, having NWMC designated as an ETC will have some benefit of increasing competitive choice. In the current case NWMC presented evidence showing increased competition in the form of new service offerings. The Commission concludes, based on the record before it, that there will be some benefit of increased competition by designating NWMC an ETC.

The second factor that the FCC considered is the impact on the Universal Service Fund. The impact on the fund of NWMC's annual USF support of \$1,468,614 is not in and of itself a significant portion of the fund as a whole. The FCC acknowledged, however, that there were concerns about the overall impact of designating multiple carriers, including wireless, as ETCs.

The ILECs believe a stricter analysis should be done. The ILECs suggest that the Commission must look to the Universal Service Principles in Section 254(b) to determine the impact on the USF. The ILECs also believe that the USF will grow too rapidly with the addition of wireless companies. The Commission is also concerned with the rapid growth of the Universal Service Fund, and awaits further guidance from the FCC and the United States Congress on improvements to the USF. The Commission must, however, resolve the case before it.

¹⁰⁰ 47 U.S.C. § 214(e)(2).

¹⁰¹ 47 C.F.R. § 54.201, *et seq.*

¹⁰² 4 CSR 240-3.570.

¹⁰³ 4 CSR 240-3.570(2)(A)(5).

The Commission has found that the advantages that NWMC will provide include mobility, access to emergency services, and an increased local calling scope for some customers. Disadvantages include such things as dead spots and dropped calls. Granting NWMC an ETC designation will benefit the public by enabling NWMC to bring wireless service, including E911 (specifically in Worth County) and CDMA, to many remote locales and by increasing competition for primary telephone service in remote areas. In addition, Lifeline and Link-Up customers will have access to service that would otherwise be unavailable to them.¹⁰⁴ The Commission concludes that the benefits to the public in rural Missouri of granting NWMC ETC status will outweigh the potential detriments to the USF.

Another disadvantage of wireless service is that the company is not subject to the mandatory quality of service standards with which the landline companies must comply. NWMC has committed to complying with the CTIA Consumer Code for Wireless Service and any applicable federal quality of service standards. Furthermore, the Commission has set out additional conditions in this order for the annual certification. In addition, enforcement of the Commission's ETC rule will ensure that the USF support is being used appropriately.

Finally, NWMC has committed that it is willing to accept carrier-of-last-resort status and there was no evidence that suggested NWMC was currently unable to serve the areas where ETC designation is requested. In addition, the ETC rule provides what the company must do to provide service if requested in an area where coverage does not exist. Thus, the Commission concludes that NWMC has the ability to serve the area.

Based on all the foregoing facts, the Commission concludes that the benefits to the public of granting NWMC ETC status outweigh the detriments of granting ETC status.

Conclusion

The Commission determines that the grant of ETC status to NWMC is in the public interest because NWMC has provided evidence to show that the public benefits from designating NWMC an ETC for USF purposes will outweigh the detriments of doing so. The Commission conditions this grant of ETC designation on the conditions set out above regarding filing of additional information and continued compliance with the Commission's ETC rule. If NWMC does not strictly abide by the Commission's ETC rule, especially the provisions requiring that funds be spent only on USF supportable services, the Commission shall not certify NWMC as an ETC on an annual basis and shall rescind this ETC designation.

NWMC has shown that it intends to bring additional services and technology to rural telecommunications customers within the state of Missouri. NWMC has further shown that by granting NWMC ETC status, these rural customers will have better signal coverage, enhanced 911 capabilities, and more competitive choices for telecommunications service.

¹⁰⁴ Tr. p. 76.

NORTHWEST MISSOURI CELLULAR LIMITED PARTNERSHIP

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NWMC has met its burden to show that a grant of ETC status in the requested wire centers is "consistent with the public interest, convenience, and necessity." Therefore, the Commission shall grant NWMC's application for ETC designation.

IT IS ORDERED THAT:

1. Northwest Missouri Cellular Limited Partnership's application to be designated an eligible telecommunications carrier for federal universal service fund purposes is granted conditioned on compliance with the items set out in ordered paragraphs 2-4 below.

2. Northwest Missouri Cellular Limited Partnership shall file no later than September 26, 2006, a revised budget and build-out plan as specified in the body of this order which fulfills the requirements for only items for which support is intended as set out in 4 CSR 240-3.570(2)(A)2.A.33.

3. Northwest Missouri Cellular Limited Partnership shall strictly abide by the provisions of 4 CSR 240-3.570.

4. Northwest Missouri Cellular Limited Partnership's application to be designated an eligible telecommunications carrier for federal universal service fund purposes is granted conditioned on compliance with the items set out in ordered paragraphs 2-4 below.

5. Northwest Missouri Cellular Limited Partnership shall file no later than September 26, 2006, a revised budget and build-out plan as specified in the body of this order which fulfills the requirements for only items for which support is intended as set out in 4 CSR 240-3.570(2)(A)2.A.

6. Northwest Missouri Cellular Limited Partnership shall strictly abide by the provisions of 4 CSR 240-3.570.

7. Northwest Missouri Cellular shall not require a credit check for Lifeline customers.

8. Exhibit 14 is admitted into the record.

9. All objections not ruled on are overruled and all motions not granted are denied.

10. This Report and Order shall become effective on October 1, 2006.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur and certify
compliance with the provisions of
Section 536.080, RSMo 2000.

***NOTE:** The Commission, in an order issued on October 19, 2006, denied applications for rehearing in this case. See page 309 for another order in this case.

MISSOURI RSA NO. 5 PARTNERSHIP

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15 Mo. P.S.C. 3d

In the Matter of the Application of Missouri RSA No. 5 Partnership for Designation as a Telecommunications Company Carrier Eligible for Federal Universal Service Support Pursuant to §254 of the Telecommunications Act of 1996.

Case No. TO-2006-0172

Telecommunications §14.1. The Commission granted Missouri RSA No. 5 Partnership's (MO5) application for status as an eligible telecommunications carrier (ETC) for federal universal service fund (USF) purposes.

APPEARANCES

Paul S. DeFord, Lathrop & Gage L.C., 2345 Grand Boulevard, Kansas City, Missouri 64108, for Missouri RSA No. 5 Partnership.

Charles Brent Stewart, Stewart & Keevil, L.L.C., Southampton Village at Corporate Lake, 4603 John Garry Drive, Suite 11, Columbia, Missouri 65203, for Spectra Communications Group, LLC, d/b/a CenturyTel, and CenturyTel of Missouri, LLC, d/b/a CenturyTel.

W.R. England, III, and Brian T. McCartney, Brydon, Swearngen & England, 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri 65102-0456, for Northwest Missouri Rural Telephone Company and Mark Twain Rural Telephone Company.

Paul G. Lane, General Counsel–Missouri, and Robert J. Gryzmala, Senior Counsel, Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri, One AT&T Center, Room 3516, St. Louis, Missouri 63101, for Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri.

Lewis R. Mills, Jr., Public Counsel, and Michael F. Dandino, Deputy Public Counsel, Office of the Public Counsel, 200 Madison Street, Suite 650, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

William K. Haas, Deputy General Counsel, Missouri Public Service Commission, 200 Madison Street, Suite 800, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Nancy Dippell, Deputy Chief Regulatory Law Judge.

REPORT AND ORDER

Issue Date: September 21, 2006

Effective Date: October 1, 2006

Syllabus: This order grants Missouri RSA No. 5 Partnership's (MO5) application for status as an eligible telecommunications carrier (ETC) for federal universal service fund (USF) purposes.

Procedural History

On October 18, 2005, MO5 filed an application for designation as an eligible telecommunications carrier for federal universal service fund purposes under

Section 254 of the Telecommunications Act of 1996. MO5 sought ETC designation throughout its FCC-licensed service area¹ in Missouri with respect to all local exchange carrier wire centers wholly within its FCC-licensed service area, all the wire centers partially within its FCC-licensed service area with the exception of the Laredo, Chula, Wheeling, and Gilliam wire centers,² and in the Hale and Dewitt wire centers which lie outside of but contiguous with its service area.

MO5 seeks ETC designation in the entire study area of the rural telephone company, Chariton Valley Telephone Company. In addition, MO5 seeks ETC designation in portions of the rural study areas of the rural telephone companies: Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, Mark Twain Rural Telephone Company (Mark Twain), Northeast Missouri Rural Telephone Company (Northeast), and Spectra Communications Group, LLC, d/b/a CenturyTel. MO5 also seeks ETC designation in the non-rural telephone company area served by Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri, with respect to the Brookfield, Marceline, Moberly, Armstrong, Higbee, and Glasgow wire centers.

Grand River initially intervened, but later withdrew from the case. CenturyTel of Missouri, LLC, and Spectra Communications Group, LLC, d/b/a CenturyTel (collectively referred to as "CenturyTel"), Mark Twain, Northeast, and AT&T Missouri intervened in opposition to MO5's request for ETC designation. The Office of the Public Counsel and the Staff of the Missouri Public Service Commission also oppose the application.

The parties filed prehearing briefs on June 14, 2006. An evidentiary hearing was held on June 22, 2006. On August 14, 2006, the parties, with the exception of the Office of the Public Counsel, filed post-hearing briefs.

Overview

Under Section 214(e)(1) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996, a telecommunications carrier may be designated as an eligible telecommunications carrier and thereby receive universal service support so long as the carrier, throughout its service areas: (a) offers the services that are supported by Federal universal service support mechanisms under Section 254(c) of the Act, either using its own facilities or a combination of its own facilities and resale of another carrier's services (including services offered by another ETC); and (b) advertises the availability of and charges for such services using media of general distribution.

Section 54.201(b) of the Code of Federal Regulations states that the Commission shall, on its own motion or upon request, designate a common carrier an ETC so long as the carrier meets the requirements of Section 54.201(d), which restates the requirements found in Section 214(e)(1) of the Act. Section 214(e)(2) of the Act and Section 54.201(c) of the Federal Communication Commission's rules state that the Commission may, in the case of an area served by a rural telephone company, and shall, in the case of all other areas, designate more than one

¹ Also known as a Cellular Geographic Service Area (CGSA).

² Application for Designation as an Eligible Telecommunications Carrier Pursuant to Section 254 of the Telecommunications Act of 1996, Appendix C.

common carrier as an ETC for a service area the Commission designates, provided each additional requesting carrier satisfies Section 214(e)(1) of the Act and Section 54.201(d) of the FCC's rules. Before designating an additional ETC for an area served by a rural telephone company, the Commission shall find that such designation is in the public interest.

The FCC set out additional requirements for the ETC designation process in its *Designation Order*.³ The requirements are that the applicant must:

- (1) Provide a five-year plan demonstrating how high-cost universal service support will be used to improve its coverage, service quality or capacity in every wire center for which it seeks designation and expects universal service support;
- (2) Demonstrate its ability to remain functional in emergency situations;
- (3) Demonstrate that it will satisfy consumer protection and service quality standards;
- (4) Offer local usage plans comparable to those offered by the incumbent local exchange carrier in the areas for which it seeks designation; and
- (5) Acknowledge that it may be required to provide equal access if all other ETCs in the designated area relinquish their designations pursuant to section 214(e)(4) of the Act.⁴

The FCC also set out the analytical framework that the FCC will use to determine whether the public interest would be served by granting the applicant an ETC designation. The state utility commissions were encouraged by the FCC to apply the same type of fact-specific analysis when determining whether the public interest would be served. The state commissions were encouraged to consider the benefits of increased consumer choice, and the unique advantages and disadvantages of the competitor's service offering.⁵

In addition, the Commission has set out its own rule regarding applications for ETC designation at 4 CSR 240-3.570. That rule became effective on June 30, 2006. The Commission's rule adopts the minimum requirements and the analytical framework suggested by the FCC in its *Designation Order* with a few additional requirements. The Commission's rule also only requires a two-year build-out plan.⁶ Thus, by analyzing MO5's compliance with the Commission's ETC rule, the

³ In the Matter of Federal-State Joint Board on Universal Service, Report and Order, CC Docket No. 96-45, (March 17, 2005).

⁴ Designation Order, para. 2.

⁵ Designation Order, para. 41.

⁶ 4 CSR 240-3.570(2)(A)2.

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Commission is assured that the applicant has met all the necessary qualifications for ETC designation.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The Commission in making this decision has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Missouri RSA No. 5 Partnership

MO5 is licensed by the FCC to provide commercial mobile radio service in the rural counties of Linn, Macon, Shelby, Randolph, Chariton, and Knox within the state of Missouri, under FCC Call Sign KNKN487.⁷ MO5 is a Missouri partnership owned by Chariton Valley Cellular RSA No. 2 Corporation (75%) and Grand River Communications, Inc. (25%). MO5 is not certificated to provide telecommunications services in Missouri by this Commission.

MO5 has requested ETC designation for the following wire centers: Laclede, Sumner, Mendon, Rothville, Atlanta, Bucklin, Bevier, Bosworth, Bynumville, Callao, Clifton Hill, De Witt, Ethel, Excello, Forest Green, Hale, Huntsville, Jacksonville, New Boston, New Cambria, Prairie Hill, Salisbury, Browning, Linneus, Meadville, Purdin, Bethel, Leonard, Winigan, Brunswick, Macon, Clarence, Dalton, Elmer, Hunnewell, Keytesville, La Plata, Shelbina, Shelbyville, Armstrong, Higbee, Clark, Moberly, Marceline, and Brookfield.

The Intervenors

All of the intervenor companies are incumbent local exchange companies (ILEC) that provide basic local and other telecommunications services in their respective service areas, as certificated by the Commission and pursuant to Commission approved tariffs. Each is a carrier of last resort and is an ETC providing service to the public throughout its respective service area. In addition, five other wireless carriers currently provide service in the area for which MO5 seeks ETC designation.⁸ No evidence was presented to show that any residents in the service areas of the incumbents are being denied access to the public switched network or service in the ILEC's service areas.

Service Offerings of MO5

MO5 produced the testimony of three witnesses regarding its service offerings. MO5 alleges that it provides all the required service offerings and no party contested that MO5 provides: voice-grade access to the public switched network; local usage;

⁷ Exhibit 1, Direct Testimony of Kathryn G. Zentgraf, p. 4.

⁸ Transcript p. 70.

dual tone multi-frequency signaling or its functional equivalent; single-party service or its functional equivalent; access to emergency services; and access to directory assistance. With regard to these services, the Commission finds that MO5 offers the core services and functions required by an ETC.

MO5 does not currently provide access to operator services but will provide such service if granted ETC status.⁹ MO5 does not currently provide toll limitation for qualifying low-income consumers because it does not currently have any such offerings. However, if granted ETC status, MO5 will offer toll-blocking to Lifeline and Link-Up customers.¹⁰ MO5 provides indirect access to one or more interexchange carriers through interconnection arrangements with interexchange carriers.¹¹ With regard to these services, the Commission finds that MO5 offers or will offer the core services and functions required by an ETC.

In addition, MO5 will advertise the availability of and charges for these core services, using media of general distribution. MO5 will also advertise the availability of Lifeline and Link-Up services to qualifying customers and take steps to comply with the advertising requirement in 47 U.S.C. § 254(c).¹²

Compliance with 4 CSR 240-3.570 – Uncontested Items

MO5 provided testimony showing that it complied with certain provisions of the Commission's ETC rule. No party contested the fact that MO5 provided construction plans with start and end dates,¹³ the populations affected by construction plans, its existing tower locations, and an estimated budget.¹⁴ There was no contest to MO5's allegations that it will: advertise the availability of its services and the charges for those services;¹⁵ provide Lifeline and Link-Up discounts and that it will advertise those discounts appropriately;¹⁶ provide equal access if necessary;¹⁷ and follow the Cellular Telecommunications and Internet Association's (CTIA) customer code.¹⁸ There was also no contest to the fact that MO5 has provided a plan outlining the method for handling unusual construction or installation charges.¹⁹ Therefore, the Commission finds that MO5 provides, or will provide if granted ETC status, these uncontested items as set out in 4 CSR 240-3.570.

⁹ Exhibit 2, Direct Testimony of James A. Simon, p. 4.

¹⁰ Ex. 2, p. 5.

¹¹ Ex. 2, p. 4.

¹² Ex. 2, p. 5-6.

¹³ CenturyTel argued that the plans were not sufficiently detailed. That argument is addressed in the discussion of 4 CSR 240-3.5702(A)1.

¹⁴ 4 CSR 240-3.570(2)(A)1.

¹⁵ 4 CSR 240-3.570(2)(A)6.

¹⁶ 4 CSR 240-3.570(2)(A)7.

¹⁷ 4 CSR 240-3.570(2)(A)9.

¹⁸ 4 CSR 240-3.570(2)(B).

¹⁹ 4 CSR 240-3.570(2)(C).

4 CSR 240-3.570(2)(A)1 – Intended Use of High-Cost Support

MO5 provided both written and oral testimony regarding the upgrades it intends to make to its system over the next five years. Included in its written testimony were Appendices D,²⁰ E,²¹ F,²² G,²³ H,²⁴ I,²⁵ M,²⁶ and N,²⁷ which were intended to comply with the requirements of 4 CSR 240-3.570(2)(A)1 for showing the intended use of high-cost support, including detailed descriptions of construction plans with start and end dates, populations affected by construction plans, existing tower site locations, and estimated budgets. Appendix M includes budget information and year-by-year proposals for spending the USF support if ETC designation is granted. Appendices E, F, G, H, I, and N show the current coverage and the proposed coverage after the implementation of a five-year plan. Appendices D and F show the population densities and changes.

MO5 first filed its application while the Commission was in the process of promulgating its ETC rule. It later supplemented its testimony in order to try to comply with the provisions of the new rule. Because the Commission's rule differs slightly from the FCC's requirements, MO5 submitted a five-year build-out plan, the FCC requirement, instead of the two-year plan required by the Commission's rules. Some of the ILECs argue that MO5 has failed to provide sufficient details of its build-out plan for the Commission to make a decision. While the Commission prefers to receive as much detail as possible in an ETC application, MO5 provides sufficient details for the Commission to determine the intended use of the USF support, the start and end dates of proposed construction, existing tower site locations, and the estimated budgets. The Commission finds that MO5 has provided these necessary requirements in sufficient detail.

4 CSR 240-3.570(2)(A)2 – Only USF Supportable Services

As stated above, MO5 filed a five-year plan instead of a two-year plan. The plan is supposed to show how the USF support will be spent and that it will only be used for USF supportable services. MO5 estimates receiving \$1,534,230 in universal service fund support annually if its application is granted.²⁸ Appendix M is intended to show how these funds will be spent.

²⁰ Ex. 5, Appendix D.

²¹ Ex. 5, Appendix E.

²² Ex. 2, Appendix F, and Ex. 5, Appendix F.

²³ Ex. 5, Appendix G.

²⁴ Ex. 5, Appendix H.

²⁵ Ex. 5, Appendix I.

²⁶ All references to "Appendix M" are to Exhibit 4, *Surrebuttal Testimony of James A. Simon*, Appendix M (Revised).

²⁷ Exhibit 6, Supplemental Direct Testimony of Jonathan D. Reeves, Appendix N.

²⁸ Exhibit 1, Direct Testimony of Kathryn G. Zentgraf, p. 16.

Included in each year of the budget is an expense for estimated depreciation and an expense for estimated taxes.²⁹ Staff makes a brief argument that it is not appropriate to use USF support to pay the taxes owed on that support or to pay depreciation expense. Mr. Simon testified that the estimated taxes may be overstated,³⁰ however, he believes that taxes are a supportable item.³¹ He also stated several times that MO5 would "build out the seventeen specified tower sites as quickly as possible given the level of funding available."³² Mr. Simon testified that there are sufficient contractors available for construction of towers as quickly as MO5 can arrange the construction. Mr. Simon stated that he would have no difficulty spending any amount of USF support received, even if it was greater than originally estimated.

The Commission finds that MO5's five-year plan was somewhat confusing. However, the Commission recognizes that this is a new process and that it may take several applications to get some clarity in the filings. The Commission finds Mr. Simon's commitment to spend USF monies on only supportable items to be credible. The Commission, however, concludes below that income tax and depreciation expenses are not USF supportable items. Therefore, the Commission shall direct MO5 not to spend its USF funds on those items.

The Commission further finds that because MO5 has committed to spending the USF support only on supportable items, and that MO5 intends to speed up the implementation of new cell towers and upgrades to meet any necessary expenditures for USF support, that MO5's five-year budget less the tax and depreciation expenses meets the requirements of the Commission's rule. The Commission will require MO5 to report those items to the Commission on an annual basis under the new ETC rule in order to receive certification for future years as an ETC.

At its annual certification, MO5 shall produce a budget which is clear and does not contain items which are not supportable, or which would have been made regardless of the USF support.

There was also some question as to whether MO5 provides access to interexchange services. MO5 provides indirect access to one or more interexchange carriers for access to any other exchanges.³³

4 CSR 240-3.570(2)(A)3 – Expenses Would Not Otherwise Occur

MO5 provided maps of the geographic coverage areas before and after its proposed improvements.³⁴ The maps were broken down on a wire center basis.

²⁹ Ex. 4, Appendix M (Revised).

³⁰ Tr. p. 194.

³¹ Tr. p. 127.

³² Post Hearing Brief of Missouri RSA No. 5 Partnership, p.8 (filed August 14, 2006)(citing Tr. p. 194-195).

³³ Ex. 2 p. 4.

³⁴ Ex. 6, Appendix N, and Ex. 5, Appendix I.

There were no wire centers that were determined to not need improvement.³⁵ AT&T Missouri argued that MO5 did not demonstrate any meaningful improvement in signal coverage in the six AT&T Missouri wire centers, or otherwise demonstrate how funding will be used to further the provision of supported services in that area.³⁶ Thus, AT&T Missouri argues that this exchange should be excluded from ETC designation.

MO5 provided the testimony of Jonathan D. Reeves to sponsor the map showing its current signal coverage.³⁷ MO5 also provided maps showing its signal coverage before and after the implementation of its proposed upgrades,³⁸ as well as the geographic locations of existing³⁹ and future⁴⁰ tower sites. Appendices F⁴¹ and M also show the projected start and end dates of proposed upgrades and improvements, the estimated populations that will be served by those improvements, and the estimated amount of investment for each project funded by high-cost USF support.

The coverage maps show current and predicted signal coverage at a basic level in green, and a lack of signal in white.⁴² The coverage maps could have been provided in more detail with regard to the signal strength as demonstrated by the Rebuttal Testimony of Glenn H. Brown.⁴³ The Commission, however, finds the evidence provided by MO5 to be sufficient to demonstrate how each of the wire centers will benefit from added coverage.

MO5 currently provides service using time division multiple access (TDMA) and has added global system of mobile communications (GSM) to its existing system. MO5 intends to use high-cost USF support to provide additional and enhanced GSM coverage in the rural-most portions of its service area.⁴⁴

The before and after improvements coverage maps show that each of the wire centers for which MO5 seeks ETC designation will benefit from the proposed upgrades.⁴⁵ Even in the areas where coverage is relatively good, there is some coverage improvement, such as gaps filled or additional signal overlay, by the upgrades and additional sites as proposed by MO5.⁴⁶ Thus, the Commission finds that MO5 has shown that it will provide improved coverage, service quality, or

³⁵ Ex. 3, p. 4.

³⁶ *AT&T Missouri's Post-Trial Brief*, p.91 (filed August 14, 2006).

³⁷ Ex. 6, Supplemental Direct Testimony of Jonathan D. Reeves, Appendix N.

³⁸ Ex. 5, Direct Testimony of Jonathan D. Reeves, Appendices H and I.

³⁹ Ex. 6, Appendix N.

⁴⁰ Ex. 5, Appendix G.

⁴¹ Ex. 5, Appendix F.

⁴² Tr. pp. 207, 213.

⁴³ Exhibit 11, Rebuttal Testimony of Glenn H. Brown, Schedule GHB-4HC.

⁴⁴ Ex. 1, p. 21; Ex. 5, Appendix E.

⁴⁵ Ex. 6, Appendix N, and Ex. 5, Appendix I.

⁴⁶ Tr. pp. 218-225.

capacity in each of the wire centers where ETC designation is requested, including the six AT&T Missouri wire centers.

Another significant issue is whether MO5 will be spending USF support on improvements that it would not have otherwise incurred without receiving USF support. As MO5 admits, Appendix M includes estimated income taxes based on the receipt of USF funds. MO5 also admits that the tax amounts on Appendix M are most likely an overestimation.⁴⁷ MO5 also admits that some of the capacity upgrades may be made regardless of USF funding if customer demand is present and capital funding is available.⁴⁸ As discussed above, however, Mr. Simon testified that MO5 will condense its five-year plan as necessary to be certain that it spends all of the USF monies it receives on supportable items.⁴⁹ Specifically, MO5 will build out the seventeen specified tower sites as quickly as possible to utilize all USF support received.⁵⁰ The Commission finds Mr. Simon's testimony to be credible.

If the five-year budget is collapsed, MO5 has shown sufficient upgrades even after subtracting estimated taxes and depreciation, to use the entire USF amount in the first two years of its plan. The Commission determines that it is reasonable to require as a condition of its ETC status that MO5 spend all of its USF support on upgrades and improvements and not on taxes or depreciation. Based on Mr. Simon's clarification and the condition that the Commission will place on the grant of ETC status, the Commission determines that MO5 has provided sufficient evidence showing how it intends to spend its expected USF support on the provision, maintenance, and upgrading of facilities and services other than those it would have made without USF support.

Mr. Simon also testified that MO5 will stop building new towers without USF support.⁵¹ The Commission further finds that the improvements would not be made without USF support.

4 CSR 240-3.570(2)(A)4 – Ability to Remain Functional in an Emergency

Mr. Simon testified about MO5's ability to remain functional in the event of an emergency. MO5 has a fully redundant network, with extensive battery backup and nine emergency generators. MO5's system is also configured to automatically reroute traffic around damaged facilities. In addition, MO5's switch is designed for additional overhead traffic to accommodate traffic spikes.⁵²

Only AT&T Missouri suggests that MO5's testimony on this point is insufficient.⁵³ Mr. Stidham suggests that MO5 has not provided sufficient detail about how the system is designed for the Commission to make a determination

⁴⁷ Tr. p. 194.

⁴⁸ Tr. pp. 130, 190.

⁴⁹ Tr. pp. 194-195..

⁵⁰ Post Hearing Brief of RSA No. 5 Partnership, p. 8, citing, Tr. pp. 194-195.

⁵¹ Tr. p. 130.

⁵² Ex. 3, p. 6.

⁵³ AT&T Missouri's Post-Trial Brief, pp. 5-6; Exhibit 15, Supplemental Rebuttal Testimony of James E. Stidham, Jr., pp. 6-7.

about emergency capabilities. Neither the Commission's Staff nor any other party objected to the sufficiency of this testimony. The Commission finds that the information provided is sufficiently detailed for it to make a decision regarding this element. The Commission further finds that MO5 has demonstrated its ability to remain functional in an emergency.

4 CSR 240-3.570(2)(A)5 – Public Interest

Granting MO5 an ETC designation will benefit the public by enabling MO5 to bring wireless service, including enhanced 911 (E911) and GSM technology, to many remote locales. The USF support will allow MO5 to compete to provide primary telephone service in remote areas thus increasing competition for basic local service in rural areas which is a benefit to the public interest.⁵⁴ In addition, Lifeline and Link-Up customers will have access to service that would otherwise be unavailable to them.

An ETC grant to MO5 will bring the benefits of advanced technology to the remote parts of MO5's service area. This includes better GSM coverage in areas which already have some coverage available. By providing these areas with GSM or better GSM coverage, MO5 is promoting the public interest of offering customers in rural areas similar services and technologies that are available in urban areas.

Using USF support, MO5 will also provide additional enhanced 911 coverage in the most rural areas. With wireless E911, wireless subscribers gain the added mobility of 911 service. Thus, a farmer on a tractor in the field may be able to call 911 in the case of an emergency where wireless 911 service is available. The ILECs argue that MO5 did not provide evidence that the other wireless carriers serving in MO5's service area do not already provide E911 service and, therefore, the Commission cannot determine that E911 service will be enhanced. The Commission finds, however, that even if other E911 service is available, there is some added benefit from having a redundant system with regard to the ability to actually make an E911 call.

The ETC designation will also bring the benefits of wireless service to the current Lifeline subscribers of the various ILECs.⁵⁵ Without USF support, MO5 will be unable to offer Lifeline discounts.⁵⁶ MO5's Lifeline plans would give qualifying consumers a \$1.75 monthly discount as well as a discount of \$6.50 per month from any of MO5's current plans. In addition, MO5 will offer two Lifeline-only plans.⁵⁷

To benefit from a \$1.75 discount, however, a low-income customer seeking only the Lifeline plan would need to pay for a handset and pay an activation fee of up to \$50 (a 50% discount is offered to Link-Up customers). Link Up eligible subscribers could pay these activation charges over a period not to exceed one year without interest.⁵⁸ Even though the wireless service is ultimately more expensive than the

⁵⁴ Ex. 2, pp. 13-14.

⁵⁵ Ex. 2, p. 6-8.

⁵⁶ Ex. 2 p. 8.

⁵⁷ Ex. 2, p.6.

⁵⁸ Ex. 2, p. 8.

ILEC's plan, the service received has additional features and benefits. An additional benefit to some Lifeline subscribers is an increased local calling scope. And finally, another benefit of granting the ETC designation is the mobility that wireless service provides.

The ILECs argue that the harm to the USF outweighs any benefits provided by the grant of ETC status. The grant of ETC status to MO5 would result in USF support in the amount of approximately \$1,534,230 annually. That represents approximately .037% of the total high-cost support received by all carriers from the USF.⁵⁹

The Commission finds that benefits to the public outweigh the potential detriments to the USF of granting ETC status.

4 CSR 240-3.570(2)(A)8 – Service Quality Standards

MO5 will comply with all the applicable consumer privacy protection standards as provided in 47 C.F.R. 64 Subpart U.⁶⁰ MO5 agreed to continue to abide by these standards.⁶¹ MO5 has also committed to complying with the CTIA Consumer Code. The CTIA's current Consumer Code for Wireless Service. Under the CTIA Consumer Code, wireless carriers agree to: (1) disclose rates and terms of service to customers; (2) make available maps showing where service is generally available; (3) provide contract terms to customers and confirm changes in service; (4) allow a trial period for new service; (5) provide specific disclosures in advertising; (6) separately identify carrier charges from taxes on billing statements; (7) provide customers the right to terminate service for changes to contract terms; (8) provide ready access to customer service; (9) promptly respond to consumer inquiries and complaints received from government agencies; and (10) abide by policies for protection of consumer privacy.⁶²

MO5, as a wireless carrier, is not subject to the same quality of service standards as traditional ILECs. However, subscribers to MO5's service are able to "test drive" the MO5 network without penalty to determine if service quality is acceptable.⁶³

4 CSR 240-3.570(2)(A)10 – Local Usage Plan Comparable to ILEC's Plan

MO5 does not serve the entire wire centers of Winigan and Bethel in the northern part of its service territory. Instead, MO5's license area only encompasses 16.8% of the potential customers in the Winigan exchange and less than 22% of the land area.⁶⁴ With regard to the Bethel exchange, MO5's licensed service area includes roughly 80%.⁶⁵ MO5's licensed service area includes the entire Leonard

⁵⁹ Ex. 1, p. 16.

⁶⁰ Ex. 3, p. 8.

⁶¹ Tr. p. 125.

⁶² Ex. 2, Appendix L.

⁶³ Ex. 3, pp. 8-10.

⁶⁴ Exhibit 13, Rebuttal Testimony of Robert C. Schoonmaker, p. 63.

⁶⁵ Ex. 5, Appendix A.

wire center. The Winigan wire center is the only wire center within MO5's requested ETC area in Northeast's ILEC territory. The Bethel and Leonard wire centers are the only wire centers within MO5's ETC area in Mark Twain's ILEC territory.

Northeast and Mark Twain each provide local calling to their customers throughout all of that company's wire centers. MO5 does not have any interconnection or roaming agreements to provide for the termination of traffic outside of its licensed service area.⁶⁶ Furthermore, MO5 is not licensed to provide resale of another wireless carrier's service and therefore, must keep its signal within its service territory to the best of its ability.⁶⁷ With regard to the Winigan wire center, MO5 admits that it would have difficulty serving customers outside its licensed service area and would have to report those to the Commission in its annual certification report.⁶⁸ MO5 did not demonstrate that it had the ability to provide a local calling plan equivalent to the local calling scope of the ILEC in the Bethel, Leonard, and Winigan wire centers.

MO5 currently offers several different calling plans. MO5 will continue to offer a wide selection of plans.⁶⁹ If designated as an ETC, MO5 intends to offer two local usage plans available only to Lifeline customers and one "ILEC-equivalent" plan available to any customer. These plans are designed to be comparable to that of the ILEC.⁷⁰ In addition, a Lifeline customer may apply the Lifeline discounts to any of MO5's calling plans.

The first of those plans will offer unlimited local calling and mobility in the area served by the subscriber's home cell site at a fixed monthly price of \$15.00 (\$6.75 per month after applying the local exchange service discount of \$1.75 and the federal line charge discount of \$6.50⁷¹). The subscriber's outbound local calling area will correspond to the traditional ILEC calling area for that subscriber's address. Calls could be originated by the MO5 Lifeline subscriber to any numbers within the ILEC exchange from any location within the subscriber's home cell site serving area. Calls could also be received within this area. The home cell site area will be defined to include coverage from all MO5 cell sites necessary to encompass the subscriber's entire corresponding ILEC exchange area. The plan would also include several vertical features, including call waiting, call forwarding, 3-way calling, caller ID, and voice mail, for no additional charge.⁷²

The second Lifeline-only plan will allow for unlimited inbound and outbound local calling and mobility through out the entire service area for which MO5 is designated as an ETC, for a flat \$20.00 (\$11.75 per month after applying the local exchange service discount of \$1.75 and the federal line charge discount of \$6.50⁷³).

⁶⁶ Tr. pp. 147-148.

⁶⁷ Tr. p. 145.

⁶⁸ Tr. p. 80.

⁶⁹ Ex. 2, p.6; Appendix J.

⁷⁰ Ex. 2, pp. 6-9.

⁷¹ The federal subscriber line charge is only \$5.25 for the non-rural AT&T Missouri exchanges.

⁷² Ex. 2, pp. 6-7.

⁷³ The federal subscriber line charge is only \$5.25 for the non-rural AT&T Missouri exchanges.

Subscribers of this plan will receive toll-free calling within the geographic area encompassing multiple telephone exchanges served by all local exchange carrier wire centers for which ETC designation is being sought. The plan will also include the same vertical features as listed above at no additional charge.⁷⁴

These Lifeline-only plans do not include roaming on other carriers' networks for routine calls. The plans will, however, allow for ubiquitous access to 911 for the MO5 Lifeline subscriber even in a roaming situation. MO5 is unable to provide either of these two plans without USF support.⁷⁵

MO5 will also offer discounts of 50% off of its \$50 activation fee to Link-Up subscribers along with a deferred schedule for payment of the charges accessed for commencing service. The consumer will not pay interest for a period of up to one year.⁷⁶ In addition, in order to initiate service a new Lifeline-only customer would have to pay the discounted activation fee and would need to purchase a wireless handset.

The "ILEC-equivalent" plan will offer the same features and services as the first Lifeline plan discussed above, but will be available to all MO5 subscribers at a price of \$15.00 per month.⁷⁷

MO5 is committed to continuing to offer its local usage plans and will attest to those plans being offered when it seeks its annual ETC certification with the Commission as required in 4 CSR 240-3.570(4).⁷⁸

MO5 provided Appendix K⁷⁹ to show how its local calling plan rate will compare with the rates of the ILECs. The total monthly charges for the ILECs, including the various surcharges and E911 taxes, range from \$13.70 for AT&T Missouri's Rate Group A to \$21.58 for Green Hills. Appendix K, however, does not show the ILEC charges after the applicable Lifeline discounts are applied. For instance, AT&T Missouri's Rate Group A rates, are only \$.15 before the applicable 911 and Relay Missouri charges, not \$13.60 as shown on Appendix K. Thus, MO5's Lifeline customers in the AT&T Rate Group A exchanges would pay \$8.00 as compared to \$.15 for AT&T customers.

While the MO5 rates are greater than those charged by the ILECs, the levels of services are not identical. Each of the current MO5 plans includes multiple vertical services. Adding the tariff rates for those features to the rates charged by the ILECs would result in substantially greater monthly rates. In addition, one of MO5's Lifeline plans will offer a larger calling scope than the ILEC, with the exception of the Bethel, Leonard, and Winigan exchanges. Furthermore, MO5's customers will have limited mobility, though there may be dead spots and the possibility of dropped calls which

⁷⁴ Ex. 2, pp. 7-8.

⁷⁵ Ex. 2, p. 8.

⁷⁶ Ex. 2, p. 8.

⁷⁷ Ex. 2, p. 8.

⁷⁸ Tr. pp. 125-126.

⁷⁹ Ex. 2, Appendix K.

is not expected with traditional landline service. Both ILEC basic local subscribers and MO5 Lifeline and Link-Up subscribers will have unlimited local calling.⁸⁰

Public Counsel argues that Lifeline customers should not be subject to credit checks unless they have a past unpaid account with the company.⁸¹ There was no indication in the record that MO5 will conduct a credit check as part of an application for Lifeline service. However, the Commission finds that such a requirement is not reasonable and as a condition of granting ETC status, MO5 shall not conduct a credit check on its Lifeline customers that do not have an unpaid account with the company.

Conclusions of Law

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

AT&T Missouri, Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, Mark Twain, Northeast, Spectra Communications Group, LLC, d/b/a CenturyTel, and CenturyTel of Missouri, LLC, are each a "telecommunications company" and a "public utility" as those terms are defined in Section 386.020, RSMo 2000, and are therefore fully subject to the regulatory jurisdiction of the Commission. Each of the companies is an incumbent local exchange carrier and has been designated as an ETC for purposes of receiving federal USF support.

Each of these companies, with the exception of AT&T Missouri and CenturyTel of Missouri, LLC, is a rural telephone company as defined by the Federal Telecommunications Act of 1996. AT&T Missouri and CenturyTel of Missouri, LLC, are non-rural telephone companies.

The commercial mobile radio service provided by MO5 is specifically excluded from the statutory definition of "telecommunications service."⁸² Thus, MO5 is not subject to the general regulatory jurisdiction of the Commission. Under the authority granted to the Commission by the FCC, MO5 has requested that the Commission designate it as an ETC for purposes of receiving federal universal service support.

Under the Commission's ETC rule, by applying for designation as an ETC, MO5 voluntarily subjects itself to the Commission's jurisdiction regarding ETC "status and USF funding and the acceptance of any additional rules made applicable to" ETCs.⁸³ MO5 admits that the Commission's rule should be applied in this case⁸⁴ and, therefore, MO5 is subject to the Commission's jurisdiction as set out in the ETC rule.

The purpose of the Universal Service Fund is to provide financial support to carriers that use the support to advance universal service principles. Before a carrier can receive support from the USF, the carrier must be designated as an ETC

⁸⁰ Ex. 2, pp. 6-8.

⁸¹ Exhibit 7, Rebuttal Testimony of Barbara Meisenheimer, p. 14.

⁸² Section 386.020(53)(c), RSMo.

⁸³ 4 CSR 240-3.570(4)(G).

⁸⁴ See, Issues List.

by the state commission with jurisdiction over the service area where the carrier seeks to apply its USF support.⁸⁵

The state commission must first confirm that the petitioning carrier offers the services that are supported by federal universal service support mechanisms under Section 254(c) of the Act.⁸⁶ Second, the state commission must confirm that the petitioning carrier advertises the availability of such services and charges using media of general distribution.⁸⁷ After making those determinations, the Commission must determine if the request is in the public interest.⁸⁸

The FCC issued an order setting forth additional guidance to be used in conjunction with a public interest finding for competitive ETC designations in areas served by rural telephone companies.⁸⁹ In addition, the FCC has issued an order in the *Highland* case⁹⁰ that helps define the public interest standard.

On March 17, 2005, the FCC issued a decision⁹¹ regarding how it will evaluate applications for ETC status, and recommending that the states use similar guidelines. Paragraph 41 of the *Report and Order* states:

41. In instances where the Commission has jurisdiction over an ETC applicant, the Commission in this Report and Order adopts the fact specific public interest analysis it has developed in prior orders. First, the Commission will consider a variety of factors in the overall ETC determination, including the benefits of increased consumer choice, and the unique advantages and disadvantages of the competitor's service offering. Second, in areas where an ETC applicant seeks designation below the study area level of a rural telephone company, the Commission also will conduct a cream skimming analysis that compares the population density of each wire center in which the ETC applicant seeks designation against that of the wire centers in the study area in which the ETC applicant does not seek designation. Based on this analysis, the Commission will deny designation if it concludes that the potential for cream skimming is contrary to the public interest. The Commission plans to use this analysis to review future ETC applications and strongly encourages state

⁸⁵ 47 U.S.C. § 214(e).

⁸⁶ 47 C.F.R. § 54.101.

⁸⁷ 47 U.S.C. § 214(e).

⁸⁸ 47 U.S.C. § 214(e)(2).

⁸⁹ In the Matter of Federal-State Joint Board on Universal Service, Highland Cellular, Inc., Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia, CC Docket No. 96-45, FCC 03-338 (rel. April 12, 2004).

⁹⁰ In the Matter of Federal-State Joint Board on Universal Service, Highland Cellular, Inc., Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia, CC Docket No. 96-45, FCC 03-338 (rel. April 12, 2004).

⁹¹ 1 Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC-05-46. Rel. March 17, 2005. ("*Report & Order*")

commissions to consider the same factors in their public interest reviews. *(footnotes omitted)*

The footnote to the “prior orders” the FCC references in the above paragraph refers to both the *Virginia Cellular Order*⁹² and the *Highland Cellular Order*.⁹³ The FCC wrote in paragraph 28 of the Virginia Cellular Order:

In considering whether designation of Virginia Cellular as an ETC will serve the public interest, we have considered whether the benefits of an additional ETC in the wire centers for which Virginia Cellular seeks designation outweigh any potential harms. We note that this balancing of benefits and costs is a fact-specific exercise. In determining whether designation of a competitive ETC in a rural telephone company's service area is in the public interest, we weigh the benefits of increased competitive choice, the impact of the designation on the universal service fund, the unique advantages and disadvantages of the competitor's service offering, any commitments made regarding quality of telephone service, and the competitive ETC's ability to satisfy its obligation to serve the designated service areas within a reasonable time frame. *(italics added)*

The same italicized phrase is contained in paragraph 22 of the *Highland Cellular Order*.

In addition, the carrier must meet the requirements of the Commission's rule governing ETC designations.⁹⁴ The Commission's rule largely incorporates the requirements set out by the FCC.

The Commission has found that MO5 offers the services that are supported by federal universal service support. The Commission has also found that MO5 advertises the availability of those services using media of general distribution. Thus, the Commission concludes that MO5 has met the requirements set out in Section 214(e)(1)(A) and (B).

4 CSR 240-3.570 – Uncontested Items

No party contested the fact that MO5 complied with portions of the ETC rule. Therefore, based on the uncontested facts, the Commission concludes that MO5 has complied with the following portions of the ETC rule: (1) providing the populations affected by construction plans, its existing tower locations, and an estimated budget;⁹⁵ (2) advertising the availability of its services and the charges for those services;⁹⁶ (3) providing Lifeline and Link-Up discounts and advertising those

⁹² FCC 03-338, CC Docket 96-45, Released January 22, 2004.

⁹³ FCC 04-37, CC Docket 96-45, Released April 12, 2004.

⁹⁴ 4 CSR 240-3.570.

⁹⁵ 4 CSR 240-3.570(2)(A)1.

⁹⁶ 4 CSR 240-3.570(2)(A)6.

discounts appropriately;⁹⁷ (4) providing equal access if necessary;⁹⁸ (5) following the CTIA's customer code;⁹⁹ and (6) providing a plan outlining the method for handling unusual construction or installation charges.¹⁰⁰ Therefore, the Commission concludes that MO5 provides, or will provide if granted ETC status, these uncontested items as set out in 4 CSR 240-3.570.

4 CSR 240-3.570(2)(A)1 – Intended Use of High-Cost Support

The Commission found that MO5 provided a sufficiently detailed plan for the Commission to make its decision. The Commission concludes that MO5 has provided a statement of intended use of its high-cost support including a detailed description of construction plans with start and end dates and estimated budget amounts. The Commission further concludes that MO5 shall, as a condition of its grant of ETC status, file a plan outlining more specifically, the proposed USF supportable upgrades for the first two years of USF support as further set out below. This condition is reasonable in that it will allow the Commission to more easily review the certification filings that MO5 will need to make on an annual basis.

4 CSR 240-3.570(2)(A)2 – Only USF Supportable Services

The Commission previously found that MO5's five-year budget in conjunction with Mr. Simon's testimony was sufficient for the Commission to make a decision regarding what services MO5 will provide using USF support. The Commission found that MO5 includes taxes and depreciation expenses in its proposed budget.

Section 254(e) of the Act states that "[a] carrier that receives such [USF] support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. No evidence was provided that income taxes or depreciation expenses are USF supportable items. Also, MO5 did not show that income tax and depreciation expenses are not the type of items that would not otherwise normally occur.¹⁰¹ The Commission concludes that income tax and depreciation expense are not USF supportable items.

The Commission has determined, however, that MO5 will spend the USF support on the provision, maintenance, and services that are supportable, such as new towers and upgrades, and MO5 has shown sufficient supportable items in its planned upgrades to meet this element. The Commission concludes that it is reasonable to condition the grant of ETC status on MO5 not using USF high-cost support for taxes or depreciation expenses.

The Commission, therefore, concludes that MO5 has met the requirement to show that high-cost support shall only be used for the provision, maintenance, and upgrading of facilities and services for which the support is intended in the Missouri service area for which it was granted. In addition, the Commission concludes that it

⁹⁷ 4 CSR 240-3.570(2)(A)7.

⁹⁸ 4 CSR 240-3.570(2)(A)9.

⁹⁹ 4 CSR 240-3.570(2)(B).

¹⁰⁰ 4 CSR 240-3.570(2)(C).

¹⁰¹ 4 CSR 240-3.570(2)(A)3.G.

is reasonable to require MO5, as a condition of the grant of ETC status, to provide a revised estimated budget showing only the USF supportable items for which it proposes to spend USF funds in the next two years.

Furthermore, the Commission concludes that under the ETC rule, failure to demonstrate "that high-cost support was used to improve coverage, service quality or capacity in the Missouri service area in which ETC designation was granted and that support was used in addition to any expenses the ETC would normally incur,"¹⁰² shall result in the Commission refusing to certify MO5 for USF support.¹⁰³

In addition, based on the facts above, the Commission concludes that MO5 is providing access to interexchange service.

4 CSR 240-3.570(2)(A)3 – Expenses Would Not Otherwise Occur

AT&T Missouri argued that MO5 did not demonstrate any meaningful improvement in signal coverage in its six wire centers, or otherwise demonstrate how funding will be used to further the provision of supported services in those areas. Thus, AT&T Missouri argues that these exchanges should be excluded from ETC designation. The Commission has found that the coverage maps provided by MO5 show sufficient detail for it to reach its decision in this matter. The maps were broken down on a wire center basis and the appendices to the various testimony included projected dates for the improvements as discussed above.

The Commission concludes that the evidence provided by MO5 demonstrates how each of the wire centers will benefit. The Commission also concludes that MO5 will provide improved coverage, service quality or capacity in each of the wire centers where ETC designation is requested, including the six AT&T Missouri wire centers.

MO5's Appendix M included budgets for unsupportable items and expenses that it would make regardless of the ETC designation. However, the testimony clarified that MO5 will make the USF supportable improvements as laid out in the five-year plan as necessary so that it spends funds on cell towers and services that it would not have otherwise spent without the USF funds. The Commission concludes, based on the remaining items in the five-year plan and the testimony, that MO5 intends to spend all its USF support on supportable services in the next two years and that the improvements would not be made without USF support.

As a condition of its ETC designation, the Commission will require MO5 to provide a new two-year budget which includes only items intended for USF support as specified in 4 CSR 240-3.570(2)(A)2.A that would not otherwise be made without USF support, and the Commission requires that USF support not be spent on taxes or depreciation as specified above.

4 CSR 240-3.570(2)(A)4 – Ability to Remain Functional in an Emergency

Only AT&T suggests that MO5's has not provided sufficient detail about how the system is designed for the Commission to make a determination about

¹⁰² 4 CSR 240-3.570(4)(D).

¹⁰³ 4 CSR 240-3.570(5)(E).

emergency capabilities. Neither the Commission's Staff nor any other party objected to the sufficiency of this testimony. Based on the evidence provided, including rerouting calls, redundant networks, the system not operating at capacity, and back-up generators, the Commission concludes that MO5 has demonstrated its ability to remain functional in an emergency.

4 CSR 240-3.570(2)(A)8 – Service Quality Standards

The Commission has found that MO5 will comply with all the applicable consumer privacy protection standards as provided in 47 C.F.R. 64 Subpart U.¹⁰⁴ Unlike the ILECs, MO5, as a wireless carrier, is not subject to the Commission's quality of service standards. However, MO5 has committed to complying with the CTIA Consumer Code and offers its customers a "test drive" of its service before a final commitment. MO5 will also be subject to the provisions of the Commission's ETC rule. Considering these facts, the Commission concludes that MO5 will satisfy consumer privacy protection standards as provided in 47 C.F.R. 64 Subpart U and any service quality standards that are applicable.

4 CSR 240-3.570(2)(A)10 – Local Usage Plan Comparable to ILEC's Plan

MO5 will offer local calling plans that are designed to be comparable to that of the ILEC. Each of the Lifeline plans and the "ILEC-equivalent" plan has unlimited local calling to a local calling scope that is at least as large as the ILEC, with the exception of the Bethel, Leonard, and Winigan exchanges. Although the MO5 Lifeline rates are more than those charged by the ILECs, the level of services is also increased. Each of the current MO5 plans includes multiple vertical services and some will offer a larger calling scope than the ILEC. Furthermore, MO5's customers will have limited mobility. While the offerings are not identical, the Commission concludes that MO5 offers a local usage plan that is comparable to those offered by the ILECs with the exception of the Bethel, Leonard, and Winigan exchanges.

The Commission further concludes that requiring a credit check of Lifeline customers who do not have unpaid accounts with the company is not a reasonable requirement. In order to protect Lifeline customers, the Commission finds that it is reasonable to condition the grant of ETC designation upon MO5 offering service to Lifeline customers without requiring a credit check.

4 CSR 240-3.570(2)(A)5 – Public Interest

Section 214(e)(2)¹⁰⁵ of the Act, as well as the FCC regulations,¹⁰⁶ and the Commission's rule¹⁰⁷ govern the designation of ETC status. Section 214(e)(2) of the Act states, in relevant part:

¹⁰⁴ Ex. 3, p. 8.

¹⁰⁵ 47 U.S.C. § 214(e)(2).

¹⁰⁶ 47 C.F.R. § 54.201, *et seq.*

¹⁰⁷ 4 CSR 240-3.570.

Upon request and consistent with the public interest, convenience and necessity, the State commission may, in the case of an area served by a rural telephone company, and shall, in the case of all other areas, designate more than one common carrier as an eligible telecommunications carrier for a service area designated by the State commission, so long as each additional requesting carrier meets the requirements of paragraph (1). Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission shall find that the designation is in the public interest.

The Commission's ETC rule also requires that the applicant for ETC designation demonstrate that the designation is in the public interest.¹⁰⁸ Thus, the Commission must determine if the designation of an additional ETC is in the public interest.

The FCC has found that an increase in competition is in the public interest. This is based on the fact that one of the main goals of the Telecommunications Act of 1996 was to increase competition. Thus, under the FCC's analysis, having MO5 designated as an ETC will have some benefit of increasing competitive choice. In the current case MO5 presented evidence showing increased competition in the form of new service offerings. The Commission concludes, based on the record before it, that there will be some benefit of increased competition by designating MO5 an ETC.

The second factor that the FCC considered is the impact on the Universal Service Fund. The impact on the fund of MO5's annual USF support of \$1,534,230 is not in and of itself a significant portion of the fund. The FCC acknowledged, however, that there were concerns about the overall impact of designating multiple carriers, including wireless, as ETCs.

The ILECs believe a stricter analysis should be done. The ILECs suggest that the Commission must look to the Universal Service Principles in Section 254(b) to determine the impact on the USF. The ILECs also believe that the USF will grow too rapidly with the addition of wireless companies. The Commission is also concerned with the rapid growth of the Universal Service Fund, and awaits further guidance from the FCC and the United States Congress on improvements to the USF. The Commission must, however, resolve the case before it. Based on the amount of the USF compared to this particular company's expected USF support, the Commission concludes that the impact of this specific ETC designation on the USF fund as a whole will be minimal.

The Commission has found that the advantages that MO5 will provide include mobility, access to emergency services, and an increased local calling scope for some customers. Disadvantages include such things as dead spots and dropped calls. Granting MO5 an ETC designation will benefit the public by enabling MO5 to bring wireless service, including E911 and GSM, to many remote locales and by increasing competition for primary telephone service in remote areas. In addition,

¹⁰⁸ 4 CSR 240-3.570(2)(A)(5).

Lifeline and Link-Up customers will have access to service that would otherwise be unavailable to them. The Commission concludes that the benefits to the public in rural Missouri of granting MO5 ETC status will outweigh the potential detriments to the USF fund.

Another disadvantage of wireless service is that the company is not subject to the mandatory quality of service standards with which the landline companies must comply. MO5 has committed to complying with the CTIA Consumer Code for Wireless Service and any applicable federal quality of service standards. Furthermore, the Commission has set out additional conditions in this order for the annual certification. In addition, enforcement of the Commission's ETC rule will ensure that the USF support is being used appropriately.

Finally, there was no evidence that suggested MO5 was currently unable to serve most of the areas where ETC designation is requested. However, MO5 did not demonstrate that it had the ability to provide a local calling plan equivalent to the local calling scope of the ILEC in the Bethel, Leonard, and Winigan wire centers. The ETC rule provides what the company must do to provide service if requested in an area where coverage does not exist. With regard to the Winigan exchange, MO5 admitted that it would most likely have to report to the Commission that it could not serve those customers outside of its service area if they requested service. The Commission concludes that because of the number of customers served relative to the number outside the service area, the fact that MO5 will not be able to serve those customers outside its service area, and that this is the only wire center of Northeast for which service is requested, it must exclude the Winigan wire center from MO5's designated ETC area.

With regard to the Leonard and Bethel wire centers, the entire Leonard wire center is in MO5's licensed service area. And, a majority of the Bethel wire center is in the service area. Furthermore, the proprietary information convinces the Commission that it is appropriate to include these wire centers in the ETC designated area. However, in order to provide a comparable local calling scope, as a condition of its ETC status, MO5 must provide a local calling scope for its Lifeline and "ILEC-equivalent" plans that is equal or greater than the calling scope of the ILEC.

Thus, the Commission concludes that MO5 has the ability to serve the entire ETC area with the exception of the Winigan exchange which is excluded.

Based on all the foregoing facts, the Commission concludes that the benefits to the public of granting MO5 ETC status outweigh the detriments of granting ETC status.

Conclusion

The Commission determines that the grant of ETC status to MO5 is in the public interest because MO5 has provided evidence to show that the public benefits from designating MO5 an ETC for USF purposes will outweigh the detriments of doing so. The Commission conditions this grant of ETC designation on the conditions set out above regarding filing of additional information, continued compliance with the Commission's ETC rule, not spending USF monies on income tax or depreciation expenses, and providing a local calling scope at least as large as the ILEC's local

MISSOURI RSA NO. 5 PARTNERSHIP

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calling scope. In addition, the Commission excludes from the ETC designation the Winigan wire center. If MO5 does not strictly abide by the Commission's ETC rule, especially the provisions requiring that funds be spent only on USF supportable services, the Commission shall not certify MO5 as an ETC on an annual basis and shall rescind this ETC designation.

MO5 has shown that it intends to bring additional services and technology to rural telecommunications customers within the state of Missouri. MO5 has further shown that by granting MO5 ETC status, these rural customers will have better signal coverage, enhanced 911 capabilities, and more competitive choices for telecommunications service.

MO5 has met its burden to show that a grant of ETC status in the requested wire centers, with the exception of the Winigan wire center, is "consistent with the public interest, convenience, and necessity." Therefore, the Commission shall grant MO5's application for ETC designation with the exceptions and conditions set out herein.

IT IS ORDERED THAT:

1. Missouri RSA No. 5 Partnership's application to be designated an eligible telecommunications carrier for federal universal service fund purposes is granted with the exception of the Winigan wire center conditioned on compliance with the items set out in ordered paragraphs 2-6 below.
2. Missouri RSA No. 5 Partnership shall file no later than September 26, 2006, a revised budget and build-out plan as specified in the body of this order which includes only items for which USF support is intended as set out in 4 CSR 240-3.570(2)(A)2.A and which would not have been made without USF support.
3. Missouri RSA No. 5 Partnership shall not use Universal Service Funds for income tax or depreciation expense.
4. Missouri RSA No. 5 Partnership shall strictly abide by the provisions of 4 CSR 240-3.570.
5. Missouri RSA No. 5 Partnership shall not require a credit check for Lifeline customers.
6. Missouri RSA No. 5 Partnership shall provide a local calling scope for Lifeline and its "ILEC-equivalent" plans that is equal to or greater than the local calling scope of the incumbent local exchange carrier.
7. All objections not ruled on are overruled and all motions not granted are denied.
8. This Report and Order shall become effective on October 1, 2006.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur and certify
compliance with the provisions of
Section 536.080, RSMo.

***NOTE:** The Commission, in an order issued on October 19, 2006, denied applications for rehearing in this case. See page 314 for another order in this case.

LACLEDE GAS COMPANY

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In the Matter of the Adequacy of Laclede Gas Company's Service Line Replacement Program and Leak Survey Procedures.

Case No. GO-99-155

Gas §10. The Commission granted the requests Staff made regarding Laclede Gas Company's direct-buried copper service line replacement program and the effectiveness of Laclede's leak survey procedures. The current requirements of the previously approved Stipulation and Agreement will be continued.

ORDER CONTINUING REQUIREMENTS OF UNANIMOUS STIPULATION AND AGREEMENT

Issue Date: February 7, 2006

Effective Date: February 17, 2006

Syllabus:

This order approves the Staff of the Commission's recommendation that the Commission continue the current requirements of the previously approved Stipulation and Agreement, with annual reporting from Staff to the Commission.

Background:

The Commission opened this case on October 30, 1998, as a general investigatory case to receive information relevant to the adequacy of Laclede Gas Company's direct-buried copper service line replacement program and the effectiveness of Laclede's leak survey procedures.¹ On February 18, 2000, Laclede, Staff and the Office of the Public Counsel filed a Unanimous Stipulation and Agreement. As part of the Agreement, Laclede agreed to submit annual reports to Staff detailing direct-buried copper service line renewals and relays² completed, and agreed to submit additional reports confirming the achievement of other milestones under the Agreement. The Agreement provided that after the third year of the program, Laclede and Staff would review the progress and results of the program to determine future relay/renewal plans, including the rate of such future actions, and potential modifications to survey techniques and other related matters. On May 18, 2000, the Commission issued an order approving the Unanimous Stipulation and Agreement.

On August 1, 2003, Staff filed its Three-Year Summary Report. Staff requested that the Commission continue the current requirements of the Unanimous Stipulation and Agreement, with annual reporting from Staff. Staff stated that the

¹ Staff's investigation into the Pralle Lane (Case No. GS-98-422) and Bergerac Drive (Case No. GS-98-423) natural gas incidents led to Staff filing, on October 14, 1998, a motion to open this case.

² As used in this order, the term "renewal" refers to a main to meter replacement of a service line and the term "relay" refers to the replacement of a specific segment of a service line.

requirements of the Copper Service Line Replacement Program reflect the overall goals of protecting the public, achieving a substantial number of replacements annually, using effective leak detection methods, and making timely repairs, while also being mindful of ratepayers' costs. Staff suggested that Laclede has met or exceeded the guidelines of the Stipulation and that the crucial goal of public safety is being maintained.

The Commission conducted a limited hearing on December 5, 2003.³ On March 5, 2004, the Commission issued its Report and Order, adopting Staff's recommendation that the Commission continue the current requirements of the previously approved Stipulation and Agreement with annual reporting from Staff.

Staff's August 29, 2005 Annual Report:

Staff filed its Annual Report on August 29, 2005. Staff states that it has completed an analysis of Laclede's copper service line replacements and bar-hole survey data. Based on its review, Staff recommends that the Commission continue the current requirements of the Stipulation and Agreement, with continued annual reporting from Staff. Staff's report contains the following specific recommendations.

1. Copper Service Line Replacements

During program year five (12 months ending March 1, 2005), Laclede completed a total of 8,420 direct buried copper service line replacements (main-to-meter). During the first five years of the program, Laclede has completed a total of 42,036 direct-buried copper service line replacements, which represents approximately 54 percent of the program's beginning total qualifying services. Through the end of program year five, Laclede has averaged 8,407 direct-buried copper service line replacements each year, which exceeds the Agreement's criteria of an annual replacement rate of 8,000 direct-buried copper service lines.

Staff believes that an aggressive annual replacement rate (i.e. ten percent annually), based upon priority, with increased frequencies of leak surveys, continues to be successful and, therefore, recommends that the annual requirement of 8,000 direct-buried copper service line replacements should be maintained at this time. The current results of the replacement program are a substantial reduction in the number of direct-buried copper service lines in the system and a reduced leakage rate in the lines that remain to be replaced.

2. Bar-hole Leak Surveys

Laclede conducted its 2005 bar-hole leak survey during the months of March - July, 2005. Laclede personnel conducted a bar-hole leak survey over 8,414 direct-buried copper service lines in Pressure Region 1 and conducted a bar-hole leak survey over 29,143 direct-buried copper service lines in Pressure Region II for a total of 37,557 direct-buried copper service line bar-hole leak surveys in 2005. A

³ The Commission indicated that the purpose of the hearing was to determine whether Staff's recommendations should be approved without the necessity for further hearings. The Commission also noted that if it does not approve Staff's recommendations, it would establish a procedural schedule.

total of 284 leaks were found during the 2005 bar-hole leak survey, which represents a 0.76 percent leak rate. As reported in Staff's September 2004 Annual Report, results from bar-hole leak surveys have shown a downward trend in the actual total number of new leaks discovered on copper service lines. Observations in the fifth year of Laclede's program indicate that this downward trend is continuing with the new leak rate of .076 percent, which is approximate 17.4 percent decrease from the leakage rates found during the 2004 leak survey.

While the bar-hole method for leak surveying demands more personnel time and effort, it is Staff's opinion that this method is far superior to other methods for detection of small leaks that previously might have gone undetected. Use of this superior method of leak detection, coupled with conducting the surveys on an annual basis, helps in achieving the program goals of early detection before the leak becomes hazardous and assists in prioritizing replacements. This guideline of the Agreement exceeds the Commission's minimum pipeline safety regulations that require three-year leak surveys on most residential service lines.

For these reasons, Staff recommends that Laclede continue to conduct an annual bar-hole leak survey of direct-buried copper service lines.

3. Leak Repairs

Expediting the removal of all leaks found during a bar-hole leak survey prior to conducting the subsequent year's bar-hole leak survey continues to enhance the downward trend in detected leaks during subsequent annual bar-hole leak surveys. In accordance with the Agreement, leaks detected during an annual bar-hole leak survey are required to be repaired within six months of discovery in Pressure Region I and within one year of discovery in Pressure Region II. Laclede continues to exceed the requirements in the Agreement by repairing Class 3 leaks in Pressure Region I within an average time of just under three months (down slightly from year 2004 of the program, further down from 3 to 4 months during the first 3 years of the program) from discovery and within an average time of just under seven months (down slightly from year 2004 of the program, further down from 7 to 9 months during the first 3 years of the program) from discovery in Pressure Region II. The guideline in the Agreement exceeds the Commission's minimum pipeline safety regulations that require Class 3 leaks to be monitored every 6 months until repaired (within 5 years of discovery).

All detected leaks, along with other historical information, are used in a prioritizing model for identifying replacement areas in a consistent manner and prioritizing the scheduling of these areas for replacement. Staff noted that it is critical that any upward trends in new leaks on replacement program pipelines be identified promptly, as upward trends can point to the need to refocus efforts to stiffen requirements to meet the program's goals and objectives.

Staff believes that timely repairs of observed leaks prior to the subsequent bar-hole leak survey provides better information to detect any upward trends in leakage rate totals. Therefore, Staff recommends that the requirements in the Agreement (calling for Class 3 leaks in Pressure Region I to be repaired within six months and Class 3 leaks in Pressure Region II to be repaired within one year) be continued.

Discussion:

The Commission has reviewed Staff's August 2005 Report and finds that Staff's recommendations are reasonable and in the public interest, and should be adopted. The Commission will therefore direct that Laclede shall continue to meet the current requirements of the Stipulation and Agreement, with continued annual reporting from Staff.

IT IS ORDERED THAT:

1. Staff's recommendation is approved. Until ordered otherwise, Laclede Gas Company shall continue to meet or exceed the current requirements of the Unanimous Stipulation and Agreement.
2. The Commission's Staff shall continue its annual reporting to the Commission until otherwise ordered. Staff's next annual report shall be filed no later than September 1, 2006, unless otherwise ordered.
3. This order shall become effective on February 17, 2006.

Murray and Appling, CC., concur
Davis, Chm., concurs, concurring opinion to follow
Gaw, C., dissents, dissenting opinion attached
Clayton, C., dissents, dissenting opinion to follow

Dale, Chief Regulatory Law Judge

***NOTE:** The Stipulation and Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

Dissenting Opinion of Commissioner Steve Gaw

I respectfully dissent from the Order Continuing Requirements of Unanimous Stipulation and Agreement issued by the majority in this proceeding. As previously stated, I continue to be concerned that Laclede has not been aggressive enough in its service line replacement program.

Concurring Opinion of Chairman Jeff Davis

I respectfully concur with the decision of the majority in this case and wish to address the concerns voiced by the dissent in this case.

Specifically, the dissent in this case would argue that Laclede should be replacing these lines more quickly than provided in the unanimous stipulation and agreement; however, had this decision been rejected, the unintended consequences would be further delay in the replacement of the copper lines. The Laclede Gas copper line replacement program is nearing the end of its sixth year and there are only four years left to go. Laclede Gas is ahead of schedule and, until someone presents a better plan or can show why the Commission should alter its path, we should follow the established course. In this case, the dissent offers no plan to

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accelerate the replacement program, no analysis as to whether such an accelerated replacement program is technically feasible and, most importantly, no plan to pay for it. In Case GR-2005-0284, the dissent voted against a 1% rate increase for Laclede Gas that was agreed to by all the parties, despite the fact that there was uncontested evidence that Laclede had invested an additional \$90 million in plant and incurred \$16 million dollars in operating expenses since 2002.¹ I share the dissent's concern about affordability, but have grave reservations about ignoring uncontested evidence in order to produce results that would make this Commission popular with the ratepayers of this state. Had the minority prevailed in that case, serious questions would be raised about Laclede's ability to recover prudently incurred capital costs, making it more difficult for Laclede to attract investment to accelerate construction projects like the one in question.

This Commission has a responsibility to make state government work for all parties, and we cannot let the fear of what might happen paralyze us to the point of inaction. We have a duty to govern. Governing requires leadership, and leadership requires a willingness to take a stand in order to advance the public interest, even though our decisions may not be popular or what an individual Commissioner would choose if he or she were acting alone.

¹ Affidavit of Stephen M. Rackers, filed Sept. 9, 2005, p.3, GR-2005-0284 (2005).

DISSENTING OPINION OF COMMISSIONER ROBERT M. CLAYTON III

This Commissioner respectfully dissents from the majority Report and Order continuing the copper line replacement program agreed to by Staff and the company. This Commissioner believes that additional scrutiny is necessary for a 6 year old program which has a direct impact on the safety of Laclede customers and employees. Unfortunately, the majority focuses on the lack of dissent to the replacement program rather than seeking new answers to vital questions about the safety and security of the Laclede distribution system. Since this Commission is not bound by prior Commission orders, it is appropriate for this Commission to ask tough questions of its Staff and of the Company.

While on its surface it appears that adequate progress is being made in the replacement of copper service lines, one must have the case background to understand the necessity of the program. Between 1985 and 1990, Staff filed three natural gas incident reports related to Laclede and all three incidents involved corrosion on copper service lines. It is believed that all three of these incidents resulted from de-icing salts corrosively attacking the copper service lines. In a 1991 settlement, Laclede agreed to follow a formal replacement program that included identification and replacement of direct-buried copper service lines in areas of known corrosive environments. Then in 1998, Staff investigated two explosions and resulting fires in Laclede's Case No. GO-99-155 service area. Staff determined that both incidents were caused by natural gas leaking from corroded sections of copper service lines.

As a result of these investigations, Staff opened this case in 1998 to investigate the adequacy of Laclede's direct-buried copper service line replacement program and the effectiveness of its leak survey procedures. Staff filed a Report on August 31, 1999, that summarizes the incidents in Laclede's service area as follows, "[s]ince November 1985-February 1999, six natural gas incidents involving corrosion on direct-buried copper service lines have resulted in the death of one man, significant bodily burns suffered by a grandmother and her grandson, structural damage to at least six properties, and loss of personal belongings." The danger these copper lines present is evident from the number of serious incidents in this service territory. In many areas of the state, copper lines have been completely removed due to the increased danger associated with their use. It is for these reasons that such lines are scheduled to be removed.

According to the Unanimous Stipulation and Agreement signed by Laclede, Staff and the Office of Public Counsel, Laclede is required, at a minimum, to continue following the guidelines of the agreement until completion of the entire program. Language exists in that agreement allowing for modification of the program if so ordered by the Commission. Allowing the Commissioners time to thoroughly review the filings in the case and ask questions of the parties at an Agenda meeting before a vote to continue this copper line replacement program is within the framework of the Stipulation. The Stipulation does not prohibit updating the program or improving it when necessary. It is incumbent on the commissioners to ensure that the program as it was created in 2000 is appropriate today. When

Commissioners raise issues or concerns with a stipulation, it is up to the Staff to make suggestions or proposals. Some have suggested that if Commissioners have concerns with the program, Commissioners should offer specific plans for improvement. When this Commission is permitted to fill its unused Pool Advisory technical staff, Commissioners will be in a position to make those specific recommendations. Until then, the Commission is dependent on the recommendations of Staff.

Additionally, circumstances have changed since this program was implemented in 2000. The legislature has seen fit to authorize the creation of new surcharges which enable the company to charge the ratepayers more for service, and to collect the revenue sooner in time. One surcharge called the Infrastructure System Replacement Surcharge (ISRS) was approved in 2003 and has been applied in several cases. In 2005, two new surcharges were authorized by the General Assembly. Gas companies will be able to apply for surcharges to replace revenue lost from customer conservation and fluctuations in weather. Additionally, gas companies will be able to apply for a surcharge for mandated environmental costs imposed by federal or state regulators. Formerly, each of these costs were part of a normal, traditional rate case, but will now ride separately over and above base rates. The ISRS is specifically designed for this type of infrastructure improvement.

This Commissioner believes that because of the assessment of three new surcharges available to the gas company, the utility should be held to a higher standard when it comes to safety. This Commission should do its own analysis rather than rely on potentially outdated work that began in 1998. The people of this state deserve a Commission willing to improve the performance of its utilities rather than simply grant them additional revenue opportunities without improving service to ratepayers. Leadership is finding improved solutions to problems; not simply rubber stamping another Commission's work.

For the foregoing reasons, this Commissioner dissents.

**Director of the Manufactured Housing and Modular Units Program of the
Public Service Commission, Complainant, v. A&G Commercial Trucking, Inc.,
Respondent.**

Case No. MC-2004-0078

Manufactured Housing §2. The Commission approved the Stipulation and Agreement entered into between the Director of the Manufactured Housing and Modular Units Program of the Public Service Commission ("Director") and A&G Commercial Trucking, Inc. with regard to the Director's August 5, 2003 Complaint against A&G, which alleged that A&G had offered four manufactured homes it owned for sale at retail while not being registered with the Public

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Service Commission as a manufactured home dealer, as is required by law. Other allegations were included as well.

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: October 17, 2006

Effective Date: October 17, 2006

Syllabus: This order approves the Stipulation and Agreement entered into between the Director of the Manufactured Housing and Modular Units Program of the Public Service Commission ("Director") and A & G Commercial Trucking, Inc. ("A & G") with regard to the Director's August 5, 2003 Complaint against A & G.

Background

A & G is a Missouri corporation, with its principal place of business at 111 Eastside Drive, Ashland, Missouri. A & G is owned by Greg DeLine, Kelly DeLine, and Rose Grant, with Greg DeLine serving as the corporation's president. On August 5, 2003, the Director filed a Complaint against A & G alleging that A & G offered four manufactured homes it owned for sale at retail while not being registered with the Missouri Public Service Commission ("Commission") as a manufactured home dealer, as required by law.

Additional allegations included the improper removal of restrictive sale notices (known as "red tags") on the four homes without authorization by the Director, and the sale of two of those homes, which did not comply with the code and did not bear the proper seal. The Director requested that the Commission find that A & G violated the provisions of sections 700.015, 700.090, and 700.045, RSMo 2000, and authorize the Director to seek civil penalties pursuant to Section 700.115.¹ After the Director filed its complaint, it discovered that three additional homes had been sold under the same circumstances as the four named in the complaint. The sales of all seven homes are the subject homes to this dispute.

The parties submitted the case to mediation and executed a Stipulation and Agreement that the Commission rejected on May 25, 2004, stating that "it would not be appropriate to approve a settlement, which encourages A & G to function as a dealer of manufactured homes." The case was set for an evidentiary hearing to be held on June 1, 2004; however, the Cole County Circuit Court issued a writ of prohibition barring the Commission from conducting the hearing. Ultimately, the writ was appealed to the Missouri Supreme Court, and after remand, the circuit court dismissed the writ returning jurisdiction of this matter to the Commission.

On September 29, 2006, the Director and A & G executed and filed with the Commission another Stipulation and Agreement ("Agreement") to resolve all issues in this case.

The Agreement

The signatories to the Stipulation and Agreement agreed on the following:

¹ All statutory citations are to RSMo 2000, unless otherwise noted.

A & G shall remedy any defects existing in the four manufactured homes the Director identified in the Complaint and any defects that remain in the three other homes that A & G sold. The Director will inspect these homes, upon consent of the owners, to confirm that the defects have been repaired, and will issue a Housing and Urban Development ("HUD") label, if appropriate. A & G shall reimburse the Director for any costs associated with these inspections.

Should A & G ever desire to sell any new or used manufactured home for the purpose of habitation it must first notify the Director allowing the Director to inspect the home, and then must comply with any corrective action ordered by the Director to bring the home into compliance with the HUD code prior to selling any home at retail. A & G shall again reimburse the Director for the cost of the inspections.

A & G, so long as Greg DeLine owns an interest in A & G, shall not act as a dealer of manufactured homes, and will not seek registration as a dealer of manufactured homes pursuant to Chapter 700.4 .

A & G shall pay a civil penalty in the amount of \$14,000 to the school fund.

Staff's Memorandum in Support

In its Memorandum in support of the Agreement, filed on October 2, 2006, the Director notes that Section 700.115 authorizes the circuit court to impose penalties of up to \$1,000 for each violation of Chapter 700. In the Agreement, A & G has agreed to pay a civil penalty in the amount of \$14,000, resulting in penalties averaging \$2,000 for each of the seven homes at issue. The Director believes this is a substantial penalty, serving as a deterrent to future misconduct by A & G or by others who are similarly situated. While the penalty per home exceeds the amount sanctioned in Section 700.115, the Director believes that a circuit court would be authorized to impose this penalty if it found that A & G had committed more than one violation per home.

The Director also states that its principal objective in negotiating this Agreement was to ensure that the disputed homes that A & G sold were brought into compliance with the HUD code and other regulatory standards and that the homes are safe and suitable for habitation. The Agreement gives the home owners the opportunity to receive such assurances and to remedy any existing defects in their homes at no cost to the homeowner. A & G will bear all costs of inspection and of any necessary corrective work.

A & G would also not be permitted to register with the Commission as a manufactured housing dealer. Under current law, however, A & G may sell used

manufactured homes and up to three new manufactured homes without registering as a dealer. The Agreement requires A & G to notify the Director prior to selling any home and allows the Director or a third party to inspect the home and identify any corrective action needed to bring the home into compliance with the HUD code. A & G would then have to bring the home up to code and allow a reinspection of the home prior to any sale. The Director would issue a HUD label for the home, if appropriate. The Director believes that these provisions provide a strong deterrent to prevent A & G and its affiliates from selling manufactured homes that do not comply with the code.

While neither A & G nor Mr. DeLine admits any liability to another party nor to any third party, it does admit, in Paragraph 9 of the Agreement, that it violated three provisions of the Manufactured Housing Law, specifically sections 700.015, 700.090, and 700.045. The Commission has not yet had an opportunity to determine whether A & G had violated any of these statutes. The Director points out, however, that except for the imposition of a civil penalty, this acknowledgment is the only relief that the Director sought in this case. The Director believes that the Agreement achieves all of its objectives without the risk and expense of additional litigation.

Discussion

The Commission has jurisdiction over manufactured home manufacturers and dealers pursuant to Chapter 700, RSMo. By Commission Rule 4 CSR 240-120.031, the Commission delegated to the Director all of its powers pertaining to manufactured homes under Chapter 700, RSMo, "except the powers to revoke, deny, refuse to renew or place on probation a registration under section 700.090, RSMo," which are retained by the Commission.

The Commission has the legal authority to accept a stipulation and agreement to resolve a case.² The Commission notes that "[e]very decision and order in a contested case shall be in writing and, except in default cases or cases disposed of by stipulation, consent order or agreed settlement . . . shall include . . . findings of fact and conclusions of law."³ Consequently, the Commission need not make findings of fact or conclusions of law in this order. Additionally, any requirement for a hearing is met when the opportunity for hearing has been provided and no proper party has requested the opportunity to present evidence.⁴ No party has requested a hearing in this case, and the Commission may grant the relief requested based on the Stipulation and Agreement.

If no party objects to a stipulation and agreement, the Commission may treat the Agreement as being unanimous.⁵ The Director and Greg DeLine, the president of A & G, have both signed the Agreement. Although the Office of the Public

² See Section 536.060, RSMo 2000.

³ Section 536.090, RSMo 2000.

⁴ State ex rel. Rex Deffenderfer Enterprises, Inc. v. Public Service Commission, 776 S.W.2d 494, 496 (Mo. App. 1989).

⁵ 4 CSR 240-20115(2)(C).

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Counsel is a party to this action, it has not filed anything in this matter or participated in any way. Pursuant to Commission Rule 4 CSR 240-2.115(2)(C) "if no party timely objects to a nonunanimous stipulation and agreement, the commission may treat the nonunanimous stipulation and agreement as a unanimous stipulation." Commission Rule 4 CSR 240-2.115(2)(B) allows each party seven days to file an objection to a nonunanimous stipulation and agreement. Because all parties have either signed the Agreement filed on September 29, 2006, or have not opposed the Agreement within the time period allowed, the Commission will treat the Agreement as unanimous.

Conclusion

The Commission has reviewed the Stipulation and Agreement, and the Director's memorandum in support of the Stipulation and Agreement, and having considered these verified pleadings, which are admitted into evidence, finds that the resolution of the Director's complaint by the terms of the Agreement is not detrimental to the public interest and shall be approved. Furthermore, no party objects to the Stipulation and Agreement. Therefore, under Commission Rule 4 CSR 240-2.115(2)(C), the Commission will treat it as unanimous.

IT IS ORDERED THAT:

1. The Unanimous Stipulation and Agreement filed by the signatories in this matter is approved.
2. A & G Commercial Trucking, Inc., shall comply with the terms and conditions contained in the Stipulation and Agreement.
3. This order shall become effective on October 17, 2006.
4. This case may be closed on October 18, 2006.

Davis, Chm., Murray, Gaw, Clayton and Appling, CC., concur

Stearley, Regulatory Law Judge

***NOTE:** The Stipulation and Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

Director of the Manufactured Housing and Modular Units Program of the Public Service Commission, Complainant v. Amega Sales, Inc., Respondent.

Case No. MC-2004-0079

Manufactured Housing §2. The Commission approved the Stipulation and Agreement entered into between the Director of the Manufactured Housing and Modular Units Program of the Public Service Commission ("Director") and Amega Sales, Inc with regard to the Director's August 5, 2003 Complaint against Amega, which alleged that Amega had improperly sold a 2000 Skyline Corporation manufactured home located on its sales lot in Ashland, Missouri. Prior to this, the Director had placed a prohibitive sale notice on this particular manufactured home and informed Amega that the home could not be sold as a new manufactured home.

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: October 17, 2006

Effective Date: October 17, 2006

Syllabus: This order approves the Stipulation and Agreement entered into between the Director of the Manufactured Housing and Modular Units Program of the Public Service Commission ("Director") and Amega Sales, Inc. ("Amega") with regard to the Director's August 5, 2003 Complaint against Amega.

Background

Amega is a Missouri corporation, with its principal place of business located at 111 Eastside Drive, Ashland, Missouri. Amega is owned by Greg DeLine, Kelly DeLine, and Rose Grant, with Greg DeLine serving as the corporation's president.

On August 5, 2003, the Director filed a Complaint against Amega alleging that it had improperly sold a 2000 Skyline Corporation manufactured home located on its sales lot in Ashland, Missouri. Prior to this sale, the Director had placed a prohibitive sale notice on this particular manufactured home and informed Amega that the home could not be sold as a new manufactured home. Despite the Director's pre-sale determination, Amega sold the home to Don Higginbotham as a new home for habitation in violation of the prohibitive sale notice. The Director requested that the Commission find that Amega had violated provisions of Chapters 700 and 407, RSMo, and that the Commission suspend Amega's registration and authorize the Director to seek civil penalties in circuit court.

The parties submitted the case to mediation, executed a Stipulation and Agreement and filed it with the Commission on March 19, 2004. The Commission never approved or rejected the Stipulation and Agreement, but instead scheduled a bifurcated hearing. The Commission conducted the first phase of the evidentiary hearing, and on September 2, 2004, issued a Report and Order where it found that Amega violated Section 700.045 by selling a home without a seal and that Amega violated Section 407.020 by misrepresenting to Mr. Higginbotham that the home he purchased was a new home.

The Cole County Circuit Court issued a writ of prohibition barring the Commission from conducting the second phase of the evidentiary hearing.

Ultimately, the writ was appealed to the Missouri Supreme Court, and after remand, the circuit court dismissed the writ returning jurisdiction of this matter to the Commission.

On September 29, 2006, the Director and Amega executed, and filed with the Commission, another Stipulation and Agreement ("Agreement") to resolve all issues in this case.

The Agreement

The signatories to the Stipulation and Agreement agreed on the following:

Amega shall pay a civil penalty in the amount of \$10,000 to the school fund for the violations that were the subject of the Commission's September 2, 2004 Report and Order.

Amega shall suspend all sales activity at its sales lot in Ashland, Missouri, for a period of twenty days. Amega may not have contact with potential customers on the Ashland lot during this time period and is prohibited from steering potential customers to other sales lots owned or maintained by Greg Deline, Amega's principal owner, or owned or maintained by any of Amega's affiliates.

Amega and its affiliates are prohibited from selling any manufactured home that does not have a Housing and Urban Development (HUD) data plate or label or modular seal, as is required by law. Amega must notify the Director any time it receives title to any manufactured home that does not have the required data plate or seal for the home to be resold.

Amega shall pay a civil penalty in the amount of \$10,000 for any future violation where Amega or one of its affiliates sells any manufactured home lacking a Housing and Urban Development (HUD) data plate or label or modular seal, as is required by law.

Staff's Memorandum in Support

On October 2, 2006, the Director filed its "Suggestions in Support of Stipulation and Agreement." In its suggestions, the Director states that the Agreement essentially puts the Ashland lot out of business for a period of 20 days, and that Amega "will not only lose the profits that it would have realized from sales for most of a month, but will also be prevented from the activity that might lead to sales after the suspension period ends."

Amega must advertise the suspension by placing a prominent sign at the main front entrance to the Ashland lot serving to prevent customers from coming onto the lot in violation of the Agreement and warn them that they may not do business with Amega during the suspension period. This sign will also advertise the suspension to members of the general public who happen to pass by the sales lot, thereby serving

a valuable public relations function. By the terms of the Agreement, Amega will not be able to steer any business from the Ashland lot to other lots owned or maintained by Amega and its affiliates.

The Director notes that its Complaint pertained only to the two violations associated with Amega's sale of the 2000 Skyline Corporation manufactured home to Mr. Higginbotham. In addition to the civil penalty that will be imposed by the terms of the Agreement for that inappropriate sale, Mr. Higginbotham, the customer who bought the subject manufactured home, has settled his claim against Amega whereby Amega provided a payment of \$38,321.63 to Mr. Higginbotham in full satisfaction of his claims. Mr. Higginbotham testified in the hearing in this case that he was satisfied with this settlement and there is no unresolved civil litigation as a result of the subject transaction.

The Director further states that while Amega's agreement, not to sell or convey any manufactured home that is "red tagged" at the time of the sale and not to sell any new manufactured home lacking the proper HUD labels and certificates, does not require Amega to do more than the law already requires, that the agreed upon future penalty for improper sales in the amount of \$10,000 per occurrence should serve as a strong deterrent to prevent Amega and its affiliates from selling manufactured homes that do not comply with the code. This penalty is far more than the \$1000 per violation penalty authorized by Section 700.115.

While Amega does not acknowledge or admit liability under the terms of the Agreement, the Agreement does provide that Amega will not seek judicial review or otherwise challenge the findings of fact or conclusions of law that are included in the Report and Order that the Commission issued in this case on September 2, 2004.

Discussion

The Commission has jurisdiction over manufactured home manufacturers and dealers pursuant to Chapter 700, RSMo. By Commission Rule 4 CSR 240-120.031, the Commission delegated to the Director all of its powers pertaining to manufactured homes under Chapter 700, RSMo, "except the powers to revoke, deny, refuse to renew or place on probation a registration under section 700.090, RSMo," which are retained by the Commission.

The Commission has the legal authority to accept a stipulation and agreement to resolve a case.¹ The Commission notes that "[e]very decision and order in a contested case shall be in writing and, except in default cases or cases disposed of by stipulation, consent order or agreed settlement . . . shall include . . . findings of fact and conclusions of law."² Consequently, the Commission need not make findings of fact or conclusions of law in this order.

If no party objects to a stipulation and agreement, the Commission may treat the Agreement as unanimous.³ The Director and Greg DeLine, the president of Amega, have both signed the Agreement. Although the Office of the Public Counsel

¹ See Section 536.060, RSMo 2000.

² Section 536.090, RSMo 2000.

³ 4 CSR 240-20115(2)(C).

is a party to this action, it has not filed anything in this matter or participated in any way. Pursuant to Commission Rule 4 CSR 240-2.115(2)(C) "if no party timely objects to a nonunanimous stipulation and agreement, the commission may treat the nonunanimous stipulation and agreement as a unanimous stipulation." Commission Rule 4 CSR 240-2.115(2)(B) allows each party seven days to file an objection to a nonunanimous stipulation and agreement. Because all parties have either signed the Agreement filed on September 29, 2006, or have not opposed the Agreement within the time period allowed, the Commission will treat the Agreement as unanimous.

Conclusion

The Commission has reviewed the Stipulation and Agreement, and the Director's memorandum in support of the Stipulation and Agreement, and having considered these verified pleadings, which are admitted into evidence, finds that the resolution of the Director's Complaint by the terms of the Agreement is not detrimental to the public interest and shall be approved. Furthermore, no party objects to the Stipulation and Agreement. Therefore, under Commission Rule 4 CSR 240-2.115(2)(C), the Commission will treat it as unanimous.

IT IS ORDERED THAT:

1. The Unanimous Stipulation and Agreement filed by the signatories in this matter is approved.
2. Amega Sales, Inc., shall comply with the terms and conditions contained in the Stipulation and Agreement.
3. This order shall become effective on October 17, 2006.
4. This case may be closed on October 18, 2006.

Davis, Chm., Murray, Gaw, Clayton and Appling, CC., concur

Stearley, Regulatory Law Judge

In the Matter of the Application of Aquila, Inc., for Permission and Approval and a Certificate of Public Convenience and Necessity Authorizing it to Acquire, Construct, Install, Own, Operate, Maintain, and Otherwise Control and Manage Electrical Distribution Substation and Related Facilities in Kansas City, Jackson County, Missouri (Near the City of Raymore).

Case No. EA-2006-0499

Electric §3. The Commission approved the Stipulation and Agreement and granted Aquila, Inc., a certificate of convenience or necessity to Acquire, construct, install, own, operate, and maintain a distribution substation and related facilities in Jackson County, near the city of Raymore.

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: October 19, 2006

Effective Date: October 29, 2006

Procedural History

On June 23, 2006, Aquila, Inc. filed an application with the Missouri Public Service Commission requesting a certificate of convenience and necessity as described in the caption of this order. On August 15, Kansas City Power & Light Company was granted its request to intervene. Although Aquila also filed a motion for expedited treatment, the process was stalled in order to allow the parties and opportunity to reach an agreement, which is now before the Commission. Although it did not join in the Agreement, KCPL filed a notice informing the Commission that KCPL does not oppose the Agreement. The Stipulation and Agreement was filed on October 10, as was KCPL's notice.

The Stipulation and Agreement

The parties agree that in Case No. 9470, the Commission granted authority to Aquila's predecessors-in-interest to construct and operate electric facilities, transmission lines and distribution systems throughout portions of Jackson County, Missouri. The parties further agree that the area in which Aquila proposes to construct its substation is within its certificated area. The estimated cost of the project is \$2.9 million, which will be funded by cash or credit. The parties finally agree that the substation will promote public convenience or necessity for customers in both Jackson and Cass Counties.

Precedential impact of *StopAquila.org v. Aquila, Inc.*¹

The parties agree that under case law, prior to the *StopAquila.org v. Aquila, Inc.* case, utility companies such as Aquila and KCPL could construct and operate a substation within its service territory without approval from the Commission. This conclusion rests on the premise that if the Commission has granted to the company

¹ *StopAquila.org v. Aquila, Inc.*, 180 S.W.3d 24 (Mo. App. W.D. 2005).

a certificate of convenience or necessity to operate in a particular service area, then the subsequent granting of such authority to build a substation in that same area would be redundant. However, since *StopAquila.org v. Aquila, Inc.*, Aquila has taken the position that Commission authority is now necessary for Aquila to build a substation in its service area.

Staff, OPC and KCPL do not believe the courts most recent ruling requires Aquila to obtain Commission approval prior to building the substation. However, because of the necessity for expedited construction of the substation due to imminent increased demand, the parties agree that the Commission should grant the requested authority to Aquila. In this regard, the parties agree that by granting the requested certificate, the Commission is not establishing a regulatory policy or precedent but is rather responding to the specific facts of this case.

Discussion

Under Section 393.170.1, RSMo 2000, electric corporations are required to obtain Commission approval prior to constructing an electric plant. In light of *StopAquila.org*, the parties agree that there is uncertainty as to whether Aquila, by previous order of the Commission, presently has the authority to build the substation. However, no party takes issue with this uncertainty. Rather, the parties agree that the Commission should grant the requested authority regardless of how Missouri courts may resolve this issue. Because the parties have not presented this issue to the Commission for resolution, the Commission need not answer that legal question.

The Commission recognizes that if Aquila need not request authority to build the substation, then granting the authority would at worst simply be redundant. However, if on the other hand, Aquila does need to requested authority from the Commission to build the substation, then the Commission must determine whether construction of the substation is necessary or convenient for the public service. The parties have stipulated that construction of the proposed substation is necessary in order for Aquila to meet expected demand.

Conclusion

The Commission has the legal authority to accept a stipulation and agreement as offered by the parties as a resolution of issues raised in this case.² The Commission notes that every decision and order in a contested case shall be in writing and, except in default cases or cases disposed of by stipulation, consent order or agreed settlement, shall include findings of fact and conclusions of law.³ Consequently, the Commission need not make findings of fact or conclusions of law in this order.

Commission rule 4 CSR 240-2.115 (2)(C) states that if no party objects to the Stipulation and Agreement, the Commission may treat the agreement as

² Section 536.060, RSMo 2000.

³ Section 536.090, RSMo 2000.

unanimous. Because KCPL has indicated that it does not oppose the agreement, the Commission will treat the agreement as unanimous.

The Commission has reviewed the facts of this case and the Stipulation and Agreement and finds that the agreement is reasonable. The Commission will therefore approve the agreement, direct that the parties to the agreement comply with its terms and, finding that it is necessary for the public interest, will grant Aquila a certificate of convenience or necessity to construct and operate the proposed substation.

IT IS ORDERED THAT

1. The Stipulation and Agreement between Aquila, Inc., the Staff of the Commission and the Office of the Public Counsel is approved.
2. The parties to the agreement shall abide by its terms.
3. Aquila, Inc. is granted a certificate of convenience or necessity to Acquire, construct, install, own, operate and maintain a distribution substation and related facilities in Jackson County, near the City of Raymore, as more fully described in the Stipulation and Agreement.
4. This order shall become effective on October 29, 2006.
5. This case may be closed on October 30, 2006.

Davis, Chm., Murray, and Appling, CC., concur.
Gaw C., dissents, with separate dissenting
opinion to follow.
Clayton, C, dissents.

Jones, Senior Regulatory Law Judge

NOTE: The Stipulation and Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

**DISSENTING OPINION OF COMMISSIONERS
ROBERT M. CLAYTON III AND STEVE GAW**

The applications filed by Aquila asked for a Certificate of Public Convenience and Necessity to construct, own, operate and manage an electrical distribution substation in Kansas City, Missouri in case number EA-2006-0499, and an electrical transmission substation near Osceola, Missouri in St. Clair County in case number EA-2006-0500. It appears from the record that no zoning requirements exist for the siting of the substation in St. Clair County¹. However, implicit within these applications is the reference to the pending application with the Kansas City Planning and Zoning Board for a land use permit. If this Board, or ultimately any

¹ If St. Clair County does not have zoning laws and regulations or if the area where the substation is to be constructed is already zoned for such use, then receiving county approval would not be necessary.

proper county authority approached, denies Aquila's request for a land use permit, then the Commission's authority to issue a certificate and grant such use may be challenged.

This majority Order should have made it clear that the Commission was not attempting to confiscate the City of Kansas City or St. Clair County's siting authority. If it was, the Commission did not hold a hearing as required under §393.170.3 and therefore, this Order is legally flawed. The proper procedure, which appears to be the intended process for Aquila, is to go to the Kansas City Planning and Zoning Board or the County authority, apply for the permit, and attach that approval to the Commission application for a Certificate of Convenience and Necessity. If Aquila was seeking to pre-empt that process and either entity's siting authority by obtaining land use approval from the Commission, then an appropriate hearing would still be required pursuant to §393.170.² However, if Aquila was not seeking to pre-empt the City or County's authority, then, if the Commission felt it needed a determination on land use, a hearing should have been held and the appropriate city or county authority joined as a party to guard against any improper extensions of authority. No evidence was offered or information stipulated, and there was no joining of the City of Kansas City or St. Clair County in this case. The appropriate process in this matter was to issue an approval of the substations pursuant to §393.170 as to the need for the facilities only, subject to the approval needed, if any, of the local zoning requirements in two political subdivisions.²

It is particularly disturbing that the majority Order in this case stands on the basis that it provided all of the authority necessary to site the facilities. This notion is opposite to the rationale of the same majority of Commissioners in the Aquila South Harper case³. There, the majority went to great lengths to assure the parties that the Commission preempted local zoning authority only after the required hearing of evidence on appropriate land use. This Order should make clear that no preemption of local authority was authorized. There is a cloud of uncertainty in this Order that stems from misapplying the prior Aquila South Harper decision and ignoring local use planning. If a local land use permit is not granted or other issue arises, this majority Order is vulnerable to challenge. Therefore, we must dissent.

² If Aquila wished to have the Commission examine the land use issue (which it appears to be deferring to Kansas City) then it should have requested a hearing before the Commission and joined Kansas City as a party.

³ PSC case no. EA-2006-0309, Aquila's Application for Certification of Public Convenience and Necessity.

In the Matter of the Application of Aquila, Inc., for Permission and Approval and a Certificate of Public Convenience and Necessity Authorizing it to Acquire, Construct, Install, Own, Operate, Maintain, and Otherwise Control and Manage Electrical Distribution Substation and Related Facilities in Kansas City, Jackson St. Clair County, Missouri (Near the City of Osceola).

Case No. EA-2006-0500

Electric §3. The Commission approved the Stipulation and Agreement and granted Aquila, Inc., a certificate of convenience or necessity to Acquire, construct, install, own, operate, and maintain a distribution substation and related facilities in St. Clair County, near the city of Osceola.

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: October 19, 2006

Effective Date: October 29, 2006

Procedural History

On June 23, 2006, Aquila, Inc. filed an application with the Missouri Public Service Commission requesting a certificate of convenience and necessity as described in the caption of this order. On August 15, Kansas City Power & Light Company was granted its request to intervene. Although Aquila also filed a motion for expedited treatment, the process was stalled in order to allow the parties and opportunity to reach an agreement, which is now before the Commission. Although it did not join in the Agreement, KCPL filed a notice informing the Commission that KCPL does not oppose the Agreement. The Stipulation and Agreement was filed on October 10, as was KCPL's notice.

The Stipulation and Agreement

The parties agree that in Case No. 9470, the Commission granted authority to Aquila's predecessors-in-interest to construct and operate electric facilities, transmission lines and distribution systems throughout portions of St. Clair County, Missouri. The parties further agree that the area in which Aquila proposes to construct its substation is within its certificated area. The estimated cost of the project is \$1.65 million, which will be funded by cash or credit. The parties finally agree that the substation will promote public convenience or necessity for customers in St. Clair and the surrounding counties bordering the Deepwater Arm of Truman Lake.

Precedential impact of StopAquila.org v. Aquila, Inc.¹

The parties agree that under case law, prior to the StopAquila.org v. Aquila, Inc. case, utility companies such as Aquila and KCPL could construct and operate a substation within its service territory without approval from the Commission. This

¹ StopAquila.org v. Aquila, Inc., 180 S.W.3d 24 (Mo. App. W.D. 2005).

conclusion rests on the premise that if the Commission has granted to the company a certificate of convenience or necessity to operate in a particular service area, then the subsequent granting of such authority to build a substation in that same area would be redundant. However, since *StopAquila.org v. Aquila, Inc.*, Aquila has taken the position that Commission authority is now necessary for Aquila to build a substation in its service area.

Staff, OPC and KCPL do not believe the courts most recent ruling requires Aquila to obtain Commission approval prior to building the substation. However, because of the necessity for expedited construction of the substation due to imminent increased demand, the parties agree that the Commission should grant the requested authority to Aquila. In this regard, the parties agree that by granting the requested certificate, the Commission is not establishing a regulatory policy or precedent but is rather responding to the specific facts of this case.

Discussion

Under Section 393.170.1, RSMo 2000, electric corporations are required to obtain Commission approval prior to constructing an electric plant. In light of *StopAquila.org*, the parties agree that there is uncertainty as to whether Aquila, by previous order of the Commission, presently has the authority to build the substation. However, no party takes issue with this uncertainty. Rather, the parties agree that the Commission should grant the requested authority regardless of how Missouri courts may resolve this issue. Because the parties have not presented this issue to the Commission for resolution, the Commission need not answer that legal question.

The Commission recognizes that if Aquila need not request authority to build the substation, then granting the authority would at worst simply be redundant. However, if on the other hand, Aquila does need to requested authority from the Commission to build the substation, then the Commission must determine whether construction of the substation is necessary or convenient for the public service. The parties have stipulated that construction of the proposed substation is necessary in order for Aquila to meet expected demand.

Conclusion

The Commission has the legal authority to accept a stipulation and agreement as offered by the parties as a resolution of issues raised in this case.² The Commission notes that every decision and order in a contested case shall be in writing and, except in default cases or cases disposed of by stipulation, consent order or agreed settlement, shall include findings of fact and conclusions of law.³ Consequently, the Commission need not make findings of fact or conclusions of law in this order.

Commission rule 4 CSR 240-2.115 (2)(C) states that if no party objects to the Stipulation and Agreement, the Commission may treat the agreement as

² Section 536.060, RSMo 2000.

³ Section 536.090, RSMo 2000.

unanimous. Because KCPL has indicated that it does not oppose the agreement, the Commission will treat the agreement as unanimous.

The Commission has reviewed the facts of this case and the Stipulation and Agreement and finds that the agreement is reasonable. The Commission will therefore approve the agreement, direct that the parties to the agreement comply with its terms and, finding that it is necessary for the public interest, will grant Aquila a certificate of convenience or necessity to construct and operate the proposed substation.

IT IS ORDERED THAT

1. The Stipulation and Agreement between Aquila, Inc., the Staff of the Commission and the Office of the Public Counsel is approved.
2. The parties to the agreement shall abide by its terms.
3. Aquila, Inc. is granted a certificate of convenience or necessity to Acquire, construct, install, own, operate and maintain a distribution substation and related facilities in St. Clair County, near the city of Osceola, as more fully described in the Stipulation and Agreement.
4. This order shall become effective on October 29, 2006.
5. This case may be closed on October 30, 2006.

Davis, Chm., Murray, and Appling, CC., concur.
Gaw C., dissents, with separate dissenting
opinion to follow.
Clayton, C, dissents.

Jones, Senior Regulatory Law Judge

NOTE: Commissioners Gaw and Clayton filed a joint dissenting opinion in cases EA-2006-0499 and EA-2006-0500. See pages 62 for a copy of that opinion.

USW Local 11-6, Complainant, v. Laclede Gas Company, Respondent.

Case No. GC-2006-0060

Gas §35. The Commission found that the tariff of Laclede Gas Company as revised on June 10, 2005, provides for safe and adequate service and therefore the Complaint is dismissed with prejudice.

APPEARANCES

Janine M. Martin and Sherrie A. Schroder, Diekemper, Hammond, Shinnors, Turcotte and Larrew, P.C., 7730 Carondelet Avenue, Suite 200, St. Louis, Missouri 63105, for USW Local 11-6.

Michael C. Pendergast, Vice President & Associate General Counsel, and Rick E. Zucker, Assistant General Counsel-Regulatory, Laclede Gas Company, 720 Olive Street, St. Louis, Missouri 63101, for Laclede Gas Company.

Charles S. Elbert, Kohn, Shands, Elbert, Gianoulakis & Giljum, One US Bank Plaza, Suite 2410, St. Louis, Missouri 63101, for Laclede Gas Company.

Michael F. Dandino, Deputy Public Counsel, and Marc Poston, Assistant Public Counsel, Office of the Public Counsel, Post Office Box 2230, 200 Madison Street, Suite 650, Jefferson City, Missouri 65102-2230, for the Office of the Public Counsel and the public.

Thomas R. Schwarz, Jr., Deputy General Counsel, Missouri Public Service Commission, Post Office Box 360, 200 Madison Street, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Nancy Dippell, Deputy Chief Regulatory Law Judge .

REPORT AND ORDER

Syllabus: This order finds that the tariff of Laclede Gas Company as revised on June 10, 2005, provides for safe and adequate service and therefore the Complaint is dismissed with prejudice.

Procedural History

On May 10, 2005, Laclede submitted proposed tariff revisions¹ to implement its automated meter reading (AMR) program. The tariff sheets became effective on June 10, 2005. USW Local 11-6 attempted to intervene in that tariff matter after the tariff had become effective and was denied intervention.² The USW Local 11-6 then filed a Complaint in which it alleges that because of these tariff revisions, Laclede

¹ Tariff Number JG-2005-0976.

² Case No. GT-2005-0496.

may not be providing safe and adequate service as required by Section 393.130, RSMo. USW Local 11-6 amended its Complaint on February 8, 2006.

The Commission held an evidentiary hearing on May 22 and 23, 2006, at which all the parties were represented. The parties submitted briefs on July 7, 2006. On July 14, 2006, USW Local 11-6 attempted to file additional evidence which the Commission rejected.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Laclede Gas Company is a local gas distribution company providing natural gas service in Missouri.

The USW Local 11-6 is a union whose members are employed by Laclede.

Some of USW Local 11-6's members are meter readers whose job is to read residential and commercial meters for billing purposes.

Laclede trains its employees, including those conducting inspections and reading meters, on how to detect natural gas leaks.

Some meter readers believe it is a component of their job to watch for signs of natural gas leaks.³ Meter readers are required by Laclede to report leaks when found and carry company cell phones for this purpose.⁴ Failure to report a leak when found can subject the employee to discipline.

Although remote meter reading devices have been used for decades,⁵ in 2005, Laclede began implementing an automated meter reading (AMR) program to replace a substantial portion of its manually read meters. As part of the AMR implementation, AMR devices are being placed on most customer meters.

Traditionally, meters were read by meter readers who physically viewed the meter on a monthly basis to determine how much natural gas was used by a particular customer.⁶

Where an AMR device has been put in place, the AMR technology allows Laclede to read the meters without physically visiting the customer's property. Thus, no meter reader is necessary to determine the amount of natural gas used. This is true whether the meter is located inside or outside the residence.

As part of its AMR implementation, Laclede revised its tariffs. Those tariff revisions were submitted on May 10, 2005, and became effective on June 10, 2005.⁷

³ Transcript at p. 235.

⁴ Exhibit 1, pp.4, 26.

⁵ Tr. at 195.

⁶ Ex. 3, Declaration of Kevin Stewart, para. 5.

⁷ P.S.C. MO. No. 5 Consolidated, Fifth Revised Sheet R-11 and R-14. (Exhibit 12)

Laclede's cover letter attached to its tariff revisions stated that the tariff changes were being made in order to implement AMR. The cover letter attached to Laclede's tariff submission only referenced "various operational changes" and did not mention changes to inspection practices with regard to the effect of the changes on customers.⁸

The Staff of the Missouri Public Service Commission reviewed the tariff changes to determine if they complied with the relevant safety regulations. Staff did not conduct any other safety studies or review.⁹

A "turn off/turn on" is when a customer requests that service be discontinued in that customer's name and the account is then transferred to a new customer name. Thus, one account is closed, or "turned off," and another account is opened, or "turned on".

Often, the natural gas service is not physically shut off, but rather, the account is set up to bill under another customer's name.

The tariff revisions eliminated the requirement that a Laclede employee conduct an inspection of customer-owned natural gas piping and appliances whenever a "turn off/turn on" occurred. This inspection is referred to as a TFTO.

For decades prior to the elimination of the tariff requirement, Laclede was required by its tariff,¹⁰ and instructed its employees to conduct TFTOs every time there was a "turn off/turn on" regardless of whether the natural gas was physically shut off.

After the tariff revisions, the TFTO inspections are only required when the flow of natural gas is interrupted.¹¹

Also prior to the tariff revisions, and prior to the implementation of AMR, Laclede was required by the tariff language to annually read meters located inside a customer's premises.

Annual meter reading started in 1991. Before that, inside meters were only read by Laclede employees in special circumstances such as a report of an unusually high bill by a customer.¹²

The tariff revisions eliminated the requirement for annual meter readings where a meter equipped with AMR is located inside a residence.

Laclede made this revision because it no longer needed to have an employee on the premises on an annual basis.¹³

Staff was aware of the changes in the inspection practices when reviewing the tariff revisions.¹⁴

Laclede has stopped performing an annual meter reading on inside meters.¹⁵

⁸ Ex. 25, pp. 4-5.

⁹ Tr. at 437-438, 442.

¹⁰ Ex.12, P.S.C. Mo. No. 5 Consolidated, Fifth Revised Sheet No. R-14.

¹¹ Tr. at 22-23.

¹² Tr. at 162.

¹³ Tr. at 530.

¹⁴ Tr. at 488-489; Ex. 11, Direct Testimony of Robert R. Leonberger, p. 5.

¹⁵ Tr. at 22-23.

Safety violations and hazards may be found during TFTOs and annual inspections. It is possible that these safety violations and hazards if left undetected could cause damage to life or property.

Laclede has approximately 250,000 meters that are located inside a customer's home or business.¹⁶

Laclede asks its customers to be available for a four-hour block of time when scheduling an inspection.¹⁷ This equals more than half a million hours of time that Laclede customers may spend waiting for inspections annually.¹⁸

Laclede bills its customers \$36.00 for each TFTO inspection.¹⁹

The \$36.00 fee does not cover all of the expenses of the inspections. Up to an additional \$3 million per year could be included in Laclede's rates to cover the complete costs of the inspections.²⁰

The customer, not Laclede, is responsible for the maintenance and safety of customer-owned equipment.²¹

Approximately three years ago, Laclede equipped some of its employees with pocket gas detection devices.²² Laclede requires its employees to carry these devices when conducting TFTO inspections and inside meter reading.²³

Laclede requires its meter readers to wear the combustible gas detection device during inside meter reads in order to help it fulfill its three-year leak survey requirement for inside piping.²⁴

Laclede considers the failure of its employees to carry the pocket gas detection devices during an inspection or an annual inside meter reading to be a safety-related violation of its operating procedures.

Laclede has disciplined employees for failure to carry these devices.

Laclede told employees that TFTOs were required for safety purposes.²⁵

Laclede implemented the TFTOs in order to reduce its liability from lawsuits. Laclede determined that if damage or injury occurred after a Laclede employee was on site, that Laclede would be exposed to liability. The implementation of the TFTOs was a business decision made by Laclede and is not required by any state or federal law or regulation.²⁶

¹⁶ Brief of Laclede Gas Company, p. 2.

¹⁷ Ex. 13, *Reitz Direct*, p. 11, lines 19-23.

¹⁸ Ex. 13, p. 11, line 14 to p. 12, line 2.

¹⁹ Ex. 13, p.11, lines 4-6.

²⁰ Ex. 13, p. 11, lines 1-17.

²¹ Tr. at 326, line 24 to 328, line 8.

²² Ex. 3, paras. 10-11; Tr. at 521-522, 578.

²³ Ex. 3, para 12; Tr. at 240.

²⁴ Tr. at 578.

²⁵ Ex. 2, Testimony of Stephen Hendricks, p. 2.

²⁶ Tr. at 530-531.

There was no evidence that any other company in the state of Missouri or the United States conducts inspections for every TFTO even where the gas flow was interrupted.

There was no evidence that customers of utilities which perform TFTOs or annual inside meter readings have fewer gas incidents than customers of companies who do not.²⁷

No evidence was presented to show that gas incidents involving injury to persons or property have increased or changed in any manner since June 10, 2005.

USW Local 11-6 witnesses testified that the installation of AMR devices has caused an increased number of meters to leak, and damage has been caused to meters by the installation of AMR devices. Whether AMR devices are being installed properly is the subject of another Commission case, GC-2006-0390.

Kevin Stewart, a Laclede employee and a member of USW Local 11-6, has over 25 years of experience as a meter reader. He testified that to his knowledge, the failure to read a meter has never resulted in injury to persons or damage to property.²⁸

Billing is the primary purpose of meter reading.²⁹

Mr. Stewart testified that in the early stages of AMR installation, he would discover one to two leaks per day on "AMR routes."³⁰ He also testified that it was critically important to check a meter regularly for leaks which may migrate into a home.³¹ He clarified during cross-examination that he was speaking of the need for corrosive pipe inspections which occur every three years according to the Commission's regulations.³²

Mr. Stewart also testified during a deposition that the three-year corrosive pipe inspections were sufficient to determine leaks.³³

Mr. Stewart further testified that he had never found an outside meter gas leak to be migrating.³⁴

The frequency of corrosive pipe inspections has not been affected by the tariff revisions.

Stephen Hendricks is a Laclede Service Department employee with twenty years of experience doing TFTOs but no formal training on gas incident investigations. He normally is assigned to emergency work, but sometimes performs route work including TFTOs.

Mr. Hendricks testified that he found safety issues in about a quarter of the homes in which he performed TFTOs.³⁵ His testimony, both written and oral, was

²⁷ Tr. at 347-350; 360-361; 418-419; 422-423; and Ex. 15.

²⁸ Tr. at 168.

²⁹ Tr. at 158, 329-330; Ex. 11, pp. 9-10.

³⁰ Tr. at 180.

³¹ Ex. 3, para. 9.

³² Tr. at 173.

³³ Tr. at 237.

³⁴ Tr. at 239.

³⁵ Ex. 2, p. 5.

very contradictory to answers he gave in a deposition. He stated that many hazards are detected during TFTOs both on the customer side of the meter and on the Laclede side. He could not state a percentage of the time he finds a hazard during a TFTO. He testified to 60 to 70 percent, 25 percent, and 2 percent of the time. He also admitted that broad statements he made about TFTOs being the only way certain hazards could be detected were not accurate.

Mr. Hendricks testified to the types of hazards that may be found during TFTOs on both the customer-owned and company-owned equipment including: uncapped flex connectors for gas stoves; vent piping with carbon monoxide leaks; delayed ignition on furnaces due to dirt build-up; cobweb build-up in furnace burner orifice; carbon build-up in furnace due to items stored too close; and rusty pipes on Laclede-owned property. On cross-examination, however, he admitted that contrary to his written testimony, these hazards would also be found during a house sale inspection, an inspection by an HVAC contractor, or a corrosive pipe inspection.

He also testified that the improper installation of AMR devices has created gas leaks.

Mr. Hendricks' testimony regarding hazards found during TFTOs was too contradictory and confusing to be credible.

TFTO inspections are not conducted in any kind of systematic way. For instance, one rental apartment may be inspected three times in one year due to a heavy turnover in renters, while the home across the street may not have an inspection for 20 years.³⁶

The USW Local 11-6 witnesses conceded that which property will have a TFTO inspection is random and haphazard.³⁷

Joseph Schulte is a Business Representative for USW Local 11-6. He was formerly an employee of Laclede Gas working as a gas man, service person, and trouble-shooter with 25 years experience. He became a full-time union representative in 1991 and officially retired from Laclede on March 1, 2004.³⁸

Mr. Schulte has never been a meter reader.³⁹

Mr. Schulte conceded that he had no statistics or facts to show that AMR creates a greater hazard to customers or the general public than manual meter reading.⁴⁰

Mr. Schulte testified that the union has never taken the position that an employee should be discharged for not following a safety procedure.⁴¹

Mr. Schulte testified that USW Local 11-6 is interested in public safety but also objects to TFTOs being eliminated because the union has an interest in protecting jobs.⁴²

³⁶ Ex. 11, p. 5, lines 5-12; Ex. 13, pp. 6-7.

³⁷ Tr. at 97, 343.

³⁸ Ex. 4, Affidavit of Joseph Schulte, paras. 1, 3.

³⁹ Tr. at 330; Ex. 4, paras. 1, 3.

⁴⁰ Tr. at 312.

⁴¹ Tr. at 323.

⁴² Tr. at 356, 358-359.

No person with personal knowledge of the safety violations listed in the attachment labeled "Exhibit 1" to Exhibit 4 testified at the hearing. Mr. Schulte admitted that he had no personal knowledge of the listed hazards. And, while Mr. Schulte claimed that this list was composed under his supervision, he admitted that he had not even read the list, nor was he familiar with the process for putting together the list.⁴³

Over one-fourth of the "hazards" on the list were not found during a TFTO inspection, but rather were found through some other form of inspection or service required by the Commission's safety rules or performed on an unregulated basis.⁴⁴

The "hazards" identified on the attachment to Exhibit 4 included the absence of an anti-tipping device. Such a device is designed to ensure that a stove does not tip over on someone if weight is placed on the open oven door. Electric stoves have a similar requirement. There is no requirement for electric utilities to inspect customer-owner appliances.⁴⁵

Laclede is not responsible for inspecting, repairing, or maintaining customer-owned fuel lines or appliances.⁴⁶

The testimony of Mr. Schulte and the attachment to Exhibit 4 are not credible.

The number of safety violations or hazards found by TFTO inspections cannot be determined from the evidence presented.

It is undisputed that the more often safety inspections are conducted, the safer natural gas appliances will be. Thus, if inspections are conducted annually, the residence is safer than if the inspections are conducted semiannually. And, if inspections are conducted daily, the residence is safer than if the inspections are conducted semiannually. However, the degree of increased safety is not necessarily high, due to the fact that a hazard can occur the moment the inspector walks out of the residence, regardless of how often the inspections occur.

Communities and public boards in Laclede's service territory are concerned with the safety of their residents, as stated in the resolutions and proclamation attached to Mr. Schulte's testimony.⁴⁷ The Commission has no way to determine what expertise and information regarding natural gas facilities the members of the various boards, councils, and commissions had when deciding to express their concern and opposition to Laclede's tariff changes. It was clear that the various public bodies had received information from USW Local 11-6 and passed nearly identical resolutions which were authored by USW Local 11-6's attorney. The Commission takes notice of the public bodies' concern for their citizens; however, these resolutions have no probative value in determining whether Laclede is providing safe and adequate service.

⁴³ Tr. at 273-275.

⁴⁴ Ex. 13, p. 8, lines 16-19.

⁴⁵ Ex. 13, p. 9.

⁴⁶ Tr. at 327.

⁴⁷ Ex. 4.

Census data was provided in an attempt to show that Laclede's service territory is more densely populated than other areas of the state.⁴⁸ However, no expert opinion was offered to link the population density to the risks associated with natural gas incidents.

Union Electric Company, d/b/a AmerenUE, is also a natural gas distribution company operating in the state of Missouri.

AmerenUE performed TFTOs from 1988 through 1996, but no longer performs them after the implementation of AMR by Cellnet approximately five years ago.⁴⁹

There was no evidence that AmerenUE's gas incidents have increased since the cessation of TFTO inspections.

Mark Lauber is Laclede's Superintendent of Maintenance Engineering with 19-½ years experience.⁵⁰

Mr. Lauber believes that "significant" leaks could be discovered while a meter reader is performing any kind of meter read.⁵¹ However, Mr. Lauber thinks that depending on meter readers to find leaks is an unreliable method of determining leaks. He believes that if there is a need for this kind of leak detection, it should be more systematic, like the copper line replacement program.⁵²

The Commission finds that TFTOs are not a comprehensive or systematic approach to leak detection.

The Commission finds that the corrosive pipe inspections and leak survey procedures required by the Commission's gas safety rule⁵³ are sufficient to locate the leaks that meter readers locate.⁵⁴

Conclusions of Law

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

Laclede is an investor-owned public utility engaged in the provision of natural gas service in the state of Missouri, and is, therefore, a "gas corporation" as defined in Section 386.020(18), RSMo 2000. As a "gas corporation," Laclede is subject to the jurisdiction of the Commission under Chapters 386 and 393, RSMo 2000.

Any decision of the Public Service Commission must be both lawful and reasonable.⁵⁵ The lawfulness of a decision is determined from the statutory

⁴⁸ Ex. 10.

⁴⁹ Tr. at 250.

⁵⁰ Tr. at 573.

⁵¹ Tr. at 586.

⁵² Tr. at 574-575.

⁵³ 4 CSR 240-40.030.

⁵⁴ Tr. at 198.

⁵⁵ *City of Oak Grove v. Pub. Serv. Com'n*, 769 S.W. 2d 139, 141 (Mo. App. W.D. 1989)

authority of the Commission.⁵⁶ For a decision of the Commission to be reasonable, it must be supported by competent and substantial evidence on the whole record.⁵⁷

Laclede has an obligation to provide gas service that is "safe and adequate and in all respects just and reasonable."⁵⁸

To ensure the provision of safe and adequate service, Section 386.010, RSMo, provides that the Public Service Commission:

shall have power, after a hearing had upon its own motion or upon complaint, by general or special orders, rules or regulations, or otherwise, to require every person, corporation, municipal gas system and public utility to maintain and operate its line, plant, system equipment, apparatus, and premises in such a manner as to promote and safeguard the health and safety of its employees, customers and the public, and to this end to prescribe, among other things, the installation, use, maintenance and operation of appropriate safety and other devices or appliances, to establish uniform or other standards of equipment, and to require the performance of any other act which the health or safety of its employees, customers or the public may demand . . .

From at least December 1, 2001, until the revision took effect on June 10, 2005, Laclede was obligated by its tariff "to obtain an actual inside meter reading from locations having inside meters on an annual basis."⁵⁹ For decades before, and until June 10, 2005, Laclede was obligated by its tariff to perform an inspection whenever a customer vacated the premises even if the gas flow was not discontinued to the premises.⁶⁰ Laclede's current tariff does not require the performance of an inspection of customer-owned equipment unless the gas flow is interrupted.⁶¹

Commission rule 4 CSR 240-40.030, prescribes the safety standards that must be followed by operators who transport natural gas in Missouri. The Missouri safety rule is similar to the Minimum Federal Safety Standards contained in 49 C.F.R. part 192. Missouri's gas safety rule is more stringent than the federal requirement in that the federal rule does not require an inspection even when the flow of gas is interrupted. Missouri's rules do not require an inspection of customer-owned equipment and piping when the flow of gas has not been interrupted.⁶² The Missouri

⁵⁶ State ex rel. Intercon Gas. v. Pub. Serv. Comm'n, 848 S.W.2d 593, 597 (Mo. App. W.D. 1995)

⁵⁷ State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n., 954 S.W. 2d 520, 528 (Mo. App. W.D. 1997)

⁵⁸ Section 393.130, RSMo.

⁵⁹ Laclede Gas Company, P.S.C. Mo. No. 5 Consolidated, Fourth Revised Sheet No. R-11.

⁶⁰ Laclede Gas Company, P.S.C. Mo. No. 5 Consolidated, Fifth Revised Sheet No. R-14.

⁶¹ 4 CSR 240-40.030(12)(S).

⁶² 4 CSR 240-40.030(14)(B)6.

rule does, however, require an inspection of both its equipment and the customer's equipment when the flow of gas is turned on.⁶³

No state or federal law requires Laclede to perform an inspection of customer-owned equipment when the gas flow is not interrupted. Laclede is required to perform a corrosive pipe inspection every three years.⁶⁴ Laclede is also required to perform leak surveys at least annually.⁶⁵ The corrosive pipe inspection and leak surveys are not affected by the tariff revisions.

Laclede's tariff as amended does not violate, conflict with, or contradict any gas safety rule. There is not sufficient evidence of a safety-related justification to impose the expense and inconvenience of mandatory TFTO inspections or annual inspections on inside meters on Laclede or its customers. The Commission finds that USW Local 11-6 has not shown that Laclede is failing to operate in a safe and adequate manner under its tariff.

When filing a tariff revision, Commission rules require that Laclede summarize any changes which will affect customers.⁶⁶ Laclede did not adequately comply with this rule. This omission, however, is not sufficiently egregious to require the inspections reinstated without some showing that Laclede is operating contrary to the law or contrary to the public interest or safety. The Commission directs its Staff to closely review tariff changes and bring to the Commission's attention any change in inspection practices for natural gas distribution companies.

Decision

None of the parties claim that TFTO inspections or annual meter readings do not provide some added safety benefits. However, what level of safety is necessary? How many inspections must be done? How often? The Commission's gas safety rule already prescribes these things. There is no evidence⁶⁷ that Laclede is in any different position from any other gas utility in the state or the United States.

Laclede is not inconsistent when it states in its safety manual that inspections are for safety purposes (or when it disciplines employees for failure to follow procedures), yet argues that the major purpose of meter reads is for billing. Laclede admits that it requires TFTO inspections and the carrying of combustible gas detectors to reduce its exposure to potential liability. Laclede made that requirement part of its tariff and established procedures to ensure that the requirement was met (via its meter reading manual, employee training, pocket gas detectors, and employee discipline). Failure to require strict adherence to its tariff would surely expose the company to claims of tariff violations or penalties relating to unsafe service from the Commission.

⁶³ 4 CSR 240-40.030(12)(S).

⁶⁴ 4 CSR 240-40.030(9).

⁶⁵ 4 CSR 240-40.030(13)(D).

⁶⁶ 4 CSR 240-3.145(22).

⁶⁷ There was some census data admitted in an attempt to show population density in St. Louis is greater than in other parts of the state; but without some significant analysis and study, this data was not conclusive.

The Commission is aware of the dissatisfaction Laclede's customers have with estimated billing.⁶⁸ AMR has the potential of eliminating many of these consumers' complaints and dissatisfaction. By implementing AMR, customers will get a bill every month with the actual usage shown on it.⁶⁹ The benefits of discontinuing the TFTO inspections and the annual meter reading are: 1) company efficiency is increased by no longer having to have a person physically present to read a meter; 2) customer convenience is enhanced in that hundreds of thousands of customers no longer have to wait for a meter reader to do an inside meter reading once a year; and 3) the cost savings of \$36.00 per TFTO inspection for customers and up to \$3 million annually for all ratepayers.

While the Commission finds that the more safety inspections that are made, the safer the system will be, the Commission cannot find sufficient evidence to support the USW Local 11-6's claim that TFTO or annual meter reading is necessary to protect the public interest and safety. The slight increment in safety is outweighed by the benefits of not having these inspections. Laclede is meeting the requirements of the current safety rules and is required to make inspections each time the gas flow is interrupted. In addition, Laclede is required to make corrosive pipe inspections at least every three years as well as annual leak surveys.

The Commission urges natural gas customers to have a qualified HVAC inspector annually inspect natural gas furnaces and appliances and to keep those appliances clean and in proper working order. However, Laclede is not responsible for inspecting the customer-owned equipment beyond the requirements of the safety rules and regulations. And, USW Local 11-6 has not shown that Laclede is operating in an unsafe manner under its tariffs as revised.

The Commission also has determined that Laclede may have violated the Commission's tariff rule by not properly summarizing the changes being made with regard to the discontinuance of inspections. However, the Staff of the Missouri Public Service Commission was aware of the changes when it reviewed the tariffs to determine if they complied with all current safety rules. In the opinion of Staff, Laclede is operating in a safe and adequate manner. In addition, after a thorough review, USW Local 11-6 has not shown that Laclede is operating in an unsafe manner. Therefore, the Commission cannot find that this possible rule violation, by itself, justifies would justify a decision that Laclede is not providing safe and adequate service.

Therefore, the Commission determines that the USW Local 11-6's request for relief shall be denied and the complaint shall be dismissed with prejudice.

IT IS ORDERED THAT:

1. The requests for relief of the USW Local 11-6 are denied and the Complaint, as amended, is dismissed with prejudice.

⁶⁸ For several examples, see the local public hearing transcripts in Laclede's last rate case, GR-2005-0284.

⁶⁹ Commission Case No. GC-2006-0390 and GC-2006-0318 are currently reviewing the alleged problems with the actual installation of AMR devices and the estimated billing practices of Laclede. Those issues are not before the Commission in this case.

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2. All objections not ruled on are overruled and all motions not granted are denied.
3. This Report and Order shall become effective on November 12, 2006.
4. This case shall close on November 13, 2006.

Davis, Chm., Murray, and Appling, CC.,
concur;
Gaw and Clayton, CC., dissent, with
separate dissenting opinion(s) to follow;
certify compliance with the provisions
of Section 536.080, RSMo 2000.

*Note: At the time of publication, no dissents have been issued.

**In the Matter of White River Valley Water Company for Sale of Facilities and
Assets to Public Water Supply District No. 2 of Taney County, Missouri.**

Case No. WM-2006-0557

Water §4. The Commission authorized White River Valley Company to sell its water system facilities and assets to the Public Water Supply District No. 2 of Taney County, Missouri, pursuant to the terms and conditions contained in the Facilities Purchase Agreement submitted to the Commission on September 28, 2006.

**ORDER APPROVING PROPOSED SALE OF UTILITY FACILITIES
AND ASSETS**

Issue Date: November 16, 2006

Effective Date: November 27, 2006

On June 30, 2006,¹ White River Valley Water Company ("White River") filed a verified application with the Missouri Public Service Commission requesting authority to sell its water system facilities and assets to the Public Water Supply District No. 2 of Taney County, Missouri ("PWSD"). On July 3, the Commission issued an order directing notice, adding PWSD as a party, and requiring that any party wishing to request a hearing or to intervene do so on or before July 24. There were no requests for a hearing or to intervene.²

¹ Unless otherwise specified, all dates throughout this order refer to the year 2006.

² Since no one has requested a hearing and the requirement for a hearing is met when the opportunity for hearing has been provided and no proper party has requested the opportunity to present evidence, the Commission may grant White River's request based on White River's verified application after affording notice and an opportunity to be heard to all proper parties. See *State ex rel. Rex Defenderfer Enterprises, Inc. v. Public Service Commission*, 776 S.W.2d 494, 496 (Mo. App. W.D. 1989).

On September 22, the Staff of the Commission filed a Motion for Order Directing Filing and for Extension of Time to File Recommendation. In support of its motion, Staff advised the Commission of deficiencies in White River's application that prevented Staff from completing its review and recommendation in this case. Staff further stated that it could complete its review and file a recommendation within thirty days of White River curing the deficiencies in the application.

The Commission issued a Notice of Deficiency in Application on September 26. Two days later, White River filed various documents, including a copy of the Facilities Purchase Agreement between it and PWSD, which cured the deficiencies in its original application. After the Commission issued an order directing Staff to file either its recommendation or a status report no later than October 30, Staff filed its Recommendation Regarding Proposed Sale of Utility Assets on October 25.

The verified Official Case File Memorandum prepared by Staff and accompanying its recommendation indicates that White River has been in business as a certificated water utility since March 1984, when, in Case No. WM-84-86, White River was granted a certificate of convenience and necessity. At that time, the Commission also authorized White River to acquire the assets of a certificated Commission-regulated utility known as the Valley View Village Water Company. White River currently serves approximately 132 customers in its service area, a subdivision in Taney County known as Valley View Village. PWSD is a publicly-owned water supply district that is not subject to the Commission's jurisdiction. It presently operates a nearby water system serving approximately 1400 customers, and its established service area includes the area in which White River currently provides service.

The memorandum further indicates that the Water District proposes to connect White River's customers to PWSD's existing system using the rates that are presently approved for White River, and intends to apply those rates to customers in the White River system for at least twelve months. Finally, Staff advises that, based on its own investigation and discussions with personnel from the Missouri Department of Natural Resources' Southwest Regional Office in Springfield, neither White River nor PWSD are presently experiencing any capacity or water quality compliance issues.

Based on all these considerations, Staff has concluded that White River's proposed sale of its water system facilities and assets to PWSD meets the requirements of section 393.190, RSMo 2000 and the accompanying Commission Rules,³ will not have a negative impact on that system, and will "not [be] detrimental to the public interest."⁴ Therefore, Staff recommends that White River's application to sell its facilities and assets to PWSD be approved.

After considering the verified application of White River along with the recommendation of Staff and accompanying verified memorandum, which are hereby admitted into evidence, the Commission concludes that the application should be granted. The Commission will also, by further order upon motion after the asset transfer is completed, cancel the certificate of service authority held by White

³ See, e.g., 4 CSR 240-2.060 and 4 CSR 240-3.605.

⁴ State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz, 596 S.W.2d 466, 468 (Mo. App. E.D. 1980).

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River with respect to its water system, along with the tariff on file pertaining to that system.

IT IS ORDERED THAT:

1. White River Valley Water Company is hereby authorized to sell its water system facilities and assets to the Public Water Supply District No. 2 of Taney County, Missouri, pursuant to the terms and conditions contained in the Facilities Purchase Agreement submitted to the Commission on September 28, 2006.

2. Before the sale of the water system facilities and assets of White River Valley Water Company to Public Water Supply District No. 2 of Taney County is completed, White River Valley Water Company shall issue appropriate written notice to all customers in its service area informing them of the impending change in ownership and operation.

3. Once the sale of its water system facilities and assets to the Public Water Supply District No. 2 of Taney County, Missouri, is complete, White River Valley Water Company shall, as quickly as is practicable, file a notice in this case informing the Commission of the completion of the transaction. At that time, White River Valley Water Company is authorized to cease providing water to customers in its service area, and the Commission will entertain a motion by any party for the Commission's issuance of an order canceling the certificate of convenience and necessity currently held by White River Valley Water Company and canceling the associated tariff currently on file.

4. This order shall become effective on November 27, 2006.

Davis, Chm., Murray, Gaw,
Clayton and Appling, CC., concur

Lane, Regulatory Law Judge

The Staff of the Missouri Public Service Commission, Complainant, v. Joe Hybl, Oakview Estates Homeowners Association, Jack Hybl, and James Scott Hybl, Respondents.

Case No. WC-2007-0088

Water §12. The Commission granted a default judgment in favor of Staff's complaints because the Respondents failed to timely respond. Therefore, the Commission first found that Respondents are both a water corporation and a public utility which is subject to the Commission's jurisdiction. The Commission has also found that the Respondents have violated §393.170 by providing water service to the Oakview Estates Subdivision in Warren County, Missouri without the requisite certificate of convenience and necessity, and that each day Respondents have done so constitutes a separate violation.

ORDER GRANTING DEFAULT

Issue Date: November 21, 2006

Effective Date: November 28, 2006

On August 28, 2006, the Staff of the Commission filed a complaint against the above-listed respondents, claiming that Respondents are providing water without the requisite Commission authority. The Commission gave Respondents notice of the complaint on August 30.

On October 3, Respondents filed a Request for Additional Time. Respondents stated that they are in the process of applying for a certificate of convenience and necessity, but needed additional time to get more information. Respondents asked for an extension of time until October 30 to file an answer, which the Commission granted. Respondents failed to meet that October 30 deadline.

Commission Rule 4 CSR 240-2.070(9) provides that if a respondent fails to timely respond to a complaint, the Commission may deem the complaint admitted, and may enter an order granting default.¹ Because Respondents have failed to timely respond, the Commission finds them in default and finds that Staff's allegations are deemed admitted.

Therefore, the Commission finds that Respondents own, operate, control or manage a water system serving Oakview Estates Subdivision in Warren County, and are a water corporation under Section 386.020(58), in that they are providing water service to the Oakview Estates Subdivision in Warren County, Missouri for gain without the certificate of convenience and necessity required by Section 393.170. The Commission further finds that Respondents are a public utility under Section 386.020(42), and are thus subject to the jurisdiction of the Commission.

Further, the Commission finds that Respondents have violated Section 393.170 by providing water service to the Oakview Estates Subdivision in Warren County, Missouri without the requisite certificate of convenience and necessity, and that

¹ The rule also allows the Commission to set aside a default order if the respondent files a motion to set aside the order within seven days of the order's issue date if the Commission finds good cause for the respondent's failure to timely respond.

each day Respondents have done so constitutes a separate violation. In addition, the Commission further finds that Section 386.570 subjects Respondents to a penalty of not less than one hundred dollars nor more than two thousand dollars for each day that they provide water service without the required certificate. As authorized by Section 386.600, the Commission permits its General Counsel to recover the penalties allowed by Section 386.570 in circuit court.

IT IS ORDERED THAT:

1. Default is hereby entered against Respondents Joe Hybl, Oakview Estates Homeowners Association, Jack Hybl and James Scott Hybl, and the averments of the complaint are deemed admitted.
2. The General Counsel of the Commission is authorized to bring a penalty action against Respondents Joe Hybl, Oakview Estates Homeowners Association, Jack Hybl and James Scott Hybl in circuit court.
3. This order shall become effective on November 28, 2006.
4. This case shall close on November 29, 2006.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur.

Pridgin, Senior Regulatory Law Judge

***NOTE:** The Commission issued an order setting aside default on January 9, 2007. On January 11, 2007, the Commission issued a notice of dismissal.

Application of Aquila, Inc., for an Order Authorizing Applicant (if and to the Extent the Transaction Described Herein Would Impose a Mortgage or Encumbrance under Section 393.190, (RSMo)) to Execute, Deliver and Perform the Agreements and Instruments Necessary to Assume a Lease and Related Documents Pertaining to the Aries Combustion Turbine Generator Facility Owned by a Subsidiary of Calpine Corp. and Cass County, Which Was Constructed as Part of a Revenue Bond Project under Chapter 100 RSMo.

Case No. EO-2007-0172

Electric §9. The Commission ordered that the application filed by Aquila, Inc., on October 31, 2006, seeking an order authorizing it to execute, deliver and perform the agreements and instruments necessary to assume a lease and related documents pertaining to the Aries combustion turbine generator facility was dismissed pursuant to Sections 393.190 and 393.200 for lack of jurisdiction.

ORDER DISMISSING APPLICATION FOR LACK OF JURISDICTION

Issue Date: November 28, 2006

Effective Date: December 8, 2006

Syllabus: This order dismisses Aquila, Inc.'s application because the Missouri Public Service Commission finds it lacks jurisdiction to enter a dispositive order in this matter.

Background

On September 22, 2006,¹ Aquila, Inc. ("Aquila") entered into an Asset Purchase and Sale Agreement ("APA") with MEP Pleasant Hill, L.L.C. to acquire the Aries Facility, a 580 megawatt gas-fired combined cycle electric generating facility in Pleasant Hill, Cass County, Missouri. MEP is a wholly owned subsidiary of Calpine Corporation. Calpine and its debtor affiliates, including MEP, filed for bankruptcy relief in the United States Bankruptcy Court for the Southern District of New York. The sale of the Aries Facility has been following a time line set by the Bankruptcy Court, and the Bankruptcy Court's Sale Order is expected to be issued on December 11.

The Aries Facility has been in commercial operation as part of an Industrial Revenue Bond project approved by Cass County, Missouri, pursuant to Chapter 100, RSMo 2000.² Under this arrangement, the County issued a single taxable industrial revenue bond in connection with the purchase and construction of the Aries Facility. Cass County owns the Aries Facility, and because the municipality owns the project, it is exempt from property taxes. Cass County leases the facility to MEP. The Lease requires MEP to operate and maintain the Aries Facility and, pursuant to an Economic Development Performance Agreement, make specified payments in lieu of taxes ("PILOT payments") to the County. MEP, as the lessee, makes its lease payments to Cass County, and these payments fund all payments by the County to the bondholder. In this instance, MEP also purchased the Bond so the Chapter 100 bond arrangement has no economic substance except for eliminating property tax liabilities to encourage economic development.

Aquila's Application

On October 31, 2006, Aquila, Inc., ("Aquila") filed an application with the Commission seeking a determination that assumption of the lease and related documents pertaining to the purchase of the Aries combustion turbine facility ("Aries Facility") in Cass County, Missouri, did not require Commission approval pursuant to Section 393.190. In the alternative, Aquila seeks expedited approval of its APA, by December 8, so that it may purchase the Aries Facility in accordance with the APA. The Commission issued notice and set a deadline for requests for intervention or for a hearing. No requests for intervention or for a hearing were filed.³

¹ All dates throughout this order refer to the year 2006 unless otherwise noted.

² All statutory citations reference RSMo 2000 unless otherwise noted.

³ Although MEP is a party to the APA, they did not join in the application. Consequently, On November 1, the Commission added MEP as a necessary party to have a full and fair adjudication of this matter, issued notice and set an intervention schedule. The Commission also directed that any requests for a hearing should be filed by November 13. No requests for intervention or for a hearing were filed.

Aquila states it will pay \$158,500,000 in cash to assume MEP's rights and obligations under the Lease and acquire all of MEP's rights, title and interest in the Bond. Exhibit 7 to Aquila's application, its Consolidated Balance Sheet, reveals that the company's cash and equivalents total \$201,100,000, thus reflecting adequate funds to execute the transaction. The Balance Sheet also records a negative "Pro Forma Adjustment" for the Aries transaction resulting in a balance of cash and cash equivalents after the sale totaling \$42,600,000.

Aquila asserts that this transaction does not dispose of, or encumber the whole or part of its franchise, works, or system, necessary or useful in the performance of its duties to the public, and therefore believes the transaction does not require Commission approval pursuant to Section 393.190. Aquila contends that its ratepayers will benefit from the transaction because the PILOT payments will be substantially less than the property taxes it would be required to pay if it acquired the Aries Facility without entering the Chapter 100 bond arrangement.

Aquila also maintains that because it will own the Bond, and because the transaction requires no substantive financing, that it will not incur any indebtedness that would need to be recorded on its accounting books. Instead, Aquila will record an amount matching the acquisition cost of the Aries Facility as being part of its net utility plant assets. Aquila further asserts that even if the Commission would construe the APA as creating long-term indebtedness, that Aquila, being a Delaware corporation, does not require Commission approval to incur long-term indebtedness. Aquila cites to *Public Service Commission v. Union Pacific Railroad Company* in support of this latter proposition.⁴

Staff Recommendation

The Staff of the Missouri Public Service Commission filed its verified Recommendation and Memorandum on November 22. Staff does not directly address the issue of the Commission's jurisdiction over this matter. Instead, Staff states: "Further, similarly to how the parties requested the Commission to act in Case Nos. EA-2006-0499 and EA-2006-0500 regarding certificates of convenience and necessity for substations, the Staff notes that, even if the Commission does not have jurisdiction over the transaction in question here, no harm will be caused by the Commission authorizing Aquila, Inc. to engage in this transaction—Staff's conditional recommendation in this case."⁵

⁴ *Public Service Commission v. Union P.R. Co.*, 197 S.W.3d 42 271 Mo. 258,268-270 (Mo. Banc 1917).

⁵ Case Nos. EA-2006-0499 and EA-2006-0500 involved applications by Aquila to obtain permission, approval and certificates of public convenience and necessity authorizing Aquila to acquire, construct, install, own, operate, maintain, and otherwise control and manage electrical distribution substations and related facilities to be located within Jackson County, near the City of Raymore, Missouri, and in unincorporated St. Clair County, near the City of Osceola, Missouri. In these cases, the jurisdictional issue centered around whether the Western District's opinion in *StopAquila.org v. Aquila, Inc.*, 180 S.W.3d 24 (Mo. App. 2005), created uncertainty as to whether an electric utility could lawfully construct and operate any electrical substation within the utility's certificated service area without first obtaining a § 393.170.1, RSMo. certificate of convenience and necessity from the Commission. Certain parties to these

Based upon prior case law and prior decisions by the Commission, Staff believes the appropriate standard for approval of Aquila's application is whether the proposed transaction is "not detrimental to the public interest." Staff asserts that, based on its review of the transaction and its investigation, it found no issues such as encumbrances on the facility (other than those in connection with the Chapter 100 financing), compliance of the facility with zoning requirements, or other legal challenges that would affect the legality of the facility or similar matters such as those Aquila, Inc., has encountered with respect to its South Harper combustion turbine generating facility. Staff concludes that the transaction has the potential to result in lower rates to customers and property tax savings to Aquila and that the proposed transaction would not be detrimental to the public interest.

Based on its review, the Staff recommends the Commission approve Aquila, Inc.'s application, subject to the following conditions:

A. Aquila shall continue to record the land and improvements (combined cycle unit) that are the subject of this transaction as a regulatory asset on its books similar to other utility property it owns.

B. Aquila shall record the investment described above in accordance with the Uniform System of Accounts as adopted by this Commission for recordkeeping purposes.

C. Aquila shall depreciate the combined cycle unit plant accounts at the following annual rates:

i. Account No. 341 (Structures & Improvements): 1.67% (ASL: 60 years);

ii. Account No. 342 (Fuel Holders, Producers & Accessories): 2.50% (ASL: 40 years);

iii. Account No. 343 (Prime Movers): 3.03% (ASL: 33 years);

actions believed that Commission certification was not required, but all of the parties agreed that the granting of a "footprint" certificate was not harmful and would serve the need for expedited construction of the substations in question. Consequently, the parties agreed that the Commission should authorize the projects and did not contest the Commission's jurisdiction in these matters.

- iv. Account No. 344 (Generators): 3.03% (ASL: 33 years);
- v. Account No. 345 (Accessory Electric Equipment): 2.50% (ASL: 40 years);
- vi. Account No. 346 (Miscellaneous Power Plant Equipment): 2.86% (ASL: 35 years).

These depreciation rates are the depreciation rates Staff will propose in the current rate case, Case No. ER-2007-0004 if Aquila successfully acquires the Aries combined cycle unit. On a composite basis they approximate the 2.86% depreciation rate (35 year ASL) ordered in The Empire District Electric Case No. 2004-0570 for the combined cycle unit plant accounts.

D. Aquila shall book each payment in lieu of tax ("PILOT") to operating expense during the remaining term of the Chapter 100 financing arrangement, as each annual payment is made.

E. No ratemaking determination is being made by the Commission in this proceeding and no party to this case has acquiesced to any present or future ratemaking treatment as it relates to this transaction. The ratemaking treatment of this transaction may be addressed in Aquila's next rate case or the Staff's next earnings complaint case, but no ratemaking treatment is being sought by Aquila in this proceeding.

F. Aquila shall seek and obtain Commission approval before it transfers any of the rights it holds pursuant to the lease where such rights are necessary or useful in the provision of regulated utility service, including the right to purchase the facility at the end of the lease.

G. Aquila shall not sell its rights to the Bond Purchase Agreement acquired through its acquisition of the Aries Facility without Commission approval.

Discussion

Section 393.190.1 provides, in pertinent part:

No gas corporation, electrical corporation, water corporation or sewer corporation shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any

part of its franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public utility, without having first secured from the commission an order authorizing it so to do. Every such sale, assignment, lease, transfer, mortgage, disposition, encumbrance, merger or consolidation made other than in accordance with the order of the commission authorizing same shall be void.

It is clear that if Aquila executes the APA, it would not be selling, assigning, leasing, transferring, or mortgaging the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public. The issue of the Commission's jurisdiction pursuant to Section 393.190 rests on whether this transaction would "encumber" any part of Aquila's assets that are necessary or useful in the performance of its duties to the public.

Aquila represents that the APA will be consummated with a cash transaction. Its Consolidated Balance Sheet reflects sufficient cash and cash equivalents to cover the \$158,500,000 purchase price to assume MEP's rights and obligations under the Lease and acquire all of MEP's rights, title and interest in the Bond. Staff's investigation did not reveal any type of financing arrangements that would result in Aquila encumbering the whole or any part of its franchise, works or system. There is no evidence in the record before the Commission to support the contention that Aquila has encumbered any Missouri rate-based assets that are necessary or useful to meet the public needs, as is required for the Commission to assert its jurisdiction pursuant to Section 393.190.

Aquila's also contends that even if the Commission would construe the APA as requiring Aquila to issue some form of long-term indebtedness, that Aquila, being a Delaware corporation, does not require Commission approval to incur long-term indebtedness. This position has merit, although the case cited by Aquila to support this proposition is not particularly persuasive. In *Union Pacific Railroad*, the court was interpreting Sections 54, 55 and 57 of the Public Service Act of 1913 and ultimately held that the railroad could sell bonds without the approval of the Commission.⁶ The court reasoned that to hold otherwise would constitute an interference with interstate commerce.⁷

The Commission no longer regulates railway companies and the current statute pertaining to the regulation of indebtedness of electric corporations is Section 393.200, a statute which has not been construed by Missouri courts to stand for the same proposition articulated in *Union Pacific*.⁸ However, Section 393.200 expressly

⁶ Public Service Commission v. Union P.R. Co., 197 S.W.39, 42 271 Mo. 258,268-270 (Mo. Banc 1917).

⁷ Id.

⁸ In Public Service Commission v. Union P.R. Co., 197 S.W.39, 42 271 Mo. 258,268-270 (Mo. Banc 1917), the court examined Section 57 of the Public Service Commission Act of 1913, entitled Approval of Issues of Stocks, Bonds and Other Forms of Indebtedness. The corollary statute applicable to electric companies at that time was in Article IV, Section 75. Section 75

applies to only those corporations “organized or existing or hereinafter incorporated under or by virtue of the laws of this state.”

Recently, in Case No. EO-2005-0156, In the Matter of the Application of Aquila, Inc. for Authority to Acquire, Sell and Lease Back Three Natural Gas-Fired Combustion Turbine Power Generation Units and Related Improvements to be Installed and Operated in the City of Peculiar, Missouri, the Commission dismissed the portion of Aquila’s application asking for approval of a Chapter 100 financing arrangement finding that it had no jurisdiction pursuant to Section 393.190. The Commission also examined whether Section 393.200 applied and stated:

A Missouri electrical corporation must seek Commission approval to issue debt; Aquila is not a Missouri electrical corporation. A Missouri electric corporation needs Commission approval before issuing debt that is based upon assets that necessary or useful to meet the public needs.⁹

Aquila is not a Missouri corporation and there is no evidence in the record to support the contention that Aquila has issued debt encumbering any Missouri rate-based assets that are necessary or useful to meet the public needs in order to execute the APA. No other statutory authority exists that confers jurisdiction upon the Commission for the regulation of a foreign electric corporation’s long-term indebtedness, if that indebtedness does not encumber Missouri rate-based assets that are necessary or useful to meet the public needs.

Decision

The Commission has reviewed the parties’ verified pleadings, which are hereby admitted into evidence. Pursuant to Commission Rule 4 CSR 240-2.080(16), the Commission shall grant Aquila’s motion for expedited treatment because of the Bankruptcy Court’s time-table for issuing a final ruling on the sale. The Commission shall also dismiss Aquila’s application finding that it lacks jurisdiction pursuant to Sections 393.190 and 393.200 to issue a dispositive order in this matter.

IT IS ORDERED THAT:

1. The motion for expedited treatment filed by Aquila, Inc., is granted.
2. The application filed by Aquila, Inc., on October 31, 2006, seeking an order authorizing it to execute, deliver and perform the agreements and instruments necessary to assume a lease and related documents pertaining to the Aries combustion turbine generator facility, assigned case number EO-2007-0172, is dismissed for lack of jurisdiction.
3. Nothing in this order shall be considered a finding by the Commission of the reasonableness or prudence of the expenditures herein involved, or of the value

from 1913 is essentially identical to the current version of Section 393.200 RSMo 2000, excepting that sewer corporations were not included in Section 75.

⁹ In the Matter of the Application of Aquila, Inc., for Authority to Acquire, Sell and Lease Back Three Natural Gas-Fired Combustion Turbine Power Generation Units and Related Improvements to be Installed and Operated in the City of Peculiar, Missouri, Case No. EO-2005-0156.

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for ratemaking purposes of the properties herein involved, nor as acquiescence in the value placed on said property.

4. The Commission reserves the right to consider the ratemaking treatment to be afforded the properties herein involved, and the resulting cost of capital, in any later proceeding.

5. This order shall become effective on December 8, 2006.

6. This case may be closed on December 9, 2006.

Davis, Chm., Murray and Appling, CC., concur
Gaw and Clayton CC., dissent

Stearley, Regulatory Law Judge

In the Matter of the Application of Laclede Gas Company for an Accounting Authority Order Authorizing the Company to Defer for Future Recovery the Costs of Complying with the Permanent Amendment to the Commission's Cold Weather Rule.*

Case No. GU-2007-0138

Gas §17. The Commission granted Laclede Gas Company an Accounting Authority Order to defer for future recovery of the costs of complying with the Commission's January 1, 2006 emergency amendment to the cold weather rule.

**ORDER GRANTING ACCOUNTING AUTHORITY ORDER RELATING
TO THE COSTS OF COMPLYING WITH THE 2006 AMENDMENT TO
THE COLD WEATHER RULE**

Issue Date: December 7, 2006

Effective Date: December 17, 2006

Laclede Gas Company filed a verified application for an accounting authority order (AAO) on September 29, 2006. Laclede seeks to defer for future recovery the costs of complying with the Commission's 2006 amendment to the cold weather rule. The issuance of such an AAO is authorized by Commission Rule 4 CSR 240-13.055(14)(F).

On October 3, the Commission issued an order and notice informing the public and other interested parties of Laclede's request for an AAO. That order also directed that any party wishing to apply to intervene do so by October 23. USW Local 11-6, the union representing some of Laclede's employees, applied to intervene on October 20. However, Local 11-6 withdrew its application to intervene on October 31. No other party has asked to intervene and no party has requested a hearing. On November 13, the Commission's Staff filed a recommendation advising

*This case was appealed to the Missouri Court of Appeals (WD70647) and affirmed. See 301 S.W.3d 556(Mo.App. W.D. 2009).

the Commission to approve Laclede's request for an AAO. No party has responded to Staff's recommendation.

Commission Rule 4 CSR 240-13.055(14)(G) provides that a gas utility is allowed to defer and recover the costs of complying with Commission Rule 4 CSR 240-13.055(14) through a 1-term AAO until the compliance costs are included in rates in a general rate case, or for a period of two years following the effective date of the 2006 amendment to the cold weather rule. That rule also provides that any such AAO is to be effective until September 30 of each year for the preceding winter. The rule does not give the Commission discretion to deny a properly filed request for an AAO.

The Commission's rule also requires a utility seeking to recover its costs of compliance to file a request for determination of the cost of compliance with Commission Rule 4 CSR 240-13.055(14) for the preceding winter season. The rule requires that such request for determination of costs be filed between September 30 and October 31 of each year. If Laclede wishes to recover the costs of complying with that section of the cold weather rule during the upcoming winter heating season, it will file the required request for determination of costs of compliance between September 30 and October 31, 2007.

The Commission finds that Laclede's request for an AAO relating to its cost of complying with the Commission Rule 4 CSR 240-13.055(14) is in proper form. The requested AAO will be granted.

IT IS ORDERED THAT:

1. Laclede Gas Company's Verified Application for Accounting Authority Order is granted.
2. Pursuant to the Accounting Authority Order granted by this order, Laclede Gas Company may book to Account 186 for review, audit and recovery all incremental expenses incurred and incremental revenue that are caused by compliance with Commission Rule 4 CSR 240-13.055(14).
3. The Accounting Authority Order granted by this order shall be effective until September 30, 2007.
4. This order shall become effective on December 17, 2006.

Davis, Chm., Murray and Appling, CC., concur
Gaw and Clayton, CC., concur, concurrence to follow

Woodruff, Deputy Chief Regulatory Law Judge

**CONCURRING OPINION OF COMMISSIONERS ROBERT M.
CLAYTON III AND STEVE GAW**

These Commissioners continue to disagree with the loose accounting method that was adopted in Case No. GX-2006-0434, finalizing the amendment to the Cold Weather Rule (CWR), and modifying the Emergency Cold Weather Rule's (ECWR) cost recovery method. This rule's cost recovery language allows Laclede to potentially recover gross costs (without reduction for additional revenues that may

be received as a result of the program) and receive inappropriate returns on alleged costs through hidden charges, rather than netting revenues against costs.

Therefore, we urge Staff to clearly match the revenues and expenses Laclede claims were incurred by compliance with the CWR or ECWR. Staff is the only gate keeper left to make sure that costs are offset with revenues received by Laclede through customers' payments made as a result of payment plans in the CWR provisions. Only to the extent Staff carefully reviews and audits Laclede's AAO documentation can this Commission assure ratepayers that Laclede is not passing through costs to them in excess of those actually incurred by Laclede, preventing the company from pocketing revenues that should be credited to ratepayers. Otherwise, ratepayers risk absorbing additional and improperly billed costs in their gas bills because this accounting method does not ensure the revenues a gas utility receives are evaluated during a rate case.

In the Matter of the Application of Laclede Gas Company for an Accounting Authority Order Authorizing the Company to Defer for Future Recovery the Costs of Complying with the Emergency Amendment to the Commission's Cold Weather Rule.

Case No. GU-2007-0137

Gas §17. The Commission granted Laclede Gas Co. an Accounting Authority Order to defer for future recovery of the costs of complying with the Commission's January 1, 2006 emergency amendment to the cold weather rule.

**ORDER GRANTING ACCOUNTING AUTHORITY ORDER RELATING
TO THE COSTS OF COMPLYING WITH THE EMERGENCY
AMENDMENT TO THE COLD WEATHER RULE**

Issue Date: December 7, 2006

Effective Date: December 17, 2006

Laclede Gas Company filed a verified application for an accounting authority order (AAO) on September 29, 2006. Laclede seeks to defer for future recovery the costs of complying with the Commission's January 1, 2006 emergency amendment to the cold weather rule. The issuance of such an AAO is authorized by Commission Rule 4 CSR 240-13.055(14)(F)4.

On October 3, the Commission issued an order and notice informing the public and other interested parties of Laclede's request for an AAO. That order also directed that any party wishing to apply to intervene do so by October 23. USW Local 11-6, the union representing some of Laclede's employees, applied to intervene on October 20. However, Local 11-6 withdrew its application to intervene on October 31. No other party has asked to intervene and no party has requested a hearing. On November 13, the Commission's Staff filed a recommendation advising

the Commission to approve Laclede's request for an AAO. No party has responded to Staff's recommendation.

Commission Rule 4 CSR 240-13.055(14)(G) provides that a gas utility is allowed to defer and recover the costs of complying with the emergency amendment to the cold weather rule through a 1-term AAO until the compliance costs are included in rates in a general rate case, or for a period of two years following the effective date of the 2006 amendment to the cold weather rule. That rule also provides that any such AAO is to be effective until September 30 of each year for the preceding winter. The rule does not give the Commission discretion to deny a properly filed request for an AAO.

The Commission's rule also requires a utility seeking to recover its costs of compliance to file a request for determination of the cost of compliance for the preceding winter season. The rule requires that such request for determination of costs be filed between September 30 and October 31 of each year. Because Laclede is seeking to recover the costs of complying with the emergency amendment that was in effect for January through March, 2006, it filed the required request for determination of costs of compliance on October 31. That request is pending in this case. Commission Rule 4 CSR 240-13.055(14)(G)2 allows all parties no longer than 120 days from that filing in which to state their position regarding Laclede's request for determination of costs, with all supporting evidence. The Commission is allowed 180 days from the filing in which to make a ruling establishing the costs that may be recovered. For this case, the responses of the other parties to Laclede's request for determination of costs are due no later than February 28, 2007. The Commission must rule on Laclede's request by April 29, 2007.

The Commission finds that Laclede's request for an AAO relating to its cost of complying with the Commission's January 1, 2006 emergency amendment to the cold weather rule is in proper form. The requested AAO will be granted.

IT IS ORDERED THAT:

1. Laclede Gas Company's Verified Application for Accounting Authority Order is granted.
2. Pursuant to the Accounting Authority Order granted by this order, Laclede Gas Company may book to Account 186 for review, audit and recovery all incremental expenses incurred and incremental revenue that are caused by compliance with the Commission's January 1, 2006 emergency amendment to the cold weather rule.
3. The Accounting Authority Order granted by this order shall be effective until September 30, 2007.
4. Any party wishing to submit a position regarding Laclede Gas Company's request for determination of the cost of compliance with the emergency amendment to the cold weather rule shall submit its position, with all supporting evidence, no later than February 28, 2007.
5. This order shall become effective on December 17, 2006.

Davis, Chm., Murray and Appling, CC., concur
Gaw and Clayton, CC., concur, concurrence to follow

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Woodruff, Deputy Chief Regulatory Law Judge

***NOTE:** Commissioners Gaw and Clayton filed a joint dissenting opinion in cases GU-2007-0137 and GU-2007-0138. See page 90 for a copy of that opinion.

Staff of the Public Service Commission of Missouri, Complainant, v. Laclede Gas Company, Respondent.

The Office of the Public Counsel, Complainant, v. Laclede Gas Company, Respondent.

Case No. GC-2006-0318

Case No. GC-2006-0431

Gas §11. Staff alleged that Laclede Gas Company has violated Commission regulations regarding notification to customers concerning the issuance of estimated bills. Also, Staff alleged that Laclede had not acted quickly enough to investigate and correct situations where it has shut off gas service at a meter or curb, but usage has continued to register on the meter. In other words, gas has continued to flow into the building under unknown conditions.

Gas §17. Office of Public Counsel alleges that Laclede has violated Commission regulations by billing customers for estimated gas usage for more than twelve months without obtaining an actual meter reading. The Commission approved Public Counsel's Stipulation and Agreement that required Laclede to provide at least \$500,000 in bill credits to residential customers who received a catch-up bill on or after November 1, 2004, for a period exceeding 12 consecutive months of estimated usage. The credit is to be equal to the amount of the catch-up bill that relates to under-billings for usage prior to the 12 consecutive months of estimated bills. The cost of such credits will be borne by Laclede's shareholders and will not be passed on to ratepayers.

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: December 21, 2006

Effective Date: December 31, 2006

This case is a consolidation of two separate complaints filed against Laclede Gas Company. The first case, Case No. GC-2006-0318, is a complaint brought by the Commission's Staff, containing two counts. The first count alleges that Laclede has violated Commission regulations regarding notification to customers concerning the issuance of estimated bills. In particular, Staff alleges:

Laclede failed to provide in a timely manner the required notification that estimated bills may not reflect actual usage and that the customer may read and report usage on a regular basis. Laclede has also failed to attempt to secure an actual reading at least annually.

The second count of Staff's complaint alleges that Laclede has not acted quickly enough to investigate and correct situations where it has shut off gas service at a meter or curb, but usage has continued to register on the meter. In other words, gas has continued to flow into the building under unknown conditions.

For both counts, Staff asks the Commission to require Laclede to take corrective actions. In addition, Staff asks leave to proceed to Circuit Court to seek statutory penalties against Laclede for the alleged violations of the Commission's regulations.

The second complaint, Case No. GC-2006-0431, is brought by the Office of the Public Counsel. It alleges that Laclede has violated Commission regulations by billing customers for estimated gas usage for more than twelve months without obtaining an actual meter reading. Public Counsel asks the Commission to require Laclede to take corrective action, and seeks penalties for the violations.

Both complaints were set for hearing beginning on November 8, 2006. On November 7, Public Counsel, Laclede, and USW Local 11-6¹ filed a Stipulation and Agreement that purports to resolve Public Counsel's complaint against Laclede, as well as Count 2 of Staff's complaint. Staff did not sign the Stipulation and Agreement.

The Commission convened the hearing at the scheduled starting time on November 8. At that time, the parties that signed the Stipulation and Agreement presented it to the Commission for approval. Staff indicated that it neither supported, nor opposed, the Stipulation and Agreement.² Staff, however, indicated that it does support the portion of the Stipulation and Agreement that concerns Count 2 of Staff's complaint relating to locked meter consumption. Staff states that it does not accept the Stipulation and Agreement as a resolution of Count 1 of its complaint and indicates that it seeks guidance from the Commission as to whether it should further pursue that portion of its complaint, either through Case No. GC-2006-0318, or by filing a new complaint.³ Laclede is aware of Staff's position, but believes that the submitted Stipulation and Agreement provides a reasonable remedy for the problems identified in Staff's complaint as well as those identified in Public Counsel's complaint.⁴ Similarly, Public Counsel indicates that the Stipulation and Agreement represents a reasonable settlement of its concerns. Despite Staff's position, the signatory parties continued to ask the Commission to approve their Stipulation and Agreement.⁵

On November 28, after the Commission initially discussed this Stipulation and Agreement at an agenda meeting, Staff filed additional comments in which it asked the Commission to impose certain requirements on Laclede to allow Staff to better monitor Laclede's customer service performance if the Commission chooses to

¹ USW Local 11-6 is the labor union that represents some of Laclede's workers. The Commission allowed Local 11-6 to intervene in the consolidated complaint case.

² Transcript pages 22-23.

³ Transcript pages 25-26.

⁴ Transcript page 34.

⁵ Transcript page 41.

approve the Stipulation and Agreement. On November 30, in response to Staff's additional comments, Laclede indicated that it would accept the monitoring requirements requested by Staff because it intended to fully comply with the Stipulation and Agreement. Laclede denied any wrong doing and opposed any suggestion that the Commission should impose additional penalties for past actions.

Staff did not sign the Stipulation and Agreement and therefore it is nonunanimous. However, Commission Rule 4 CSR 240-2.115 provides that if no party objects to a nonunanimous stipulation and agreement it may be treated as a unanimous agreement. Since no party objects to the Stipulation and Agreement, it will be treated as a unanimous agreement, as it relates to Public Counsel's complaint and Count 2 of Staff's complaint.

The Stipulation and Agreement resolves Public Counsel's complaint by requiring Laclede to provide at least \$500,000 in bill credits to residential customers who received a catch-up bill on or after November 1, 2004, for a period exceeding 12 consecutive months of estimated usage. The credit is to be made within 60 days of the approval of the Stipulation and Agreement. The amount of the credit is to be equal to the amount of the catch-up bill that relates to under-billings for usage prior to the 12 consecutive months of estimated bills. The cost of such credits will be borne by Laclede's shareholders and will not be passed on to ratepayers.

Laclede also agrees that in the future it will, in most situations, limit any residential billing of an undercharge to no more than 12 months from the date it obtains an actual meter reading. In addition, except in cases of diversion or fraudulent receipt of service, Laclede agrees to provide written notice to customers who receive a catch-up bill of \$100 or more, advising those customers of their right to pay the catch-up amounts in equal installments over a time period equal to the period over which the under-billing occurred. The Stipulation and Agreement also requires Laclede to take other specified steps to improve its service to its customers.

With regard to Count 2 of Staff's complaint, the Stipulation and Agreement requires Laclede to begin sending a notification letter to the affected location within five business days of discovering the unauthorized gas consumption. If the occupant of the affected location does not promptly contact Laclede to begin legitimate service, Laclede is to disconnect the flow of gas to the affected location no less than 10 business days and no more than 15 business days after the unauthorized flow of gas is detected. That disconnection may be performed regardless of the outside temperature.

Staff filed a separate complaint from that filed by Public Counsel. In particular, Staff contends that Laclede failed to secure actual meter readings at least annually and failed to provide timely notification to customers that estimated bills may not reflect actual usage and that those customers may read and report their own meters. Staff suggests that further penalties could be imposed on Laclede for alleged violations of the Commission's regulations regarding customer billings, and asks the Commission's guidance on how to proceed.

After reviewing the Stipulation and Agreement, the Commission finds that the steps that Laclede has agreed to take in this Stipulation and Agreement significantly benefit Laclede's customers, particularly those customers who were most affected by Laclede's billing practices. The customers who will receive bill credits if the

Stipulation and Agreement is approved are those who received catch-up bills based on more than 12 months of estimated bills. Although those customers may have been harmed by receiving an unexpectedly large catch-up bill after Laclede obtained an actual meter reading, the Stipulation and Agreement will require Laclede to give them a bill credit for gas that they actually used to compensate them for hardship they may have suffered.

The Commission finds that Laclede's customers, and the public, will be better served by the prompt resolution of these complaints that will be afforded by the approval of the Stipulation and Agreement. Therefore, the Commission will approve the Stipulation and Agreement as a final resolution of Public Counsel's complaint, and as a resolution of Count 2 of Staff's complaint.

Staff did not, however, sign the Stipulation and Agreement and is not bound by its terms. Therefore, the Stipulation and Agreement cannot finally resolve Count 1 of Staff's complaint. The Commission has not yet heard evidence about Staff's complaint and for that reason is unable to make any finding about that count. The Commission believes that the resolution of Public Counsel's complaint that is embodied in the Stipulation and Agreement provides relief for the customers allegedly harmed by Laclede's actions. For that reason, the Commission will direct its Staff not to seek additional penalties at this time.

To ensure that Laclede's billing practices improve as a result of the measures it is required to take by this Stipulation and Agreement, the Commission will hold Count 1 of Staff's complaint in abeyance and order Staff to monitor those billing practices for a period of three years. If Staff finds that Laclede does not comply with the terms of the Stipulation and Agreement, as well as the monitoring conditions requested by Staff, Staff may again ask the Commission for authority to seek penalties against Laclede.⁶

Since all aspects of Public Counsel's complaint are resolved by the Stipulation and Agreement, that case will be severed from the consolidated case and closed. Staff's complaint in Case No. GC-2006-0318 will remain open and pending before the Commission.

IT IS ORDERED THAT:

1. The Stipulation and Agreement filed on November 7, 2006, is approved as a resolution of the Office of the Public Counsel's complaint in Case No. GC-2006-0431 and of Count 2 of Staff's complaint in Case No. GC-2006-0318, and the signatory parties are ordered to comply with its terms.

2. Case No. GC-2006-0431 is severed from this consolidated case and shall be closed on January 1, 2007.

3. The Commission's Staff is directed not to pursue the imposition of penalties against Laclede Gas Company for the violations alleged by Staff in Count 1 of its complaint in Case No. GC-2006-0318, unless Laclede fails to comply with the terms of the Stipulation and Agreement and the requirements of this order. If, within the

⁶ The running of the two-year statute of limitation on the filing of a penalty action established by Section 516.390, RSMo 2000, is tolled while Staff's complaint is pending before the Commission. See *De Paul Hosp. v. Southwestern Bell Tel. Co.*, 539 S.W.2d 542 (Mo App. E.D. 1976); *State ex rel. Sure-Way Transp., Inc.* 836 S.W. 2d 23 (Mo App. W.D. (1992).

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next three years, Staff determines that Laclede Gas Company has failed to comply, it may again ask the Commission for authority to seek penalties against Laclede Gas Company.

4. Laclede Gas Company shall comply with the following monitoring conditions:

5. Laclede Gas Company shall provide consumer complaint responses in more timely fashion, as follows:

6. Laclede shall provide responses on disconnect and denial of service complaints within one business day;

7. Laclede shall provide responses on all other consumer complaints within five business days;

8. Laclede shall provide on all complaint responses the Statement of Account with the resolution form.

9. Laclede Gas Company shall provide to Staff and the Office of the Public Counsel a monthly status report on its AMR installation project;

10. Laclede Gas Company shall provide to Staff and the Office of the Public Counsel, on a monthly basis, the number of estimated bills issued, broken down by increments of 3, 4, 5, 6, 7, 8, 9, 10, 11, and 12 consecutive months of estimated billing;

11. Laclede Gas Company shall provide on a monthly basis, all call center performance reports currently being submitted on a quarterly basis.

12. Laclede Gas Company shall provide quarterly internal strategies and objectives for improving call center performance and customer service

13. Case No. GC-2006-0318 shall remain open for three years from the date of this order.

14. This order shall become effective on December 31, 2006.

Davis, Chm., and Appling, CC., concur
Murray, Gaw and Clayton, CC., concur,
concurrences to follow

Woodruff, Deputy Chief Regulatory Law Judge

CONCURRING OPINION OF COMMISSIONER CONNIE MURRAY

In its order, the Commission voted to hold Staffs complaint case open for three years to monitor Laclede Gas Company's ("Laclede") billing practices and its compliance with the Stipulation and Agreement. Laclede's failure to do so could result in staff requesting penalties against it. The Commission found that the Stipulation and Agreement resolved completely both the Office of Public Counsel's complaint and Count 2 of Staffs complaint. I voted for the Order because I believe the terms of the Stipulation and Agreement have benefit to Laclede's customers and that the revised language at least provides some clear direction as to Laclede's future responsibilities. I believe, however, that the Commission should have accepted the Stipulation and Agreement as a resolution of all the issues and closed the case.

CONCURRING OPINION OF COMMISSIONERS
ROBERT M. CLAYTON III AND STEVE GAW

These Commissioners concur in the result of the Report and Order because Laclede will now be directed to compensate its customers who were harmed by the company's improper billing practices. The Commission found that the Stipulation and Agreement signed by the Office of Public Counsel (OPC) and Laclede fully resolved the issues in OPC's complaint case (GC-2006-0431) and resolved Count 2 of Staff's complaint case (GC-2006-0318). These Commissioners support the approval of the Stipulation and Agreement because it requires Laclede to provide a minimum of \$500,000 in bill credits to residential customers who received a catch-up bill on or after November 1, 2004, or for a billing period exceeding 12 consecutive months of estimated usage. Laclede must make these credits within 60 days of the approval of the Stipulation and Agreement. These credits will help compensate the customers who received unexpectedly large catch-up bills after Laclede obtained an actual meter reading by reimbursing them for gas they used during this period. However, approval of the Stipulation and Agreement is not the only way to provide reparation for the hardship these customers may have experienced.

These Commissioners would have preferred to approve the Stipulation and Agreement as it related to OPC's complaint and Count 2 of Staff's complaint and severed Count 1 of Staff's complaint. This scenario would have put money back in the pockets of Laclede's customers and allowed Staff to prosecute its complaint and potentially seek penalties. It is significant to note that Staff sought penalties of at least \$50 million and stated that they may actually reach \$5 billion. Never in the history of the Public Service Commission has a case resulted in penalties of this extreme amount. These Commissioners are concerned that the opportunity to punish a company for systematically and persistently violating Commission rules may have been missed.

The Signatories to the Stipulation and Agreement specifically included language that would have allowed the process these Commissioners prefer to occur.

These agreements are being entered into for the sole purpose of disposing of all of the issues raised by the signatories in the case. Nothing herein, however, shall preclude Laclede from arguing that the measures agreed upon herein are also sufficient to resolve in an appropriate way any other issues that may have been raised in these consolidated cases. *Stipulation and Agreement at p.6*

However, the majority of the Commission did not support this process. Instead of standing in the way of Laclede customers receiving compensation, these Commissioners agreed to support the Stipulation and Agreement with Staff's suggested conditions.

The Stipulation and Agreement includes a directive to Staff to not pursue penalties against Laclede for the violations alleged in Count 1 of Staff's complaint unless Laclede disobeys the conditions established in the Stipulation and

Agreement in the next three years. Laclede will report information related to customer billing issues as specified in the Stipulation and Agreement to Staff who will thoroughly review this information. Staff is specifically authorized to pursue penalties for the alleged violations in the original complaint case (GC-2006-0318) if Laclede violates any of the conditions in the Stipulation and Agreement. This enables Staff to seek punishment for the alleged past violations; closely monitor Laclede's customer billing practices; and one may argue that it will allow Staff to pursue a new complaint case based on any new violations found during this three year time period if appropriate.

It is important to note that Laclede does not object to the conditions in the Stipulation and Agreement. The Stipulation, contrary to inference in the majority opinion, does not prevent the Commission from continuing to consider the practice of statutory penalties.

These Commissioners support the Stipulation and Agreement because of the payment of bill credits directly to the customers who were harmed by Laclede's improper billing practices. However, we believe Staff should continue to pursue its case regarding the appropriateness of penalties.

In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Provided to Customers in its Missouri Service Area.*

Case No. ER-2006-0315

Electric §20. The Commission ordered that the proposed electric service tariff sheets submitted under Tariff File No. YE-2006-0597 on Feb 1, 2006, by Empire District Electric Company for the purpose of increasing rates for retail service to customers is rejected.

APPEARANCES

James C. Swearingen, Dean L. Cooper, and L. Russell Mitten, Attorneys at Law, Brydon, Swearingen & England, P.C., 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri 65102-0456, For The Empire District Electric Company of Joplin, Missouri.

Diana C. Carter, Attorney at Law, Brydon, Swearingen & England, P.C., 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri 65102-0456, for Aquila, Inc.

James M. Fischer, Fischer & Dority, P.C., 101 Madison, Suite 400, Jefferson City, Missouri 65101, for Kansas City Power & Light.

*See 236 S.W.3d 632 for granting of Writ of Mandamus regarding rehearing of order approving tariff. The Report and Order was appealed to the Missouri Court of Appeals and affirmed. See 328 S.W.3d 329 (Mo.App. W.D. 2010).

Shelley A. Woods, Assistant Attorney General, Supreme Court Building, Post Office Box 899, Jefferson City, Missouri 65102, for the Missouri Department of Natural Resources.

Stuart Conrad and David Woodsmall, Attorneys at Law, Finnegan, Conrad & Peterson, 1209 Penntower Office Center, 3100 Broadway, Kansas City, Missouri 64111, for Explorer Pipeline Company and Praxair, Inc.

Lewis Mills, Public Counsel, Office of the Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Dennis L. Frey, Senior Counsel, Steven Dottheim, Chief Deputy General Counsel, Kevin A. Thompson, General Counsel, Nathan Williams, Deputy General Counsel, David A. Meyer, Senior Associate General Counsel, Jennifer Heintz and Robert Berlin, Assistants General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Colleen M. Dale, Chief.

REPORT AND ORDER

Issue Date: December 21, 2006

Effective Date: December 31, 2006

I. Background

A. Procedural History

On February 1, 2006, The Empire District Electric Company ("Empire") filed proposed tariff sheets, Tariff File No. YE-2006-0597, designed to implement a general rate increase for retail electric service. The matter was opened and denominated ER-2006-0315. The new rates contained therein were designed to produce an additional \$29,513,713 in gross annual electric revenues, excluding gross receipts, sales, franchise, and occupational taxes, a 9.63% increase over existing revenues. The tariff sheets proposed an effective date of March 3, 2006.

The Commission issued its Suspension Order and Notice on February 7, 2006, suspending the proposed tariff sheets for 180 days plus six months from the original proposed effective date, that is, until January 1, 2007. In that order, the Commission also set an evidentiary hearing and a deadline for intervention applications. Intervention was granted to Praxair, Inc., Explorer Pipeline Company, Aquila, Inc., Kansas City Power & Light, and the Missouri Department of Natural Resources ("DNR").

On April 11, the Commission adopted a procedural schedule that included dates for the filing of prepared testimony and a briefing schedule. On June 26 and June 27, pursuant to notice provided by the Company through billing inserts, the Commission convened local public hearings within Empire's service territory, at Joplin and Reeds Spring, respectively.

Pursuant to the procedural schedule, the Commission convened an evidentiary hearing on September 7 at its offices in Jefferson City, Missouri. Proceedings continued during that week and during the week of September 15. The true-up portion of the hearing was held on November 20. The Commission heard the testimony of 44 witnesses; 153 exhibits were offered during the hearing, including the pre-filed testimony of the witnesses. Most of those exhibits were admitted, some over objection preserved for appeal, some of which were admitted after a portion was stricken. Some of the exhibits were not admitted, although of some, administrative notice was taken.

Many issues were resolved by the agreement of the parties. On August 18, a Stipulation and Agreement as to Certain Issues was filed and served on the parties. No party objected and the stipulation was approved by the Commission on August 31. On September 13, a Nonunanimous Stipulation and Agreement Regarding Rate Design Issues was filed. No party objected and the stipulation became unanimous by operation of Commission rule on September 20. Two further stipulations were filed, one concerning corporate allocations and one on regulatory plan amortizations. As timely objections were raised to those two stipulations, by Commission rule the stipulations are reduced to non-binding position statements and all issues contained therein remain for determination on the merits.

On November 20, at the conclusion of the hearing, with no further briefing or pleadings due, the parties were informed that although no further filings were required, they were welcome to file any supplemental pleading they believed was appropriate. The Industrials availed itself of the opportunity and filed a True-Up Brief on November 27.

B. Previous Agreement Concerning Fuel and Purchased Power Expense

On April 30, 2004, The Empire District Electric Company ("Empire") filed proposed tariff sheets, Tariff File No. YE-2004-1324, designed to implement a general rate increase for retail electric service. The matter was opened and denominated ER-2004-0570. The proposed rates were designed to produce an additional \$38,282,294 in gross annual electric revenues. In partial settlement of that matter, on February 22, 2005, a Nonunanimous Stipulation and Agreement Regarding Fuel and Purchased Power Expense ("2005 Stipulation") was filed and served on the parties. No party objected and the stipulation became unanimous by operation of Commission rule on March 1.¹ As such, it was subsequently approved by the Commission in its Report and Order issued on March 10, 2005.

The 2005 Stipulation purported to resolve the fuel and purchased power expense at issue in ER-2004-0570 by agreement to a certain level of recovery of those expenses in Empire's permanent rates, not subject to refund, and recovery of an additional amount on an interim basis, subject to true-up and refund, referred to as the Interim Energy Charge ("IEC"). The IEC was to be in effect for three years. The 2005 Stipulation provided:

¹ The Commission's Staff did file Comments in response to the Nonunanimous Stipulation, but expressly stated that these were not objections.

The IEC tariff or rate schedule will expire no later than 12:01 a.m. on the date that is three years after the original effective date of the revised tariff sheets authorized by the Commission in this case, Case No. ER-2004-0570, unless earlier terminated by the Commission. (page 4)

and

In consideration of the implementation of the IEC in this case and the agreement of the Parties to waive their respective rights to judicial review or to otherwise challenge a Commission order in this case authorizing and approving the subject IEC, for the duration of the IEC approved in this case Empire agrees to forego any right it may have to request the use of, or to use, any other procedure or remedy, available under current Missouri statute or subsequently enacted Missouri statute, in the form of a fuel adjustment clause, a natural gas cost recovery mechanism, or other energy related adjustment mechanism to which the Company would otherwise be entitled. (page 12)

One of the many issues in the present matter is whether the language in the 2005 Stipulation precludes Empire from seeking a different fuel adjustment clause, precludes Empire from seeking to terminate the IEC and recover all of its fuel and purchased power expenses through its permanent rates, or precludes the Commission from terminating the IEC *sua sponte* and including all of the fuel and purchased power expenses in Empire's permanent rates.

On March 24, 2006 in the present matter, Empire requested clarification of the 2005 Stipulation. In its initial filing creating the present case, Empire sought to terminate the use IEC and implement an energy cost recovery rider ("ECR"). Certain other Parties asserted that such a request contravened the 2005 Stipulation. Empire asserted that the 2005 Stipulation anticipated the use of the IEC for up to three years, but that it could be terminated at any time during that period by the Commission, contemplating the possibility that the IEC could be terminated early, allowing Empire to avail itself of the newly-created ECR.

After review of the matter, the Commission issued an Order on May 2, 2006 that determined that Empire's position was not supported by the language in the 2005 Stipulation and that Empire is precluded from requesting the use of another fuel adjustment mechanism during the period in which the IEC is in effect, but may have the option of requesting that the IEC be terminated. The Commission required that Empire remove from its pleadings and other filings in this matter any request, or testimony in support of a request, for an ECR. Empire did not seek rehearing of that Order, but did not remove the precluded language. On May 26, 2006, Praxair Inc. and Explorer Pipeline, Inc. ("the Industrials"), filed a Motion to Reject Specified Tariff Sheets and Strike Testimony seeking to strike not only the precluded language, but also language pertaining to termination of the IEC and inclusion of the associated expenses in permanent rates. On June 1, 2006, Empire conceded that it should strike the precluded language but not the additional language the Industrials sought

to have stricken. The Commission, by Order issued June 15, 2006 rejected tariffs and struck testimony pertaining to the ECR, but not that pertaining to termination of the IEC and inclusion of the associated expenses in permanent rates.

II. Discussion

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.²

A. Jurisdiction

The record shows that Empire operates generation plants for the purpose of generating electricity for sale at retail. The Commission concludes that Empire is

² In making its Findings of Fact and Conclusions of Law, the Commission is mindful that it is required, after a hearing, to "make a report in writing in respect thereto, which shall state the conclusion of the commission, together with its decision, order or requirement in the premises." Section 386.420.2, RSMo 2000. Because Section 386.420 does not explain what constitutes adequate findings of fact, Missouri courts have turned to Section 536.090, which applies to "every decision and order in a contested case," to fill in the gaps of Section 386.420. *St. ex rel. Laclede Gas Co. v. Pub. Serv. Comm'n of Mo.*, 103 S.W.3d 813, 816 (Mo. App., W.D. 2003); *St. ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n*, 24 S.W.3d 243, 245 (Mo. App., W.D. 2000). Section 536.090 provides, in pertinent part:

Every decision and order in a contested case shall be in writing, and . . . the decision . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order.

Missouri courts have not adopted a bright-line standard for determining the adequacy of findings of fact. *Glasnapp v. State Banking Bd.*, 545 S.W.2d 382, 387 (Mo. App. 1976). Nonetheless, the following formulation is often cited:

The most reasonable and practical standard is to require that the findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence. *Id.* (quoting 2 *Am. Jur.2d Administrative Law* § 455, at 268).

Findings of fact are inadequate when they "leave the reviewing court to speculate as to what part of the evidence the [Commission] believed and found to be true and what part it rejected." *St. ex rel. Int'l. Telecharge, Inc. v. Mo. Pub. Serv. Comm'n*, 806 S.W.2d 680, 684 (Mo. App., W.D. 1991) (quoting *St. ex rel. Am. Tel. & Tel. Co. v. Pub. Serv. Comm'n*, 701 S.W.2d 745, 754 (Mo. App., W.D. 1985)). Findings of fact are also inadequate that "provide no insight into how controlling issues were resolved" or that are "completely conclusory." *St. ex rel. Monsanto Co. v. Pub. Serv. Comm'n*, 716 S.W.2d 791, 795 (Mo. banc 1986) (relying on *St. ex rel. Rice v. Pub. Serv. Comm'n*, 359 Mo. 109, 220 S.W.2d 61 (1949)).

thus an electrical corporation within the intendments of Section 386.020(15) and a public utility pursuant to Section 386.020(42), RSMo Supp. 2004.³ The Commission thus has jurisdiction over Empire's services, activities, and rates pursuant to Sections 386.020(42), 386.250 and Chapter 393.

B. Burden of Proof

Section 393.150.2 provides in part, "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation . . . and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

C. Ratemaking Standards and Practices

The Commission is vested with the state's police power to set "just and reasonable" rates for public utility services,⁴ subject to judicial review of the question of reasonableness.⁵ A "just and reasonable" rate is one that is fair to both the utility and its customers;⁶ it is no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."⁷ In 1925, the Missouri Supreme Court stated:⁸

The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of

³ Unless otherwise specified, all statutory references are to the Revised Statutes of Missouri (RSMo), revision of 2000.

⁴ Section 393.130, in pertinent part, requires a utility's charges to be "just and reasonable" and not in excess of charges allowed by law or by order of the commission. Section 393.140 authorizes the Commission to determine "just and reasonable" rates.

⁵ *St. ex rel. City of Harrisonville v. Pub. Serv. Comm'n of Missouri*, 291 Mo. 432, 236 S.W. 852 (1922); *City of Fulton v. Pub. Serv. Comm'n*, 275 Mo. 67, 204 S.W. 386 (1918), error dis'd, 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; *City of St. Louis v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 509, 207 S.W. 799 (1919); *Kansas City v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 539, 210 S.W. 381 (1919), error dis'd, 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348 (1951).

⁶ *St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n*, 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

⁷ *St. ex rel. Washington University et al. v. Pub. Serv. Comm'n*, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

⁸ *Id.*

fair returns for capital invested. * * * These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

The Commission's guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.⁹ "[T]he dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental."¹⁰ However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.¹¹ "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."¹²

The Commission has exclusive jurisdiction to establish public utility rates,¹³ and the rates it sets have the force and effect of law.¹⁴ A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission;¹⁵ neither can a public utility change its rates without first seeking authority from the Commission.¹⁶ A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's.¹⁷ Thus, "[r]atemaking is a balancing process."¹⁸

Ratemaking involves two successive processes:¹⁹ first, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to

⁹ *May Dep't Stores Co. v. Union Elec. Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 48 (1937).

¹⁰ *St. ex rel. Crown Coach Co. v. Pub. Serv. Comm'n*, 179 S.W.2d 123, 126 (1944).

¹¹ *St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 49 (Mo. banc 1979).

¹² *St. ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

¹³ *May Dep't Stores, supra*, 107 S.W.2d at 57.

¹⁴ *Utility Consumers Council, supra*, 585 S.W.2d at 49.

¹⁵ *Id.*

¹⁶ *Deaconess Manor Ass'n v. Pub. Serv. Comm'n*, 994 S.W.2d 602, 610 (Mo. App., W.D. 1999).

¹⁷ *May Dep't Stores, supra*, 107 S.W.2d at 50.

¹⁸ *St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n*, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988).

¹⁹ It is worth noting here that Missouri recognizes two distinct ratemaking methods: the "file-and-suspend" method and the complaint method. The former is initiated when a utility files a tariff implementing a general rate increase and the second by the filing of a complaint alleging that the subject utility's rates are not just and reasonable. See *Utility Consumers Council, supra*, 585 S.W.2d at 48-49; *St. ex rel. Jackson County v. Pub. Serv. Comm'n*, 532 S.W.2d 20, 28-29 (Mo. banc 1975), *cert. denied*, 429 U.S. 822, 50 L.Ed.2d 84, 97 S.Ct. 73 (1976).

the investors.²⁰ The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers. Revenue requirement is usually established based upon a historical test year that focuses on four factors:²¹ (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.²² The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D) R$$

where: RR = Revenue Requirement;
 C = Prudent Operating Costs, including Depreciation Expense and Taxes;
 V = Gross Value of Utility Plant in Service;
 D = Accumulated Depreciation; and
 R = Overall Rate of Return or Weighted Cost of Capital.

The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.²³ The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. Section 393.140(4) authorizes the Commission to prescribe uniform methods of accounting for utilities and Section 393.140(8) authorizes the Commission to examine a utility's books and records and, after hearing, to determine the accounting treatment of any particular transaction. In this way, the Commission can determine the utility's prudent operating costs. Section 393.230 authorizes the Commission to value the property of electric utilities operating in Missouri, that is, to determine the rate base.²⁴ Section 393.240 authorizes the Commission to set depreciation rates and to adjust a utility's depreciation reserve from time-to-time as may be necessary.

The Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a Rate of Return. For any utility, its fair Rate of Return is simply its composite cost of capital. The composite cost of capital

²⁰ St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n, 850 S.W.2d 903, 916 n. 1 (Mo. App., W.D. 1993).

²¹ In the present case, the test year was established as the twelve months ending December 31, 2003, updated for known and measurable changes through June 30, 2004. *In the Matter of the Tariff Filing of the Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service to Customers in its Missouri Service Area*, Case No. ER-2004-0570 (Order Concerning Test Year and True-up, and Adopting Procedural Schedule, issued June 17, 2004) at 7.

²² *Id.*, citing Colton, "Excess Capacity: Who Gets the Charge From the Power Plant?," 34 Hastings L.J. 1133, 1134 & 1149-50 (1983).

²³ See St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n, *supra*.

²⁴ Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."

is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

D. Overview

1. The Parties

The Empire District Electric Company is a publicly-traded Kansas corporation, headquartered in Joplin, Missouri. Empire provides retail electric service in Missouri, Kansas, Arkansas, and Oklahoma; retail water service in Missouri; and is also certificated to provide telecommunication services in Missouri. In addition, Empire recently acquired Aquila, Inc.'s natural gas distribution operations in Missouri. On April 18, 2006, the Commission issued an order approving that transaction; on June 15 it recognized the adoption of Aquila's relevant tariffs.

Intervenor Praxair, Inc., produces compressed gases at a plant near Neosho, Missouri, within Empire's service territory. Praxair is served under interruptible rates, which means that service to Praxair can be reduced on short notice, making more power available to Empire to serve other customers.

Intervenor Explorer Pipeline, Inc., operates a refined petroleum products pipeline stretching from the coast of the Gulf of Mexico to the Chicago area, with various truck terminals along that route. Explorer uses electric compressors to move its products through the pipeline and has three compressor stations within Empire's service territory.

Intervenor Kansas City Power & Light is a regulated electric and gas utility that operates in Missouri and elsewhere.

Intervenor Aquila, Inc. is a regulated electric and gas utility that operates in Missouri and elsewhere.

The Missouri Department of Natural Resources ("DNR") is an executive branch department authorized and established by Chapter 640, RSMo. Sections 640.150 through 640.185 charge the Department with certain responsibilities with respect to energy.

The Public Counsel ("OPC") is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"²⁵

The Staff of the Commission traditionally appears as a party in Commission proceedings and is represented by the Commission's General Counsel, an employee of the Commission authorized by statute to "represent and appear for the Commission in all actions and proceedings involving this or any other law [involving the Commission.]"²⁶

²⁵ Sections 386.700 and 386.710.

²⁶ Section 386.071.

2. Empire's Proposed General Rate Increase

As filed, Empire's proposed tariffs sought additional gross annual Missouri jurisdictional revenue of approximately \$29.5 million annually, a 9.63% increase.

3. Empire's Operations

Empire provides electric service in an area of about 10,000 square miles in Southwest Missouri and the adjacent areas of Arkansas, Kansas and Oklahoma. As of September 30, 2005, Empire had 135,222 residential electric customers, 23,773 commercial customers, 366 industrial customers, 1,861 public authority customers, and 4 wholesale customers in 121 communities in 20 counties. Most of these communities are small; the largest is Joplin, with about 45,500 inhabitants at the end of 2004. About 88.8% of Empire's 2005 retail electric revenues are derived from Missouri. In Missouri, as of September 30, 2005, Empire had 118,631 residential customers, 20,968 commercial customers, 294 industrial customers, 1,503 public authority customers, and 3 wholesale customers.

E. The Issues

As required by the procedural schedule, the parties jointly filed a list of issues to be determined by the Commission. Each party also filed a statement of its position with respect to each issue. In setting out the issues developed by the parties and the parties' stated positions on those issues, the Commission seeks only to inform the reader of these items. The parties' framing of the issues may not accurately reflect the material issues under the applicable statutes and rules. Those issues as formulated by the parties are fully recited at the beginning of the discussion of each issue, set forth below.²⁷

1. Return on Common Equity: What return on common equity should be used for determining Empire's rate of return?

The Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.²⁸ The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must guide the Commission in its task.²⁹ In the earlier of these cases, *Bluefield Water Works*, the Court stated that:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render

²⁷ Only the issues and sub-issues not resolved by the two unanimous stipulations are shown. The numbering of the issues is unchanged from the original list. The parties' positions on the issues are discussed, to the extent necessary, elsewhere in this order.

²⁸ Phillips, *The Regulation of Public Utilities*, supra, 394; Goodman, *1 The Process of Ratemaking*, supra, 606.

²⁹ *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.³⁰

In the same case, the Court provided the following guidance as to the return due to equity owners:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.³¹

The Court restated these principles in *Hope Natural Gas Company*, the later of the two cases:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.³²

Two principal methods have emerged for determining the cost of Common Equity: these are the "market-determined" approach and the "comparable earnings" approach.³³ The market-determined approach relies upon stock market transactions

³⁰ *Bluefield, supra*, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

³¹ *Id.*, 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

³² *Hope Nat. Gas Co., supra*, 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

³³ *Phillips, supra*, 394.

and estimates of investor expectations.³⁴ Examples of market-determined methods are the discounted cash flow ("DCF") and the capital asset pricing model ("CAPM").³⁵ The comparative earnings approach relies upon the concept of "opportunity cost," that is, the return the investment would have earned in the next best alternative use.³⁶ The comparative earnings approach requires a comparative study of earnings on common equity in enterprises of similar risk, regardless of whether the enterprises are regulated or unregulated.³⁷ A method that was used by Empire witness Vander Weide, and which does not fall within the boundaries of either of the principal approaches referred to above, is the Risk Premium method. This method is "relatively straightforward" and requires that the analyst "(1) determine the historic spread between the return on debt and the return on common equity, and (2) add this risk premium to the current debt yield to derive an approximation of current equity return requirements."³⁸ In the final analysis, it is not the method employed, but the result reached, that is important.³⁹ The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."⁴⁰

The annual form of the DCF method of calculating a fair return on common equity can be expressed algebraically by this equation:

$$k = D_1/P_S + g$$

where: k is the cost of equity;

g is the constant annual growth rate of earnings, dividends and book value per share;

D_1 is the expected next period annual dividend; and

P_S is the current price of the stock.

Assuming that dividends grow at a constant annual rate, g , this equation can be solved for k , the cost of equity. The term D_1/P_S is called the dividend yield component of the annual DCF model, and the term g is called the growth component of the annual DCF model. The annual DCF model is only a correct expression for the present discounted value of future dividends if the dividends are

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*, at 397.

³⁷ *Id.*, at 397-98.

³⁸ *Id.*, at 399.

³⁹ Within a wide range of discretion the Commission may select the methodology. *Missouri Gas Energy v. Public Service Comm'n*, 978 S.W.2d 434 (Mo. App., W.D. 1998), rehearing and/or transfer denied; *State ex rel. Associated Natural Gas Co. v. Public Service Commission*, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981). It may select a combination of methodologies. *State ex rel. City of Lake Lotawana v. Public Service Comm'n of State*, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

⁴⁰ *Fed. Power Comm'n v. Nat. Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

paid annually. The quarterly DCF model differs from the annual DCF model in that it expresses a company's price as the present discounted value of a quarterly stream of dividend payments. The quarterly DCF equation shows that the cost of equity is: the sum of the future expected dividend yield and the growth rate, where the dividend in the dividend yield is the equivalent future value of the four quarterly dividends at the end of the year, and the growth rate is the expected growth in dividends or earnings per share.⁴¹

The CAPM describes the relationship between a security's investment risk and its market rate of return. This relationship identifies the rate of return that investors expect a security to earn so that its market return is comparable with the market returns earned by other securities that have similar risk. The general form of the CAPM is as follows:

$$k = R_f + \beta (R_m - R_f)$$

where: k = the expected return on equity for a specific security;

R_f = the risk-free rate;

β = beta; and

R_m - R_f = the market risk premium.⁴²

The "Risk Premium Method" is based on the principle that investors expect to earn a return on an equity investment in Empire that reflects a "premium" over and above the return they expect to earn on an investment in a portfolio of bonds. This equity risk premium compensates equity investors for the additional risk they bear in making equity investments instead of bond investments. The formula for the ex ante risk premium calculation is as follows:

$$RP_{\text{PROXY}} = DCF_{\text{PROXY}} - I_A$$

Where: RP_{PROXY} = the required risk premium on an equity investment in the proxy group of companies,

DCF_{PROXY} = average DCF cost of equity on a portfolio of proxy companies, and

I_A = the yield to maturity on an investment in A-rated utility bonds.

Empire is a publicly-traded utility. Empire's consolidated common equity ratio has ranged from a high of 48.02% to a low of 37.26% from 2001 through 2005. During the past five years, Empire's average return on common equity ("ROE") has been fairly low. Although Empire's ROE was above 8% in 2001 and 2002, since then it has been 6% or lower. Empire's corporate credit rating by Standard & Poor's was downgraded, on May 16, 2006, from BBB to BBB-, the lowest investment grade rating, although it does give Empire a "stable" outlook. Further, it removed Empire from a negative credit watch on February 13, 2006.⁴³

⁴¹ Vander Weide Direct at 20-23.

⁴² King Direct at 20.

⁴³ Murray Direct at 13-14.

The industry national average ROE for electric utilities in 1st Quarter 2006 was 10.57%, and 10.55% for the year 2005.⁴⁴ Empire's ROE was 6.04% for 2005.⁴⁵ Empire's ROE is expected by analysts to be 6.5% for 2006. Since 2001, Empire has paid out virtually all of its earnings as dividends, dipping below 100% only once in the past five years.⁴⁶ Empire's 2005 Annual Report, filed with the Commission as required by statute, states that Empire's total operating revenues were \$386,160,000 for the 12 months ended December 31, 2005, versus \$325,540,000 for the 12 months ended December 31, 2004. These 2005 revenues resulted in an overall net income applicable to common stock of \$23,768,000 for an earnings per share of \$0.92 as compared to the 2004 net income applicable to common stock of \$21,848,000 for an earnings per share of \$0.86. These revenues and net incomes were generated from total property, plant and equipment of \$896,033,000 at December 31, 2005 and \$857,035,000 at December 31, 2004.⁴⁷

James Vander Weide is a Research Professor at Duke University who testifies in this matter on behalf of Empire. Charles King is an economic consultant who testifies in this matter on behalf of OPC. David Murray is a Utility Regulatory Auditor III who testifies in this matter on as a member of the Staff. All three are experienced in testifying and are experts in the area of regulatory economics.

Vander Weide estimated Empire's cost of equity in two steps. First, he applied the quarterly DCF method yielding a result of 10.9%; the risk premium method (both the ex ante and ex post methods) which yielded results of 11% and 11.4% respectively;⁴⁸ and the CAPM yielding a result of 12.2% to a proxy group of comparable companies, including 34 electric utilities and 13 gas utilities, for a total of 47 companies, and determined that the average cost of equity for his proxy companies was 11.3%.⁴⁹ Second, he adjusted the average cost of equity for the proxy group for the difference in the financial risk implied by the capital structure of Empire⁵⁰ by adding 40 basis points to the result to reach his recommendation of 11.7%.⁵¹

King used the DCF method, applying it to two groups of comparison companies. The first group consisted of 16 electric companies that derive over 75% of their revenue from regulated utility service, noting that Empire generated 93.2% of its 2005 revenue from such services.⁵² The second group consisted of those plus 10 additional companies that derive a significant portion of their revenue from unregulated activities. As a check, King calculated Empire's cost of common equity

⁴⁴ Murray Direct at 32.

⁴⁵ Murray Direct at 14-15.

⁴⁶ Murray Direct at 15.

⁴⁷ Murray Direct at 13.

⁴⁸ VanderWeide Rebuttal at 43.

⁴⁹ Vander Weide Direct at 49.

⁵⁰ Vander Weide Direct at 50.

⁵¹ Vander Weide Direct at 51.

⁵² King Direct at 6.

using the CAPM analysis, producing a 9.85% ROE.⁵³ Using the classic DCF method, King's analyses produced results of 9.65% for the first group, 10.09% for the second group and 10.57% for Empire itself.⁵⁴ Based on his conviction that the DCF for the first group, whose derivation of revenue is most closely aligned with Empire's, was the more appropriate conclusion, King gives 9.65% as his final recommendation.⁵⁵

Murray primarily relied on a comparable-companies method to determine the cost of common equity for Empire. He first relied on the Standard & Poor's list of vertically-integrated electric utilities, of which there are eleven, including Empire. He then applied additional criteria to narrow the group to six, including Empire. He then treated the five remaining comparables as a group. Using the DCF method, and after compensating for growth volatility, Murray arrived at a range of 9.0% - 9.3% for the proxy group of comparable companies. Murray also used the CAPM analysis to check the reasonableness of his DCF results. Using three different variables in the risk premium value in the CAPM formula, the resulting ROEs for the proxy group were 6.24%, 8.98% and 10.26%. Using forward-looking risk premium inputs yielded 7.39% - 8.79% ROEs for the proxy group. Finally, Murray selected a group of four comparable companies and applied the DCF method and the CAPM to them to further test the reasonableness of his company-specific DCF result. Using the comparable company analysis, giving "considerable deference" to the projected earnings per share growth rates and adding ten basis points for every notch of credit rating differential from the comparable company average of BBB+, Murray recommended an ROE for Empire of 9.2% - 9.5%. In his rebuttal testimony, Murray revised the growth rate and dividend yield, resulting in a revised recommendation of 9.5% - 9.6%.⁵⁶

Determining ROE "is an area of ratemaking in which agencies welcome expert testimony and yet must often make difficult choices between conflicting testimony."⁵⁷ The experts did not agree in their recommendations or in the methods used to reach those recommendations, although they used the same formulae and performed similar analyses. Vander Weide and King both began with DCF approaches, and both then used a CAPM analysis. King used it as a check on his DCF analysis, Vander Weide as a second computational method from which to derive an average; he then went on to apply two risk premium analyses. Murray started with a comparable companies approach, then applied the DCF and CAPM analyses to his group of companies. Their methods were similar; the difference in results is derived mainly from the comparable companies that formed the "proxy group." Vander Weide's consisted of 47 regulated energy utilities; King's consisted of 16 regulated electric utilities that derive over 75% of their revenue from retail electric service; Murray's consisted of 5 comparable, vertically-integrated, regulated energy utilities.

⁵³ King Direct at 23.

⁵⁴ King Direct at 15.

⁵⁵ King Direct at 27-28.

⁵⁶ Murray Rebuttal at 3.

⁵⁷ Goodman, 1The Process of Ratemaking, supra, 606.

Each of the expert witnesses used a comparative analytical strategy in which Empire's cost of common equity was determined by examining a proxy group of regulated utilities selected on the basis of comparable investment risk. They each selected a sample that they believed had "comparable risk." They all went on to use other analytical tools to check the reasonableness of their results. In addition, Vander Weide performed an additional risk assessment and added 40 basis points to his calculated return.

All of the three analysts performed the sort of risk-based, comparative analysis *required* by *Hope* and *Bluefield*. All three analysts yielded results that, at least initially, fall within the "zone of reasonableness" defined by this Commission in a previous case (within 100 basis points above or below the industry average).⁵⁸ The national average ROE was 10.57% in the first quarter of 2006 and 10.55% for calendar year 2006; Vander Weide was at 11.3% (prior to adding the 40 basis points); King was at 9.65% and Murray was at 9.5-9.6%.

Finding: The Commission finds that none of the experts' final results appear to be reasonable. Although Empire's financial position seems more precarious than average, it is not more so than in the last rate case. On the other hand, the risk associated with investment in Empire does not appear to have abated significantly since then.⁵⁹ In that case, Empire was granted an ROE of 11%. An ROE of 11.7% is well beyond an appropriate compensation for any perceived additional risk; an ROE of 9.5% assumes that investment in Empire involves very little risk.

Empire's DCF and ex ante risk premium calculations yielded the results of 10.9% and 11.0%, respectively, using the largest group of comparable companies. Although the Commission is unwilling to set a minimum number of companies in a proxy group, it understands that the smaller the sample size, the greater the chance, statistically, for error. A sample group of five companies is simply too small to perform a credible analysis in this scenario. The OPC used two samples, the larger of which yielded a higher ROE. We view as less credible the reduction of the sample size to yield the low ROE the OPC recommended. When a sufficiently large group is used as the proxy, the results fall between 10% and 11%, which makes sense since the national average is approximately 10.5%.

Conclusion: The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's *Hope* and *Bluefield* decisions. Pursuant to those decisions, returns for Empire's shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of *Hope* and *Bluefield* unmistakably requires a *comparative method*, based on a quantification of risk.

Investor expectations of Empire are not the sole determiners of ROE under *Hope* and *Bluefield*, we must then compare it to the performance of other companies

⁵⁸ *In the Matter of Missouri Gas Energy*, Case No. GR-2004-0209 (*Report & Order*, issued Sept. 21, 2004) 20.

⁵⁹ The evidence is unrefuted that Empire's credit rating is the lowest investment-grade rating. It has not been able to realize the return on equity of 11.0% authorized in its last rate case.

that are similar to Empire in terms of risk. *Hope* and *Bluefield* also expressly refer to objective measures. The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk.

In its decision in *Missouri Gas Energy*, the Commission stated that it does not believe that its return on equity finding should "unthinkingly mirror the national average."⁶⁰ However, the national average is an indicator of the capital market in which Empire will have to compete for necessary capital. One requirement imposed by *Hope* and *Bluefield* is that Empire's rates be sufficient to permit it to obtain necessary capital.

In light of the comparable companies' average ROE at or near 10.9%, the national average ROE of 10.5%, and the perceived risks associated with investment in Empire (including the downgrade of Empire's credit rating to the lowest investment grade after this case was filed), the Commission concludes that 10.9% is the reasonable and appropriate ROE for Empire.

2. Capital Structure: What capital structure should be used for determining Empire's rate of return? Should the unamortized expenses and discounts be reduced from the total principal amount of long-term debt and trust preferred stock outstanding for determining Empire's capital structure for ratemaking purposes?

Empire's actual consolidated capital structure as of March 31, 2006, was composed of 43.99% long-term debt, at an embedded cost of 7.02%; 6.32% trust preferred securities, at an embedded cost of 8.90%; and 49.74% common equity. All three of the parties who provided witnesses on this topic agreed that this is the capital structure to be used in the calculation of the rate of return, including agreement on the embedded cost of long-term debt.⁶¹ Based on the ROE determination discussed above, the Staff recommends a rate of return of 8.37% - 8.42%.⁶² Empire seeks an overall rate of return of 9.55%.⁶³

The composition of the capital structure and the embedded cost of the components other than common equity is not difficult to ascertain. It is simply a "snap shot" as of a given moment in time. The parties that filed testimony and took a position on this issue agreed to use of Empire's actual consolidated capital structure.

Having determined Empire's Cost of Common Equity, the Commission may calculate Empire's composite weighted cost of capital, that is, its fair rate of return:

⁶⁰ Id.

⁶¹ Murray Rebuttal at 3-4.

⁶² Murray Rebuttal at 3.

⁶³ Keith Direct at 11.

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Component	Proportion	Cost	Weighted Cost
Long-term debt	43.99%	7.02%	3.09. %
Preferred securities	6.32%	8.90%	.56%
Common equity	49.74%	10.9%	5.42%
	100.00%		9.07%

Finding: Empire's actual consolidated capital structure as of March 31, 2006, was composed of 43.99% long-term debt, at an embedded cost of 7.02%; 6.32% trust preferred securities, at an embedded cost of 8.90%; and 49.74% common equity.

Conclusion: The Commission will use Empire's actual consolidated capital structure as of March 31, 2006, the end of the update period ordered in this case. The use of updated figures is generally preferable, as they more nearly reflect the Company as it will exist on the day that the new rates will take effect.

3. Off-system Sales: What amount should be included in Empire's revenue requirement for off-system sales?

The Staff recommends that the amount to be included in the off-system sales is that which actually occurred in the 12-month period ending March 31, 2006, as most representative of the level of off-system sales on an ongoing basis.⁶⁴ Although in the previous case, which was less than five years ago, the Staff opined that a five-year average was more reasonable, that previous position was an aberration; in all the preceding Empire cases over the last ten years (encompassing four rate cases) the Staff recommended that the amount not be averaged.⁶⁵ Though the Staff notes that it more often uses the trued-up test year to determine the level of off-system sales, it does sometimes use an average, usually over five years, when it feels such an average is appropriate to reach more "normalized" results.⁶⁶

Staff Witness Fischer explains that, in this instance, the result of averaging the off-system sales over five years resulted in an amount that appeared to be skewed too high when the "AEP transactions" were included, and too low when they were excluded.⁶⁷ Empire Witness Keith asserts that that a five-year average is more appropriate in a rate case than using the true-up test year alone, because any aberrational peaks and valleys are smoothed out in the averaging process.

⁶⁴ Fischer Surrebuttal at 3.

⁶⁵ Fischer Surrebuttal at 4.

⁶⁶ Fischer Surrebuttal at 4.

⁶⁷ Fischer Surrebuttal at 7.

However, even with averaging, Empire believes it would be appropriate to remove the AEP transactions from the group of off-system sales to be averaged. Moreover, Mr. Keith asserts that the AEP transactions are not an off-system sale at all, and should be excluded on that basis as well.⁶⁸ OPC, the only other party to submit testimony on this issue, uses a five-year average without any insertions or removals of any off-system sales transactions. Although OPC Witness Smith concedes that the AEP transactions are not technically off-system sales as the term is generally used, they are a type of transaction appropriately included. He notes that,

while the individual transaction might have been unusual, the average annual level of off-system sales margin when this transaction is included in computing the average is very close to the actual test year amount and to Empire's test year budget amount for off-system sales margin.⁶⁹

Although the Commission is not bound by its previous decisions,⁷⁰ in light of the fact that in the last case, decided just under two years ago, the Commission authorized use of a five-year average, it is unnecessarily complicated to change back and forth, especially when there is little actual difference between the five-year average and the 12-month amount.

Finding: The Commission agrees with OPC that using an average smoothes out the peaks and valleys, and that to exclude a transaction because it was unusual defeats the purpose of calculating the average.

Conclusion: The Commission concludes that the AEP transaction was properly included in the calculation of off-system sales. Although not an off-system sale *per se*, we agree with OPC that it is the type of transaction properly included in the category of off-system sales. The Commission concludes that the continued use of an unadjusted five-year average for the calculation of off-system sales is the most reasonable alternative.

4. Regulatory Plan Amortizations: Should Empire's revenue requirement include regulatory plan amortizations? If so, (i) how should Empire's off-balance sheet obligations be valued for purposes of the amortizations and (ii) should the amortized amount be subject to an income tax gross-up?

The Staff, in true-up testimony, updated its calculations for the Regulatory Plan amortizations authorized in the Stipulation and Agreement for Case No. EO-2005-0263 to reflect the Staff's updated true-up revenue requirement. The Staff proposed changes to the methodology used to calculate the Regulatory Plan amortizations in the area of capital structure allocation and in the amount of additional book depreciation required to meet the rating agency metrics.

⁶⁸ Keith Rebuttal at 10-13.

⁶⁹ Smith Surrebuttal at 3.

⁷⁰ See the discussion under "f." below.

In the amortization calculations it sponsored in supplemental direct testimony, the Staff derived the long-term debt component used in the ratio analysis by taking Empire's total company capital structure, determining the portion of that capital structure supported by long-term debt, and then applying a Missouri jurisdictional plant allocation factor to that long-term debt amount. At that time, that approach was believed to provide an accurate quantification of Empire's long-term debt associated with its electric operations. Since then, Empire has acquired significant natural gas operations. To ensure that the debt associated with new gas and existing non-regulated operations was not included in the amortization intended only for Missouri jurisdictional electric operations, the Staff revised its approach so the amount of debt attributable to Empire's electric business is more appropriate. Under the new approach, the Staff analyzed Empire's Electric Balance Sheet as of June 30, 2006, and determined the amount of Empire's net investment in its electric operations not reflected in its rate base (such as construction work in progress and net regulatory assets). The Staff then combined this amount with its recommended electric rate base and applied the current percentage of long-term debt in Empire's capital structure to the combined rate base/balance sheet net investment amount to determine the amount of long-term debt attributable to Empire's electric operations used in the Regulatory Plan calculation.

In prior testimony, the Staff recommended that the Commission order that any Regulatory Plan amortizations included in rates be treated as book depreciation by Empire, and that a tax straight-line depreciation deduction equal to the amount of the amortizations be reflected in the ratemaking process. The Staff has made updated calculations to determine the amount of additional book depreciation required by Empire to address the full cash flow requirements of the credit rating agency metrics, as measured in the Regulatory Plan amortization calculation. Consistent with any increase in book depreciation, Empire will recognize a corresponding increase in the tax straight-line depreciation deduction used in calculating deferred income taxes. The impact on deferred tax expense has also been considered in the Regulatory Plan amortization calculations, consistent with the increased book depreciation and increased tax straight-line depreciation deduction resulting from the amortization amounts granted in rates. This impact on deferred tax expense was not considered in the Staff's prior Regulatory Plan amortization calculations. The net result of the Staff's proposed increase in book depreciation recovery through the Regulatory Plan amortization mechanism addresses the agreement to provide Empire the opportunity to obtain the necessary after-tax cash flow required to meet the two Regulatory Plan credit metrics.

The Staff's current Regulatory Plan amortization calculations show, for the IEC Termination scenario, an amount of \$20,745,271; and for the IEC Continuation scenario, an amount of \$43,009,776. This resulted in a change of the Staff's total revenue requirement recommendation under the IEC Termination scenario to \$27,865,449, and for the IEC Continuation scenario to \$27,750,809. This significant increase mostly related to Empire's greater average debt level for the twelve months ended June 30, 2006, compared to the twelve months ended March 31, 2006. All other things being equal, higher debt levels will drive the Company's Regulatory

Plan financial ratios lower, and thereby increase the amount of the necessary amortizations to maintain Empire at investment grade credit ratings.⁷¹

The OPC supported Staff's changes, which it understood Staff would file as part of its true-up testimony.⁷² OPC expected a change to reflect additional investment in excess of rate base. The primary investment related to Missouri electric operations that is not contained in rate base is construction work in progress. OPC believed it appropriate to add CWIP to rate base prior to synchronizing the Missouri electric operations investment with the capital structure. The CWIP balance should be reduced by the amount of short term debt used in the additional amortization calculation. OPC is unaware of other such items not included in rate base. If a prudent investment in Missouri electric operations is recorded in the future, it should be reviewed for inclusion in the additional amortization calculation.⁷³

Empire specifically refrained from addressing the issue of amortizations in its true-up testimony and no other party has taken a position on the issue. In addition, it appears the parties involved in this issue are all now treating the Elk River Wind Farm agreement as a purchased power agreement. With the changes the Staff made to its position, which are reasonable, there appears to be no further dispute on this issue.

Finding: Finding no dispute among the parties who filed testimony on this issue that the Staff's present calculation of the regulatory plan amortizations is correct, we find that Staff's calculation is correct.

Conclusion: The Staff has revised its position on this issue and recalculated the amounts to be included in the regulatory plan amortizations. Having reviewed the Staff's revisions, the Commission finds the Staff's position to be reasonable. As no party disputes them, the Commission concludes that the amortization amounts submitted by the Staff are appropriate.

5. Fuel and Purchased Power Expense: What is the appropriate level of on-system fuel and purchased power expense Empire should be allowed to recover in rates?

Empire uses a variety of fuel sources to generate electricity, and the fuel costs at issue in this matter include not only the market price of the fuel used in power

⁷¹ Oligschlagler True-Up at 12-15.

⁷² OPC did not have an opportunity to review the revisions as true-up testimony was concurrently filed. OPC expected the changed calculation to increase the amortization to recognize decreased cash flow due to reduced deferred income tax resulting from treating the amortization as additional book depreciation expense. The reduction in cash flow creates a need for additional amortization to meet the financial metrics in the Regulatory Plan. OPC also expected and supported Staff's changes to revise the calculation format so the investment in Missouri jurisdictional retail electric operations is properly synchronized with the capital structure, which is required to preclude cash flow to operations other than Missouri retail electric operations.

⁷³ Trippensee True-up at 2-5

plants, but the costs associated with obtaining that fuel.⁷⁴ In instances in which Empire's costs of generating electricity are greater than the cost of buying electricity generated by another company or if Empire's power needs exceed its generation capacity, Empire may purchase power from another provider. If Empire generates more power than its customers need, then it can sell that power through off-system sales. Those off-system sales are included in the revenue requirement elsewhere as discussed above, and are not included as an offset to fuel and purchased power costs.⁷⁵

The costs of many of the fuels Empire uses to generate power have risen due to causes both foreseen and unforeseen. Fuel prices are generally increasing,⁷⁶ but certain circumstances have created more erratic price increases, resulting in a highly volatile market for most fuel sources, but especially for natural gas. A train derailment in May 2005 constrained the movement of coal out of the Powder River Basin in Wyoming, and Hurricanes Rita and Katrina significantly disrupted natural gas supply from the Gulf Coast.⁷⁷ Empire has significant dependence on natural gas and exposure to natural gas price volatility. Although Empire has diversified its fuel mix for the generation of electricity, it still expects to burn approximately 10 million MMBtu in a "normalized" year.⁷⁸ At such consumption levels, a ten cent change in the price of natural gas per MMBtu results in a \$1 million change in fuel costs.⁷⁹

For ratemaking purposes, Empire's total fuel costs are computed using a modeling program that ascertains, based on which generating units are used for a given duration throughout the year, what the total fuel costs will be. As Empire is so heavily dependent on natural gas, the anticipated price of gas figures prominently in the calculation. The difference in the forecasted price of natural gas is the reason that the position taken by the Industrials is so far afield from the positions taken by other parties on this issue, and the reason the OPC position differs slightly from Empire's and the Staff's positions.

There is another small reason for the different results of Empire and the Staff. Although they use the same model, they differed slightly on other inputs to the model than just the price of natural gas, such as transportation costs. However, the price of natural gas is the main factor in the differences in the projected fuel cost. No party involved in this case can predict, with any accuracy, the price for natural gas in the coming year. As the Commission is convinced that the spike in natural gas prices in 2005 was an aberration, looking to the test year for guidance on the appropriate level of fuel and purchased power cost would be unreasonable.

Under the previous rate case, in which the fuel and purchased power issue was resolved by the 2005 Stipulation as discussed above, \$103 million (Mo

⁷⁴ As an example, see Fischer Direct at 22.

⁷⁵ Fischer Direct at 29.

⁷⁶ See Choe Rebuttal Schedule 2.

⁷⁷ Tarter Direct at 12.

⁷⁸ Tarter Surrebuttal at 3.

⁷⁹ Tarter Surrebuttal at 3.

jurisdictional) was included in base rates and \$8 million (Mo jurisdictional) was recoverable through an interim energy charge ("IEC") that could fluctuate within limits. If the fuel price was below the minimum, refunds would be made to customers; if the fuel price was above the upper limit, Empire would simply bear the cost without recourse to recovery of those costs in rates.⁸⁰

Empire asserts that the fuel costs it incurred have been prudently incurred. Although the actual numbers for its hedging program are classified in this case as highly confidential, it can be said that Empire has implemented a sound hedging program that is effective in ameliorating the volatility of natural gas prices.⁸¹ This is not to say that Empire will never have to buy gas on the spot market, as Empire does not hedge 100% of the most it could ever need. Empire's present plan to hedge approximately 80% of anticipated need for a weather-normalized year is both proper and prudent.

In addition to the new hedging program, Empire has engaged in other activities to mitigate the volatility of natural gas prices. During periods of high volatility, Empire's energy traders are staffed to cover extended hours in an effort to find the most economical power available on an hourly basis. During summer of 2005, when fuel oil was less expensive than natural gas, Empire burned fuel oil in some of its dual fuel units. Since October 2005, Empire has been receiving power from the Elk River Wind Farm. Finally, Empire has signed a letter of intent to be a partner in the latan 2 coal-fired generation facility.⁸²

Based on its fuel model run, Empire proposes an annual total company fuel and purchased power expense including demand charges of \$166,012,277 (\$137,839,369 Missouri jurisdictional) or \$30.87/MWh. This amount is comprised of total variable fuel and energy costs from the production cost model run of \$140,908,100 with the remaining \$25,104,177 assigned to purchase demand charges, natural gas firm transportation charges and other on-system fuel-related charges.⁸³ The Staff proposes a fuel and purchased power expense of \$161,981,643⁸⁴ (\$135 million Missouri jurisdictional), only \$3 million less than Empire.⁸⁵ OPC proposes a fuel and purchased power expense of \$164,804,530,⁸⁶ close to mid-way between Staff and Empire. The Industrials did not run a fuel model, but based on its fuel price input, would propose a fuel and purchased power expense of \$133,249,000 (\$109 million Missouri jurisdictional),

Empire asserts that, since the rates from its last rate case were put into effect, it has expended fuel costs in excess of the amount it may recover in rates by over \$18 million.⁸⁷ Throughout the record, this amount is loosely referred to as a "loss." It is

⁸⁰ Commission Case No. ER-2004-0570.

⁸¹ Tarter Direct at 14-15.

⁸² Tarter Direct at 14.

⁸³ Tarter Rebuttal at 2; Keith True-Up at 9.

⁸⁴ Oligschlager True-Up at 3.

⁸⁵ Keith True-up at 9.

⁸⁶ Transcript at 699.

⁸⁷ Transcript at 934.

not a loss in the traditional sense, as Empire operated at a profit during all times at issue in this matter. The total company fuel cost is one of the most significant elements making up Empire's revenue requirement. Empire has and is expected to continue to under-recover fuel costs if the 2005 Stipulation is left in place.

Finding: We do not find the Industrials' position on fuel and purchased power expense to be credible. Although there is no way to accurately predict what fuel prices will do,⁸⁸ the fuel prices used by the Industrials do not appear to be consistently derived from actual, spot or futures prices, nor do they appear to be appropriately normalized for weather.⁸⁹

Having eliminated the position of the Industrials as not credible, the highest model run for the Missouri jurisdiction is only \$3 million from the lowest. The remaining positions are Empire, which ran its own model; the OPC, which ran Empire's fuel model but substituted a different natural gas price, and the Staff, which ran its own fuel model. Having reviewed the differences in model inputs between the Staff and Empire, we find Empire's inputs to be more credible than the Staff's. Empire has a greater familiarity with the intricacies of its system and facilities and is better able to know which facilities require certain fuel ratios, which facilities are used for peaking or base load and all the other myriad inputs into the fuel model.

Conclusion: Having considered the prices and methodologies of the Industrials, OPC, Staff and Empire in developing their positions, the Commission concludes that Empire's is reasonable and most likely to accurately predict its annual fuel costs.

6. Fuel and Purchased Power Expense Recovery Method: What method should be used for recovery by Empire of its fuel and purchased power expense? Alternatively, should the Commission continue to enforce the 3-year term of the Interim Energy Clause that was approved by the Commission in Case No. ER-2004-0570? Is the Commission barred from terminating the Interim Energy Clause by Section 386.266.8? Relying upon the four corners of the Stipulation and Agreement, are the terms of the IEC ambiguous? In the event that the Stipulation and Agreement is found to be ambiguous, do Empire's actions demonstrate its belief that it was bound to a 3-year term? What is the practical construction that Empire has given to the agreement? What is the burden of proof of ambiguity and on whom does it rest? What is the significance of a burden of proof? Has Empire properly applied to terminate the Interim Energy Clause, approved by the Commission in Case No. ER-2004-0570? What standard should the Commission apply in deciding whether to prematurely terminate the IEC? What would be the extent of Empire's financial harm if it were bound to the remaining term of the IEC? What is the comparative financial harm that would be experienced by the ratepayers if the Stipulation and Agreement were prematurely terminated? In the event that Empire is permitted to prematurely terminate the Interim Energy Clause, what amount of revenues collected by Empire under the IEC should be refunded to customers?

⁸⁸ See Choe Rebuttal at 3-6, Busch Supp. Direct at 3.

⁸⁹ Tarter Rebuttal at 9,10; Brubaker Surrebuttal at 9.

As discussed above, many of the parties entered into a Stipulation and Agreement to settle the fuel and purchased power issues in the previous rate case. Consideration having been given and received, that agreement, referred to as the 2005 Stipulation, appears to be a binding contract among the signatory parties. It is unambiguous in its requirement that Empire may not, during the term of the IEC portion of the agreement, seek any other kind of fuel adjustment recovery mechanism. For that reason, Empire's tariff filings and supporting testimony concerning an "Energy Cost Recovery" mechanism were stricken and will not be addressed in this order.

The 2005 Stipulation established a set amount of fuel and purchased power recovery in base rates, with an additional amount recoverable through an additional charge, within fixed limits. If the fuel and purchased power costs fell within this "collar," Empire could recover them. If fuel and purchased power costs were below the collar, then Empire would refund a certain portion to ratepayers. If fuel and purchased power costs were above the collar, then Empire would absorb those costs. The 2005 Stipulation anticipated that the "IEC Period" would last for three years from the date on which it was approved, unless earlier terminated by the Commission.

However, the 2005 Stipulation does contemplate that the Commission might terminate the agreement at some time other than the end of the agreed-to expiration date.

The Commission's obligations to ensure just and reasonable rates cannot be constrained by an agreement among the parties. There is no evidence in the record that would permit the Commission to modify the 2005 Stipulation to allow for recovery of all prudently incurred fuel and purchased power costs. On the contrary, the consensus appears to be that the Commission does not have authority to modify it.⁹⁰ Likewise, no evidence was given for ways to adjust other parts of the revenue requirement equation to offset the under-recovery of fuel and purchased power costs. The Commission may retain the 2005 Stipulation as it is or terminate it prior to its scheduled expiration. The 2005 Stipulation does not allow sufficient recovery of Empire's prudently incurred fuel and purchased power costs by \$26.8 million annually.

There are several questions set forth in the description of this issue that pertain to Empire's actions concerning the 2005 Stipulation: whether by its action or inaction it ratified the 2005 Stipulation, whether it may properly seek termination, or whether the 2005 Stipulation is unambiguous. The 2005 Stipulation appears to be a contract that binds the signatories unambiguously to its terms. However, the Commission is not a party to the 2005 Stipulation and the Commission's approval of it does not and cannot bind the Commission to its terms.

In discussing whether the Commission is bound by or to its prior decisions, the Missouri Supreme Court quoted an Illinois case and concluded as follows,

⁹⁰ See the Notice Requiring Filing issued on September 20, 2006 and the responses thereto.

“The construction contended for seems to be in conflict with the act. One of its primary purposes was to set up machinery for continuous regulation as changes in condition require. It appears to be inherent in the act itself.” The statute of Illinois is different from that of Missouri, but we think the “spirit of the act” analysis is logical and should be the standard in this state. In fact, this court said in *State ex rel. Chicago, R.I. & P.R.R. Co. v. Public Service Commission*, 312 S.W.2d 791, 796 (1958): “Its [Commission’s] supervision of the public utilities of this state is a continuing one and its orders and directives with regard to any phase of the operation of any utility are always subject to change to meet changing conditions, as the commission, in its discretion, may deem in the public interest.” To rule otherwise would make §393.270(3) of questionable constitutionality as it potentially could prevent alteration of rates confiscatory to the company or unreasonable to ratepayers. *** Since the very purpose of having the Commission is to have an agency with such expertise as to be sensitive to changing conditions, we rule the trial court was in error in rejecting the Commission’s action in that regard.⁹¹

In its September 20, 2006 response to a Commission notice, the Industrials asserted:

Nevertheless, to the extent that Empire is permitted to prematurely terminate the IEC, the Commission would be undertaking the judicial role of rescission of a contract. Consistent with contract law, courts undertaking such rescission would seek to return the parties to their positions prior to the contract. This would involve a return of all previously exchanged consideration. As such, other changes to the Stipulation and Agreement that would be necessary would be to return the entire amount of IEC revenues collected up to the point of rescission.⁹²

We find this argument to be nonsense. It is clear under Missouri law that the Commission may ignore a contract between Empire and other entities and proceed with its statutory obligation to set just and reasonable rates. We look to a Missouri Supreme Court case from 1930, in which the Court handed down the following bits of wisdom:

The fixing of public utility rates being an exercise of the police power of the state, it must follow that the Legislature could not by contract, statutory enactment, or otherwise limit or abridge the right of the state to fix reasonable rates for public service,

⁹¹ *State ex rel. Jackson County, et al. v. Public Service Commission*, 532 SW2d 20,29 (Mo Banc, 1975)

⁹² Response of Praxair/Explorer to Commission Notice Requiring Filing, filed September 20, 2006 at 3.

because to do so would be to abridge the exercise of the police power of the state, a thing which the Constitution prohibits. This proposition is so well settled by numerous decisions of this court that nothing more need be written on this subject.

In determining whether or not the franchise contract precludes the Public Service Commission from taking cognizance of the company's application for increase in rates, and conducting an investigation to determine whether the rates fixed by the franchise ordinance are reasonable, three well settled propositions of law must be kept in mind: (1) That the fixing of reasonable rates to be charged by the utility for public service is the exercise of the police power of the state; (2) that the Legislature can delegate the exercise of that power to a body created by it; and (3) that, by the passage of the Public Service Commission Act, the Legislature did delegate that power to the Public Service Commission, and under the power so delegated the commission may at any time, on its own motion or on complaint, conduct a hearing for the purpose of determining whether or not the rates charged by a utility for the service it renders to the public are just and reasonable to both the utility and the public.

This brings us to the vital question in the case, and that is, whether or not the rates fixed by the franchise contract are subject to future regulation by the Commission.

The contention is that, after the commission approved the contract, the rates fixed thereby were not subject to regulation or change [...].

If the statute be given that construction, it would abridge the exercise of the police power of the state in the fixing of reasonable rates and for that reason would be unconstitutional.

Every utility is entitled to charge a rate that will produce a reasonable net income on the fair value of its property after deduction for depreciation and necessary expenses incident to operation.

If, as we have held, a municipal corporation may not by contract fix and regulate utility rates, it must follow that it cannot by contract, fix and regulate the factors which determine such rates, and thus accomplish by indirection what the law prohibits it from doing directly.

The commission has exclusive power to determine and fix reasonable rates irrespective of the rates fixed by the franchise ordinance, but it has no jurisdiction to construe or enforce the contract as to extension of car lines, street paving, etc., or to try to determine an alleged breach thereof. When the application for increase in rates was filed with the commission, it was the official duty of the commission to determine and fix just and reasonable rates of fare, and leave the construction and enforcement of the contract to a court having jurisdiction to determine such matters. [cites and notes omitted]⁹³

The case quoted above is uncannily on point. In the present matter, the utility and other entities limited by contract the amount of recovery of the utility's major expense. The contract was submitted to and approved by the Commission.⁹⁴ Upon discovery that it was significantly under-recovering its cost, the utility asked the Commission to establish rates that would permit it to fully recover its reasonably incurred costs. The other parties to the contract asserted that the contract precludes the utility from recovering costs that were limited by the contract.

It is important to note that the terms of the 2005 Stipulation specifically provided that it could be terminated by the Commission before it expired:

The IEC tariff or rate schedule will expire **no later than 12:01 a.m.** on the date that is three years after the original effective date of the revised tariff sheets authorized by the Commission in

⁹³ State ex rel. Kansas City Public Service Company v. Latshaw, 30 SW2d 105, 107-110 (Mo Banc 1930).

⁹⁴ For an exhaustive discussion on whether such approval raises equitable estoppel issues, see State ex rel. Capital City Water Co. v. Missouri Public Service Commission, 850 SW2d 903 (Mo. App. 1993).

this case, Case No. ER-2004-0570, **unless earlier terminated by the Commission.** [emphasis added, page 4]

Therefore, the Commission need not address the issues surrounding the contractual relations between Empire and the other signatories to the 2005 Stipulation. The Commission must determine just and reasonable rates based on what it deems to be Empire's prudently incurred costs. To the extent that the 2005 Stipulation limits recovery of Empire's prudently incurred fuel and purchased power expenses, then it attempts to limit one of the "factors which determine rates" and is overcome by the Commission's exercise of the police power granted to it. The Commission's prior approval of the 2005 Stipulation in no way *estops* or hampers it in its determination of just and reasonable rates. Empire may recover the prudently incurred fuel and purchased power costs at the level determined above in base rates.

This Commission has the duty to ensure that rates are just and reasonable in a manner that will allow a utility to adequately recover its costs. The Commission cannot set rates at a level that could place a utility in serious financial jeopardy. Further, without adequate revenues, a utility cannot ensure safe and adequate service for its customers. The existing IEC agreement has and will continue to create a significant under-recovery of costs for Empire because of the volatility of natural gas prices that was unforeseen at the time the IEC agreement was reached. This Commission cannot abrogate its duty to both the utility and its customers simply because some of the parties have previously reached a Stipulation and Agreement that addresses the issue of fuel costs to the serious detriment of the utility. Given our statutory mandate, the Commission must ignore the Stipulation and Agreement as it pertains to fuel cost recovery, and set rates that are just and reasonable and that may better ensure Empire's solvency and its ability to provide safe and adequate service to its customers.

As to the question of refunds to customers set forth in the issues list, we have found that during the test year, Empire under-recovered its prudently incurred fuel and purchased power costs. Therefore, any refund to customers of amounts collected pursuant to the 2005 Stipulation would be unreasonable and unjust in that it would exacerbate the under-recovery.

Finding: The Commission finds that the 2005 Stipulation does not allow sufficient recovery of Empire's prudently incurred fuel and purchased power costs by \$26.8 million annually.

Conclusion: The Commission concludes that it need not address the issues surrounding the contractual relations between Empire and the other signatories to the 2005 Stipulation. The Commission concludes that it must determine just and reasonable rates based on what it deems to be Empire's prudently incurred costs. To the extent that the 2005 Stipulation limits recovery of Empire's prudently incurred fuel and purchased power expenses, then it attempts to limit one of the "factors which determine rates" and is overcome by the Commission's exercise of the police power granted to it. Moreover, the Commission concludes that its prior approval of the 2005 Stipulation in no way *estops* or hampers it in its determination of just and reasonable rates. The Commission concludes that Empire may recover the

prudently incurred fuel and purchased power costs at the level determined above in base rates.

7. Gain from unwinding forward natural gas contract: Should Empire's gain from unwinding a forward natural gas contract during the test year offset test year fuel and purchased power expense? If so, should the entire gain be an offset in the test year, or should it be amortized and only a portion of the gain be applied as an offset in the test year?

This issue concerns the transaction to undo (referred to as "unwinding") a portion of a long-term natural gas contract between Empire and British Petroleum that had locked in the price of natural gas deliveries scheduled to take place in the summers of 2009, 2010 and 2011. The positions were closed to market and Empire recorded a gain of slightly over \$5 million.⁹⁵

Some of the parties differ on how this should be recorded on Empire's books. Empire believes that, as the transaction was in the past and is of a non-recurring nature, it should be used to off-set the under-recovery of fuel and purchased power expenses that occurred in the same year as the unwinding.⁹⁶ The Industrials assert that, since these were forward positions, the benefit of the transaction should flow through to retail customers. They assert that the "net impact of reflecting this gain along with current forward prices for unhedged natural gas volumes is to decrease Empire's claims by approximately \$12 million per year."⁹⁷ The Staff recommended that gain be amortized over a five year period and netted against fuel expense, noting that Empire's hedging program directly related to provision of regulated electric service. As the gain from unwinding this contract was exceptionally large, the Staff recommended "smoothing [it] out" over five years.⁹⁸ Empire seeks to use the gain from the unwinding to directly offset the under-recovery of fuel and purchased power costs, as the unwinding and under-recovery occurred in the same year.⁹⁹

Finding: The Commission agrees that the transaction was of a non-recurring nature, that it was clearly within the category of fuel costs, and that it occurred in the same time period as an under-recovery of fuel costs. It seems reasonable that a gain in the fuel category should offset a loss in the fuel category of roughly the same time. We do not find the Industrial's position to be reasonable, in that it multiplies the effect of the transaction in a way unfair to Empire. Although the Staff's suggestion for an amortization does smooth out the transaction, we do not believe it is appropriate in this instance to do so.

⁹⁵ Keith Rebuttal at 2-3.

⁹⁶ Keith Rebuttal at 4-8.

⁹⁷ Brubaker Direct at 11-12.

⁹⁸ Fischer Direct at 20.

⁹⁹ Keith Rebuttal at 4-5.

Conclusion: The Commission concludes that the most reasonable approach to this issue is to allow Empire to use the gain to directly offset the under-recovery of fuel and purchased power costs.

8. Incentive Compensation: Are all the costs of Empire's incentive compensation plan an expense Empire should recover from Empire's ratepayers? If not, what costs should be recovered?

Empire has three incentive compensation plans. For officers, there is the management incentive compensation plan; for salaried non-officer employees, there is a discretionary compensation incentive award; and for certain other employees, there is a program that offers certain lump-sum payments in the nature of bonuses called "Lightning Bolts."

In its disallowance of a portion of the incentive compensation Empire pays its employees, the Staff applied what it views as straightforward criteria: At a minimum, an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be ascertainable and reasonably related to the plan.¹⁰⁰ In addition, the Staff excluded incentive payments for goals related to financial performance because these goals primarily benefit the shareholder.¹⁰¹

In its review of Empire's costs of providing electric service, the Staff included the entire amount of the base salary in payroll. For incentive pay, the Staff used criteria espoused in a previous Commission order¹⁰² to analyze the goals on which the incentive pay was contingent. To be included in cost of service, Staff asserts that incentive compensation should be the result of employees performing beyond basic job requirements and provide a benefit to ratepayers. The Staff eliminated awards pertaining to earnings goals, as those primarily benefit shareholders, not, customers. The Staff also eliminated payment for goals related to non-regulated activities. The Staff eliminated the cash incentives paid out relating to goals in which the results were over-budget or past the scheduled completion date.

The Staff eliminated all expenses for stock options during the test year, as they are granted with no increase in duties or goals and no measurement as to whether any specific goals were met. These stock options accumulate dividend equivalents, which Staff asserts are intended to focus executives' efforts on dividend maximization, with no direct connection to improvement in operating performance or quality of service to the ratepayer. Therefore, the Staff asserted that the stockholders should bear those costs; the Staff excluded costs for performance shares for the same reason.

¹⁰⁰ Report and Order in Case Nos. EC-87-114 and EC-87-115, Union Electric Company, 29 Mo.P.S.C.(N.S.) 313, 325 (1987)

¹⁰¹ Report And Order in Case No. GR-96-285, Missouri Gas Energy (MGE), 5 Mo.P.S.C.3d 437, 458 (1997)

¹⁰² Report And Order in Case No. GR-96-285, Missouri Gas Energy (MGE), 5 Mo.P.S.C.3d 437, 458 (1997)

As to discretionary compensation incentive awards for salaried non-officer employees, the Staff allowed recovery of a portion of this program's costs. In some instances, employees received awards for objectives that were already part of the employees' job duties and some employees received awards for objectives unrelated to their jobs, such as running the United Way campaign. Based on the sample provided by Empire, the Staff calculated a percentage of awards that compensated for performance of normal job duties as opposed to the percentage related to charitable activities and activities related to the provision of services other than retail electric service, then applied that percentage to the total discretionary pool awarded to employees. The Staff disallowed the resulting amount from the cost of service recoverable in rates.

Finally, as to the Lighting Bolts incentive compensation program, the Staff disallowed these awards, as they did not relate to the provision of electric service, but related to such activities as working on the United Way Campaign and the Aquila United, Inc. gas property acquisition, or were for performing normal duties. Moreover, the Staff notes that there were no performance criteria for receipt of the awards; they were given solely at the Company management's discretion.¹⁰³

Empire counters that it is reasonable and prudent to have three components of executive pay: annual base salary, annual bonus, and a long-term incentive. With non-executive employees, Empire has found it increasingly important to have a portion of compensation tied to key company objectives. Empire notes that, with respect to the total compensation package for executives, Empire places total cash compensation at the 25th percentile and total direct compensation near the 38th percentile of the average compensation at a peer group of companies.¹⁰⁴ Empire notes that variable pay is a primary component of a performance-based work culture.¹⁰⁵ Empire agrees that some of the objectives for which it gives performance-based compensation may be within the normal scope of an employee's duties. It asserts that if it were to roll the incentive-based compensation for those duties into the base salary, the Staff would not object to the higher base salary. It would remove "an effective driver of performance and achievement," which may "prevent an employer from operating as effectively and efficiently as possible."¹⁰⁶ On the other hand, Empire could just as easily re-write its job descriptions in such a way that clarifies what level of performance is compensated by base pay and what additional performance merits incentive compensation. If that additional performance relates to the provision of retail electric service in Missouri, the Staff would not disallow it.

There are sound reasons to use incentive pay. The Commission does not agree with the Staff that the spread of incentive-based compensation is a slippery slope, but does understand the Staff's discussion of the use of objective criteria that it can apply even-handedly. No other party took a position on this issue.

¹⁰³ McMellen Direct at 9-17

¹⁰⁴ Bauer Rebuttal at 7-9

¹⁰⁵ Bauer Rebuttal at 11.

¹⁰⁶ Bauer Rebuttal at 9.

Finding: The Commission finds that the Staff reasonably applied objective criteria for exclusion of certain incentive compensation. The Staff disallowed compensation related to charitable activities and activities related to the provision of services other than retail electric service. The Staff disallowed the Lighting Bolts incentive compensation, as they did not relate to the provision of electric service and there were no performance criteria for receipt of the awards; they were given solely at the Company management's discretion.

Conclusion: We conclude that incentive compensation for meeting earnings goals, charitable activities, activities unrelated to the provision of retail electric service, discretionary awards, and stock options should not be recoverable in rates.

9. Low Income Assistance Program: Should Empire's Experimental Low-Income Program (ELIP) be continued with changes? If so, what should those changes be, should the Customer Program Collaborative (CPC) determine those changes and have oversight responsibility respecting the program, and how should the cost of the program be included in Empire's cost-of-service for collection from ratepayers? What should be done with unspent ELIP funds?

On April 24, 2003, after a successful collaborative process to develop and implement an experimental rate discount program targeted to low-income customers in Empire's Joplin service area, the Commission approved tariff sheets that established the experimental low-income program ("ELIP"). Qualifying low-income program recipients with a household income of up to 50% of the Federal Poverty level receive bill discounts of \$40. Program recipients with a household income of 51% to 100% of the Federal Poverty level receive bill discounts of \$20. The discounts are available for up to 24 months under the current tariff.

The ELIP is funded by a shareholder contribution of \$150,000 and a ratepayer contribution of \$150,000 annually, for a total annual budget of \$300,000 annually.

The OPC notes that the program costs in each year have fallen far short of the total \$300,000 annual allotment, never exceeding \$150,000. The total discounts applied appear to have fallen dramatically in the first quarter of 2006 to less than \$15,000. The OPC asserts that the funding level should be reduced and the following steps should be taken to increase customer participation: modify the eligibility criteria to extend participation beyond 24 months, with the expectation that extending the length of participation maintain the previous level of annual expenditures rather than increasing it and earmark \$2,000 annually for outreach, with the expectation that the collaborative group that created the program could develop recommendations on potential outreach methods.

The OPC also supports increasing the level of support for the poorest families to \$50 monthly, increasing the maximum qualifying household income to 125% of the federal poverty level, and allocating up to \$30,000 of existing program funds to add an experimental arrearage repayment incentive to the program. A flexible, simple to understand arrearage repayment incentive is likely to benefit Empire's entire customer base by encouraging a greater level of repayment, and is consistent with the program's goals.

Finally, the OPC recommends that the ratepayer contribution be reduced by \$100,000 annually, or if the program is not modified, the ratepayer contribution should cease. If the program is terminated, OPC asserts that the balance should be refunded to ratepayers instead of to ProjectHelp for helping elderly and disabled Empire customers with emergency energy-related expenses, and that interest should be paid to ratepayers of any unspent fund balance.¹⁰⁷

Empire suggests ending the program and asking the collaborative group for guidance on use of the unused fund balance.¹⁰⁸ The Staff believes that the ELIP should be eliminated and the funds redirected to the low-income weatherization program, which the Staff believes is a more effective and lasting way to reduce energy bills for low-income families than the ELIP.¹⁰⁹ The Staff notes that the weatherization program is currently funded at \$155,000 annually, and the entire amount is being used. However, the Staff believes that the collaborative group is best suited to determining where the fund dollars can be most effectively spent, and would refer the matter to that group for final allocation.¹¹⁰

While the Staff makes a sound argument that weatherization and other energy-saving methods provide a more long-term benefit to low-income customers, it would be unreasonable to require all low-income customers to weatherize their homes instead of, or as a prerequisite to, receipt of ELIP assistance. Many low-income customers rent their homes. The suggestion that landlords be required to weatherize or at least apply for weatherization assistance is beyond the control of tenants and unreasonable.

If the ELIP is terminated, the presently effective tariff provides that the unspent balance will be delivered to ProjectHelp. The transfer of such a large balance would be unreasonable. The funds should be redirected to another demand-side management program for low-income customers. The Commission will require that change when Empire files its tariffs in compliance with this order.

The OPC's suggestions have merit, except that the funding level shall not be reduced at this time. The Commission expects the collaborative group to make a recommendation as to the funding levels of both the ELIP and the demand-side management programs discussed below. If the collaborative group recommends a change, then Empire may propose a tariff change.

Finding: The Commission finds that the ELIP is a reasonably effective program. If the program were terminated in this case, the presently effective tariff provides that the unspent balance will be delivered to ProjectHelp, an unreasonable result. As all the witnesses on this topic noted, the collaborative group is the appropriate body to design changes to the program for Commission approval. The OPC makes several suggestions for improvement to the program, all but one of which the Commission finds have merit.

¹⁰⁷ Meisenheimer Direct at 13-19.

¹⁰⁸ McCormack Rebuttal at 4.

¹⁰⁹ Empire does not oppose this. See McCormack Surrebuttal at 2.

¹¹⁰ Mantle Rebuttal at 3-4.

Conclusion: The Commission concludes the OPC's suggested changes shall be made, except that the level of funding will not be altered at this time. The Commission will not terminate the ELIP at this time. The collaborative group shall make a recommendation as to the funding levels of both the ELIP and the demand-side management programs discussed below. If the collaborative group recommends a change, then Empire may propose a tariff change. In any event, Empire shall revise its tariff to clarify that, if any of its energy assistance or demand-side management programs is terminated, any unspent funds will be redirected to the remaining program(s). The Commission will require that change be made when Empire files its tariffs in compliance with this order.

10. Unspent Funding of Current Energy Efficiency and Affordability Programs: What should be done with unspent funds from the current energy efficiency and low income weatherization programs? What should be the amortization amount respecting the demand side management (DSM) regulatory asset account?

Demand-side management programs are those that help utility customers reduce their demand. Weatherization programs, conversions to energy-efficient appliances and changing lights from incandescent to compact fluorescent are all examples of demand-side management.

Staff notes that the funds in question were collected entirely from ratepayers. Staff recommends that any unspent funds be placed as a negative amount in the demand-side program account for future demand-side programming.¹¹¹

Empire proposes the following accounting treatment:

Costs of \$53,000 associated with the CPC and new DSM and affordability programs to be funded in 2006 have been included as a regulatory asset in rate base. This amount included \$10,000 for the Missouri Residential Market Assessment, approximately \$41,500 for AEG's consulting work and approximately \$1,500 for travel and related expenses. Furthermore, an adjustment to increase expenses of \$5,300 has been included in the income statement. This adjustment reflects the amortization of the regulatory asset over ten years in accordance with the Stipulation and Agreement reached in Case No. EO-2005-0263.¹¹²

The Staff agrees with Empire's approach, but would alter the amounts to reflect actual costs incurred.¹¹³

Finding: The Commission finds that the Staff and Empire's accounting methodology is reasonable, but shall reflect actual costs incurred, provided that the same level of funding is dedicated to the programs and that any unspent balance remains dedicated to the programs.

¹¹¹ Mantle Rebuttal at 5.

¹¹² McCormack Direct at 4-5.

¹¹³ McMellen Rebuttal at 2.

Conclusion: The Commission concludes that these programs, lawfully in place, are valuable and likely to make a lasting difference in the energy bill burdens shouldered by low-income customers. Therefore, the Commission concludes that the Staff's recommendation concerning the continuity of these programs and their accounting treatment is reasonable and will be adopted.

F. The Settled Issues

Four separate Stipulations and Agreements were filed. None were joined by all parties. The Commission has the legal authority to accept a stipulation and agreement as offered by the parties as a resolution of issues raised in this case.¹¹⁴ In reviewing that Stipulation and Agreement, the Commission notes that:¹¹⁵

- (a) Every decision and order in a contested case shall be in writing, and, except in default cases disposed of by stipulation, consent order or agreed settlement, the decision, including orders refusing licenses, shall include or be accompanied by findings of fact and conclusions of law. * * *

Consequently, the Commission need not make either findings of fact or conclusions of law with respect to the issues resolved by the Stipulation and Agreement. The Commission convened an evidentiary hearing in this case and the parties presented such evidence as they chose; the requirement of a hearing has been met.

On August 18, 2006, the Staff and Empire jointly filed a Nonunanimous Stipulation and Agreement as to Certain Issues. The issues to which the parties stipulated were: banking fees, outside services, Edison Electric Institute expense, health care expense, life insurance expense, rate case expense, deferred income taxes, Energy Center income statement, Energy Center rate base, state tax flow-through, prepaid pension asset, allocation of taxes other than income taxes, FAS 87 pension costs, other post-employment benefit costs, test period revenue, retirement work in progress, other maintenance costs, cash working capital, growth on sales to municipals, storm damage tracker expense and tariff issues relating to the Experimental Green Power Schedule, Rider EGP, street lighting service charge, tariff section 5, sheets 12-17 and 17a, and tariff sheet header presentation. The Stipulation and Agreement also provided that the testimony of witnesses concerning these issues would be admitted without the witnesses taking the stand to present the testimony or being subject to cross-examination. No party filed a timely objection or request for hearing with respect to this Nonunanimous Stipulation and Agreement. The Commission issued an Order Approving the Stipulation and Agreement as to Certain Issues on August 28, 2006.

On September 13, 2006, the Staff, the OPC and the Industrials jointly filed a Nonunanimous Stipulation and Agreement Regarding Rate Design Issues. No party filed a timely objection or request for hearing with respect to this Nonunanimous

¹¹⁴Section 536.060, RSMo Supp. 2004.

¹¹⁵Section 536.090, RSMo Supp. 2004. This provision applies to the Public Service Commission. *St. ex rel. Midwest Gas Users' Assoc. v. Pub. Serv. Comm'n*, 976 S.W.2d 485, 496 (Mo. App., W.D. 1998).

Stipulation and Agreement. The Stipulation and Agreement settled all issues under the Class Cost-of-Service/ Rate Design heading in the issues listed by the Parties on August 28, 2006, including the sub-issues. The Signatories agreed that (1) customer charges will not change; (2) that if the IEC is not terminated, any increase in permanent rates the Commission orders in this case, whether or not generated as a result of a regulatory amortization, shall be changed in proportion to each class' percentage of current permanent revenues, as trued-up; (3) that if the IEC is terminated, rates shall be changed, whether or not generated as a result of a regulatory amortization, in proportion to each class's current share of total rate revenues as trued-up, where total rate revenues are equal to current permanent revenues plus the IEC revenues; and (4) that the methodology the Staff employed to determine the rate revenues shown in Schedules DCR-1 and DCR-3 attached to the Direct testimony of Staff witness David C. Roos shall be the methodology used to determine rate revenues for purposes of changing permanent rates. No party filed an objection to the Stipulation and Agreement. Therefore, the Commission may, pursuant to Commission Rule 4 CSR 240-2.115(2), treat it as unanimous. The Commission has reviewed the Stipulation and Agreement Regarding Rate Design Issues filed in this case and is of the opinion that it is just and reasonable and shall be approved.

Two other Stipulations and Agreements were filed, but timely objections were raised to them. They have become, by operation of Commission rule 4 CSR 240-2.115(2)(D), non-binding statements of position by the signatory parties. The issues included in those Stipulations and Agreements have been fully addressed in the Findings of Fact and Conclusions of Law above.

IT IS THEREFORE ORDERED:

1. That the proposed electric service tariff sheets submitted under Tariff File No. YE-2006-0597 on February 1, 2006, by Empire District Electric Company for the purpose of increasing rates for retail electric service to customers are hereby rejected. The specific sheets rejected are:

P.S.C. Mo. No. 5, Section A

21st Revised Sheet No. 1, Canceling 20th Revised Sheet No. 1

P.S.C. Mo. No. 5, Section 1

13th Revised Sheet No. 1, Canceling 12th Revised Sheet No. 1

10th Revised Sheet No. 2, Canceling 9th Revised Sheet No. 2

P.S.C. Mo. No. 5, Section 2

12th Revised Sheet No. 1, Canceling 11th Revised Sheet No. 1
1st Revised Sheet No. 1a, Canceling Original Sheet No. 1a
12th Revised Sheet No. 2, Canceling 11th Revised Sheet No. 2
12th Revised Sheet No. 3, Canceling 11th Revised Sheet No. 3
7th Revised Sheet No. 3a, Canceling 6th Revised Sheet No. 3a
13th Revised Sheet No. 4, Canceling 12th Revised Sheet No. 4
8th Revised Sheet No. 4a, Canceling 7th Revised Sheet No. 4a
12th Revised Sheet No. 6, Canceling 11th Revised Sheet No. 6
12th Revised Sheet No. 7, Canceling 11th Revised Sheet No. 7
5th Revised Sheet No. 7a, Canceling 4th Revised Sheet No. 7a
8th Revised Sheet No. 9, Canceling 7th Revised Sheet No. 9
5th Revised Sheet No. 9a, Canceling 4th Revised Sheet No. 9a
7th Revised Sheet No. 13, Canceling 6th Revised Sheet No. 13

P.S.C. Mo. No. 5, Section 3

13th Revised Sheet No. 1, Canceling 12th Revised Sheet No. 1
17th Revised Sheet No. 2, Canceling 16th Revised Sheet No. 2
12th Revised Sheet No. 3, Canceling 11th Revised Sheet No. 3
12th Revised Sheet No. 4, Canceling 11th Revised Sheet No. 4

P.S.C. Mo. No. 5, Section 4

5th Revised Sheet No. 17, Canceling 4th Revised Sheet No. 17
(Sheets No. 21, 22, and 23 were previously rejected)

P.S.C. Mo. No. 5, Section 5

7th Revised Sheet No. 12, Canceling 6th Revised Sheet No. 18
5th Revised Sheet No. 13, Canceling 4th Revised Sheet No. 18
4th Revised Sheet No. 14, Canceling 3rd Revised Sheet No. 18
4th Revised Sheet No. 15, Canceling 3rd Revised Sheet No. 18
4th Revised Sheet No. 16, Canceling 3rd Revised Sheet No. 18
4th Revised Sheet No. 17, Canceling 3rd Revised Sheet No. 18
1st Revised Sheet No. 17a, Canceling Original Sheet No. 18

2. That Empire District Electric Company shall file proposed electric service tariff sheets in compliance with this Report and Order.
3. That the Nonunanimous Stipulation and Agreement Regarding Rate Design, filed on September 13, 2006, and deemed to be unanimous by operation of Commission Rule, is hereby approved. The parties shall comply with the terms of the Stipulation and Agreement.
4. That all pending motions, not otherwise disposed of herein, are hereby denied.
5. That this Report and Order shall become effective on December 31, 2006.

LACLEDE GAS COMPANY

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15 Mo. P.S.C. 3d

6. That this case may be closed on January 31, 2007.

Davis, Chm., Murray, and Appling, CC.,
concur;
Gaw and Clayton, CC., dissent, with
separate dissenting opinion to follow;
certify compliance with the provisions
of Section 536.080, RSMo.

The nonunanimous stipulation and agreement regarding rate design has not been published.
If needed, this document is available in the official case files of the Public Service Commission.

NOTE: At the time of publication, no dissents have been issued.

KANSAS CITY POWER & LIGHT COMPANY

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15 Mo. P.S.C. 3d

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of its Regulatory Plan.*

Case No. ER-2006-0314

Electric §29. The Commission determined that the appropriate return on equity (ROE), for Kansas City Power & Light Company (KCPL), was 11% and that an 11% ROE was within the "zone of reasonableness". The Commission also considered a request by KCPL for an "adder" of 50 basis points due to the company's construction risk, the Commission found that evidence did not warrant an upward adjustment of 50 basis points, instead the Commission reduced the "adder" to 25 basis points resulting in a final Cost of Common Equity at 11.25%.

REPORT AND ORDER

Issue Date: December 21, 2006

Effective Date: December 31, 2006

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*This case was appealed to the Circuit Court of Cole County and affirmed. Case No. 07AC-CC00131.

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SENIOR REGULATORY LAW JUDGE: Ronald D. Pridgin

LIST OF ISSUES

On October 6, 2006, Staff submitted a list of issues for determination by the Commission. Commission Rule 4 CSR 240-2.080(15) allows parties ten days to respond to pleadings. No party timely objected to Staff's list. Therefore, the Commission will articulate the list of issues as Staff has. The issues that the parties present to the Commission are as follows:

Incentive Compensation

What amount, if any, of incentive compensation should be included in rates?

Pensions

How should the expense and contributions relating to pension benefits for (1) Joint Partners and (2) the Supplemental Executive Retirement Plan (SERP) be accounted for in the tracking of the regulatory asset required by the Stipulation and Agreement in Case No. EO-2005-0329?

Should FAS 88 pension expenses be treated consistently with the KCPL application in this proceeding and its application for an AAO in Case No. EU-2006-0560?

Hawthorn 5

Should the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion in 1999 have been accounted for differently?

Is the AFUDC amount overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?

Is the gross plant value of Hawthorn 5 overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?

Should an adjustment be made to KCPL's books and records regarding the amount for AFUDC to fund the Hawthorn 5 reconstruction?

Ice Storm Costs

What amount of the amortization of the costs associated with the 2002 ice storm should be included in rates?

EEL Dues

What amount of EEL dues should be included in rates?

Severance Costs

What amount, if any, of severance costs should be included in rates?

Bad Debts

Should the bad debt percentage be applied to reflect the total revenues, including any rate increase in Missouri jurisdictional retail revenues awarded in this proceeding?

Fuel & Purchased Power Expense

What is the appropriate level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?

What level of natural gas fuel price should be used in the production cost modeling that is used, along with appropriate fuel adders, to quantify the level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?

Surface Transportation Board Litigation

Should the deferred expenses associated with the Surface Transportation Board rail rate complaint case that were incurred through June 30, 2006, be included in rate base?

SO2 Premiums

How should SO2 premiums related to lower-sulfur coal be recorded for book and ratemaking purposes?

What parameters does the Commission-approved Stipulation & Agreement in Case No. EO-2005-0329 impose on the treatment of SO2 premiums in this case?

Injuries and Damages

What is the appropriate amount of injuries and damages expense to include in rates?

Rate Case Expense

What amount of rate case expense should be included in rates?

Should rate case expense be normalized or deferred and amortized? If the latter, then what is the appropriate amortization period for the deferred rate case expense?

Should the costs deferred for future amortization be included in rate base?

Corporate Projects and Strategic Initiatives

Should the costs of the LED-LDI and CORPDP-KCPL projects, which are being deferred and amortized over 5 years, be included in rate base?

Payroll, Including A&G Salaries

How should annualized payroll costs of Great Plains Energy Services (GPES) employees be allocated to KCPL?

What is the proper method to be used in determining the allocation or assignment of A&G salaries to be capitalized or expensed?

Other Benefits

What amount of other benefits should be included in rates?

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Maintenance Expense

Should an adjustment be made to normalize test year maintenance for production and distribution expenses? If so, how?

Property Taxes

Should property taxes be adjusted to reflect changes in tax jurisdiction assessment values, levy rates, in plant additions, and other factors during the test period, including both the update period and true-up period?

Decommissioning Expense

Should decommissioning expense be reduced to reflect the amount of annual accruals expected under a 60-year license?

True-Up

What elements of Cost of Service and Rate Base should be updated in the September True Up?

Regulatory Plan Additional Amortizations

What amount of Regulatory Plan additional amortizations should be allowed to maintain KCPL's credit rating?

Should a "gross up" for taxes be added to this amount? If so, what amount is appropriate?

What risk factor should be used in calculating the Regulatory Plan additional amortizations for off-balance sheet purchased power agreements?

Over what period of time should the Regulatory Plan additional amortizations be treated as an offset to rate base?

Should the capital structure be synchronized with the investment in Missouri jurisdictional electric operations? How should that be accomplished?

Should an amount be added to Missouri jurisdictional rate base to reflect additional investments related to Missouri jurisdictional electric operations?

Weather Normalization/Customer Growth

What methodology should be used to compute Large Power class kWh sales and revenues?

Jurisdictional Allocations

What is the appropriate method (4 CP vs. 12 CP) to use for allocating generation and transmission costs among jurisdictions?

How should A&G expenses be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?

Off-system Sales

What level of off-system sales margin should be included in determining KCPL's cost of service?

How should the off-system sales margin be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?

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What parameters do the Commission-approved Stipulation and Agreement in Case No. EO-2005-0329 impose on the treatment of off-system sales revenue in this case?

Should KCPL's customers receive the benefit of all margins of off-system sales or should it be shared between customers and shareholders? Should a mechanism be adopted to ensure that the benefit is received by the appropriate party or parties? If so, what mechanism?

Depreciation

What are the appropriate depreciation rates to be used in establishing rates in this proceeding?

Cost of Capital

What is the appropriate capital structure?

What is the appropriate return on common equity (ROE)?

Should ROE be adjusted either upwards or downwards to reflect increased or decreased risk or company performance? If so, what adjustment should be made?

Class Cost-of-Service

On what basis should distribution costs be allocated to classes? Should the allocation of primary distribution costs include any customer-related component? What type of demand should be used to allocate the cost of distribution substations and distribution lines?

On what basis should production capacity and transmission costs be allocated to classes?

What is the appropriate method to use for allocating margins on off-system sales among Missouri retail customer classes?

Do KCPL's computation of coincident peak demands and class peak demands properly recognize line losses?

To what extent, if any, are current rates for each customer class generating revenues that are greater or less than the cost of service for that customer class?

What is the appropriate basis for allocating Administrative and General Expense Account Numbers 920, 933, 923, 930.2 and 931 among Missouri retail customer classes?

Should revenue adjustments among classes be implemented in order to better align class revenues to class cost-of-service? If so, what percentage increase or decrease should be assigned to each customer class?

Should class revenue adjustments be implemented even if no increase or decrease in revenue requirement is granted?

Should revenue adjustments be phased in over multiple years?

Should revenue adjustments among the non-residential classes be applied uniformly or non-uniformly?

How should any increase in the revenue requirement be implemented?

Rate Design

Should a comprehensive analysis of KCPL's class cost-of-service issues and rate design be conducted after the conclusion of the regulatory plan and the in-service date of Iatan 2? Should the cost-basis of general service all-electric rates be included in this analysis?

Should KCPL's proposed changes to the General Service customer charge be implemented?

Availability of General Service Space-Heating Rate Discounts

In this case, should the qualification provision of the existing general service all-electric rate schedules be expanded as proposed by KCPL, and the all-electric winter energy rate increased an additional 5%, to make rate discounts available to existing and future customers who are not all-electric customers?

Should the existing general service all-electric rate schedules and the separately metered space heating provisions of KCPL's standard general service tariffs be eliminated or restricted to existing customers only until there is a comprehensive class cost of service study and/or cost-effectiveness study which analyzes and supports such tariffs and provisions as well as KCPL's Affordability, Energy Efficiency and Demand Response programs?

Weatherization

Should the weatherization program be modified so that KCPL's Call Center will refer customers to the program?

Should LIHEAP recipients be directed to the weatherization program and be required to participate in it?

Should KCPL participate in an "Energy Conservation Program" that will provide consultation, weatherization materials and installation? If so, should the cost of the program to be underwritten by KCPL and charged to the customer?¹

FINDINGS OF FACT

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The Commission in making this decision has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

In making its Findings of Fact and Conclusions of Law, the Commission is mindful that it is required, after a hearing, to "make a report in writing in respect thereto, which shall state the conclusion of the commission, together with its decision, order or requirement in the premises."² Because Section 386.420 does

¹ The Missouri Department of Natural Resources and The City of Kansas City, Missouri object to this issue.

² Section 386.420.2, RSMo 2000. All further statutory references, unless otherwise specified, are to the Revised Statutes of Missouri (RSMo), revision of 2000.

not explain what constitutes adequate findings of fact, Missouri courts have turned to Section 536.090, which applies to "every decision and order in a contested case," to fill in the gaps of Section 386.420.³ Section 536.090 provides, in pertinent part:

Every decision and order in a contested case shall be in writing, and . . . the decision . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order.

Missouri courts have not adopted a bright-line standard for determining the adequacy of findings of fact.⁴ Nonetheless, the following formulation is often cited:

The most reasonable and practical standard is to require that the findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence.⁵

Findings of fact are inadequate when they "leave the reviewing court to speculate as to what part of the evidence the [Commission] believed and found to be true and what part it rejected."⁶ Findings of fact are also inadequate that "provide no insight into how controlling issues were resolved" or that are "completely conclusory."⁷

With these points in mind, the Commission renders the following Findings of Fact.

Procedural History

On February 1, 2006, Kansas City Power & Light Company submitted to the Commission proposed tariff sheets, effective for service on and after January 1, 2007, that are intended to implement a general rate increase for electrical service provided in its Missouri service area. KCPL's proposed tariffs would increase its Missouri jurisdictional revenues by approximately \$57 million, or by 11.5%. The

³ St. ex rel. Laclede Gas Co. v. Pub. Serv. Comm'n of Mo., 103 S.W.3d 813, 816 (Mo. App., W.D. 2003); St. ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n, 24 S.W.3d 243, 245 (Mo. App., W.D. 2000).

⁴ Glasnapp v. State Banking Bd., 545 S.W.2d 382, 387 (Mo. App. 1976).

⁵ Id. (quoting 2 Am.Jur.2d Administrative Law § 455, at 268).

⁶ St. ex rel. Int'l. Telecharge, Inc. v. Mo. Pub. Serv. Comm'n, 806 S.W.2d 680, 684 (Mo. App., W.D. 1991) (quoting St. ex rel. Am. Tel. & Tel. Co. v. Pub. Serv. Comm'n, 701 S.W.2d 745, 754 (Mo. App., W.D. 1985)).

⁷ St. ex rel. Monsanto Co. v. Pub. Serv. Comm'n, 716 S.W.2d 791, 795 (Mo. banc 1986) (relying on St. ex rel. Rice v. Pub. Serv. Comm'n, 359 Mo. 109, 220 S.W.2d 61 (1949)).

Commission issued an Order and Notice on February 3, in which it gave interested parties until February 23 to request intervention.

The Commission received timely intervention requests from: the United States Department of Energy, acting on behalf of the National Nuclear Security Administration; the City of Kansas City, Missouri; Missouri Gas Energy, a Division of Southern Union Company; The Empire District Electric Company; Aquila, Inc.; Trigen-Kansas City Energy Corporation; Jackson County, Missouri; AARP; and Missouri Industrial Energy Consumers.

In addition, the Commission received untimely intervention requests from Wal-Mart Stores East, L.P. and W. Bill Dias. The Commission granted these requests as well.

Furthermore, in Commission Case No. EO-2005-0329, KCPL had entered into a Stipulation and Agreement regarding an Experimental Regulatory Plan, which was the genesis for this rate case. A portion of that agreement provided that the non-KCPL signatories would automatically become intervenors in this rate case. The non-KCPL signatories to the Stipulation and Agreement in Case No. EO-2005-0329 that are intervenors in this case are: the Staff of the Commission; the Office of the Public Counsel; the Missouri Department of Natural Resources; Praxair, Inc.; Missouri Industrial Energy Consumers; Ford Motor Co.; Aquila, Inc.; The Empire District Electric Company; Missouri Joint Municipal Electric Utility Commission; and the City of Kansas City, Missouri.⁸

In addition, part of the Commission's February 3 notice stated that in Case No. EO-2005-0329, the signatories to the stipulation in that case agreed that the test year for this case would be the historic test year period ending December 31, 2005, updated for known and measurable changes through June 30, 2006, with a true-up period through September 30, 2006, and KCPL filing a reconciliation in the true-up proceeding on or about October 21, 2006. No parties objected to the aforementioned true-up dates, and the Commission will adopt them. The Commission held local public hearings in Kansas City on August 24, an evidentiary hearing on October 16-17, 19-20, 23-24, 26-27, and a true-up hearing on November 16.

Discussion

KCPL is an electric utility and a public utility subject to Commission jurisdiction. The Staff of the Commission is represented by the Commission's General Counsel, an employee of the Commission authorized by statute to "represent and appear for the commission in all actions and proceedings involving this or any other law [involving the commission.]"⁹ The Public Counsel is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"¹⁰ The remaining parties consist of political subdivisions

⁸ On April 17, 2006, the Commission granted the Missouri Joint Municipal Electric Utility Commission's motion to withdraw.

⁹ Section 386.071.

¹⁰ Sections 386.700 and 386.710.

served by and located within KCPL's service territory, industrial and commercial consumers, a competitor, labor union locals, and a pro se intervenor.

Revenue Requirement

Ratemaking involves two successive processes:¹¹ first, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.¹² The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers. Some of the parties have filed a non-unanimous stipulation on class cost of service and rate design, to which no party has objected.

Revenue requirement is usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.¹³ These four issues will be discussed separately below.

The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D) R$$

where: RR=Revenue Requirement;
 C = Prudent Operating Costs, including Depreciation Expense and Taxes;
 V = Gross Value of Utility Plant in Service;
 D = Accumulated Depreciation; and
 R = Overall Rate of Return or Weighted Cost of Capital.

The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.¹⁴ The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. Section 393.140(4) authorizes the Commission to prescribe uniform methods of

¹¹ It is worth noting here that Missouri recognizes two distinct ratemaking methods: the "file-and-suspend" method and the complaint method. The former is initiated when a utility files a tariff implementing a general rate increase and the second by the filing of a complaint alleging that the subject utility's rates are not just and reasonable. See Utility Consumers Council, *supra*, 585 S.W.2d at 48-49; St. ex rel. Jackson County v. Pub. Serv. Comm'n, 532 S.W.2d 20, 28-29 (Mo. banc 1975), cert. denied, 429 U.S. 822, 50 L.Ed.2d 84, 97 S.Ct. 73 (1976).

¹² St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n, 850 S.W.2d 903, 916 n. 1 (Mo. App., W.D. 1993).

¹³ Colton, "Excess Capacity: Who Gets the Charge From the Power Plant?," 34 *Hastings L.J.* 1133, 1134 & 1149-50 (1983).

¹⁴ See St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988).

accounting for utilities and Section 393.140(8) authorizes the Commission to examine a utility's books and records and, after hearing, to determine the accounting treatment of any particular transaction. In this way, the Commission can determine the utility's prudent operating costs. Section 393.230 authorizes the Commission to value the property of electric utilities operating in Missouri, that is, to determine the rate base.¹⁵ Section 393.240 authorizes the Commission to set depreciation rates and to adjust a utility's depreciation reserve from time-to-time as may be necessary.

To begin deciding KCPL's revenue requirement, the Commission will first discuss rate of return.

Rate of Return:

What is the appropriate capital structure?

What is the appropriate return on common equity (ROE)?

Should ROE be adjusted either upwards or downwards to reflect increased or decreased risk or company performance? If so, what adjustment should be made?

The equation set out above shows that the Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a Rate of Return. For any utility, its fair Rate of Return is simply its composite cost of capital.

The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

1. Capital Structure and Embedded Cost of Capital:

The composition of the capital structure and the embedded cost of the components other than common equity are not difficult to ascertain. It is simply a "snapshot" as of a given moment in time. The parties agree that a proper capital structure for this case is: Debt – 44.79%; Preferred Stock – 1.53%; Common Equity – 53.69%.¹⁶

2. Cost of Common Equity:

Determining an appropriate return on equity is without a doubt the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them. In contrast, determining a return on equity requires speculation about the desires and requirements of investors when

¹⁵ Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."

¹⁶ See Post-Hearing Brief of Kansas City Power & Light Company, p. 5 (filed November 17, 2006); Staff's Post-Hearing Brief, pp. 69-70 (filed November 17, 2006); Initial Post-Hearing Brief of The Office of The Public Counsel, p. 22 (filed November 17, 2006).

they choose to invest their money in KCPL rather than elsewhere. As a result, the Commission cannot simply find a rate of return on equity that is "correct"; a "correct" rate does not exist.

However, there are some numbers that the Commission can use as guideposts in establishing an appropriate return on equity. In Missouri Gas Energy, the Commission stated that it does not believe that its return on equity finding should "unthinkingly mirror the national average."¹⁷ Nevertheless, the national average is an indicator of the capital market in which KCPL will have to compete for necessary capital.

In a survey of regulatory decisions from around the country, as reported by Regulatory Research Associates, the average allowed return in the electric utility industry for the third quarter of 2006 was 10.06%.¹⁸ That same study revealed that for the first quarter of 2006, the average ROE for electric utilities was 10.38%; for the second quarter, 10.69%.¹⁹ The average of those three ROEs is approximately 10.37%; thus, the Commission finds that it should set return on equity somewhere in a range from 9.37% to 11.37%.

For additional guidance on exactly where in that "zone of reasonableness" the Commission should set KCPL's return on equity, the Commission must turn to the expert advice offered by financial analysts. This "is an area of ratemaking in which agencies welcome expert testimony and yet must often make difficult choices between conflicting testimony."²⁰

KCPL, Staff, OPC, and the U.S. Department of Energy (DOE) sponsored financial analysts who recommended a return on equity in this case. Their recommended ROEs are: KCPL – 11%, plus a 50 basis point adder; OPC – 9.9%; Staff – 9.32-9.42%; DOE – 9%. Because the return on equity recommended by DOE falls outside of the "zone of reasonableness", the Commission will discard it and find that it merits no further discussion.²¹ KCPL's recommended ROE of 11.5% is actually a recommendation of 11%, with a 50 basis point adder; thus, the Commission finds KCPL's recommendation of 11%, plus any potential adder to make the ultimate ROE 11.37%, within the "zone of reasonableness." The Commission must now analyze the remaining suggested ROEs.

KCPL

Although KCPL offered witnesses Cline, Giles, and Bassham to support its requested ROE, KCPL's main witness on this issue, in the Commission's opinion, was Dr. Hadaway. Dr. Hadaway's credentials are impeccable; he earned his Doctor of Philosophy in Finance from The University of Texas – Austin in 1975, and has

¹⁷ In re Missouri Gas Energy, 12 Mo.P.S.C.3d 581, 593 (Report and Order issued September 21, 2004).

¹⁸ Tr. Vol. 12, p. 1241.

¹⁹ Ex. 34, p. 4.

²⁰ L.S. Goodman, 1 The Process of Ratemaking, 606 (1998).

²¹ The Commission notes that DOE's witness, Dr. Woolridge, has impressive credentials, being a professor of finance at Penn State University. However, in contrast to Dr. Hadaway, Dr. Woolridge has never worked for, or even testified for, a public utility.

also been an adjunct professor there.²² He has also been either an Assistant or Associate Professor of Finance at The University of Alabama, Texas Tech University and Texas State University – San Marcos. Furthermore, Dr. Hadaway was Director of the Economic Research Division at the Public Utility Commission of Texas. His job duties consisted of supervising the Texas Commission's economic, finance and accounting staffs, as well as serving as the Texas Commission's chief financial witness in telecommunications and electric cases. Finally, he has taught numerous courses at utility conferences concerning, among other issues, cost of capital. In conclusion, Dr. Hadaway has testified between two and three hundred times before public utility commissions concerning cost of capital.²³

Dr. Hadaway's analysis began with the entire 60 company group of electric utilities followed by Value Line, which is an investment survey that is published for approximately 1,700 companies, both regulated and unregulated.²⁴ He then narrowed that group to 24, including only companies that have: at least a triple-B (investment grade) bond rating; at least 70 percent of revenues from regulated utility sales; consistent financial records not affected by recent mergers or restructuring; and a consistent dividend record with no dividend cuts within the past two years.²⁵ Those 24 companies included companies mostly from the Midwestern United States, but also included companies from other regions to make the sample more representative of the entire country. Even DOE's witness, Dr. Woolridge, found Dr. Hadaway's proxy groups acceptable.²⁶

Once he obtained his proxy group, Dr. Hadaway then used a traditional discounted cash flow (DCF) model to arrive at his ROE estimate of 9.3 to 9.4%, virtually identical to the same ROE estimate that Staff witness Barnes used. However, finding those results unreasonably low, Dr. Hadaway then used recalculated constant growth results with the growth rate based on long-term forecasted growth in GDP, yielding an ROE range of 11.2% to 11.3%. Finally, using a multistage DCF model, Dr. Hadaway arrived at an ROE range of 10.6% to 10.8%.

In short, Dr. Hadaway used a risk premium model as a check of reasonableness on his DCF results, and his results were between 10.6% and 11.3%. His ultimate ROE recommendation is an approximate mid-point of that range at 11%, with a 50 basis point "add" to account for the high construction risk KCPL will have during its Experimental Regulatory Plan, for a total of 11.5% recommended ROE. His "add" came from risk adders he studied in FERC cases that ranged from 50 to 200 basis points, as well as a recent case from this Commission in which the Commission added 30 basis points to The Empire District Electric Company's ROE.²⁷

²² Ex. 33, Sch. SCH-8.

²³ Tr. Vol. 12, p. 1301.

²⁴ Ex. 34, p. 11; Ex. 201, p. 17.

²⁵ Ex. 33, pp. 3-4.

²⁶ Tr. Vol. 12, p. 1343.

²⁷ Id. at 1248.

Staff

Staff witness Matthew Barnes earned a Bachelor of Science degree in Business Administration in Accounting from Columbia College in December 2002, and an MBA with an emphasis in Accounting from William Woods University in May 2005. He has been an auditor for Staff since 2003.²⁸

This case is the first case in which Staff witness Barnes has been a chief cost-of-capital witness.²⁹ In contrast to the other cost of capital witnesses, who used 21-24 companies in their proxy group, Mr. Barnes used only five.³⁰ He chose those companies because they met the following criteria: vertically integrated electric utility; publicly traded stock; information printed in ValueLine;³¹ ten years of available data; at least investment grade credit rating; two sources for projected growth available with one from ValueLine; and no Missouri operations.³² In selecting companies for a proxy group, Mr. Barnes did not consider the amount of non-regulated business, the location of the company, or the company's fuel mix. As Dr. Hadaway noted, besides being too small from a statistical standpoint, Mr. Barnes ends up with a flawed sample because it is dominated by companies that are not similar to KCPL. Four of the five companies are in Value Line's West Region: Hawaiian Electric (based in Honolulu, Hawaii); IDACORP (based in Boise, Idaho); Pinnacle West (based in Phoenix, Arizona); and Puget Energy (based in Bellevue, Washington). The other company, Southern Company (based in Atlanta, Georgia), is in Value Line's East Region. Staff's sample does not assist the Commission in determining whether KCPL would have the opportunity to earn a rate of return equal to that " . . . generally being made at the same time **and in the same general part of the country** on investments in other business undertakings which are attended by corresponding risks and uncertainties."³³

As a consequence of the small sample of companies used in its sample group, the fact that those companies are outside the Midwest, and Mr. Barnes' decision not to allow for construction risk when calculating return on equity, the Commission will reject Staff's recommended return on equity.

OPC

OPC's cost of capital witness, Mr. Baudino received a Bachelor of Arts Degree with majors in Economics and English in 1979, and a Master of Arts degree in

²⁸ Ex. 101, p. 1.

²⁹ Tr. Vol. 9, p. 994.

³⁰ Tr. Vol. 9, p. 984, p. 1001.

³¹ An investment survey published for approximately 1,700 companies, both regulated and unregulated. It is updated quarterly and probably represents the most comprehensive and widely used of all investment information services. It provides both historical and forecasted information on a number of important data elements. Ex. 201, p. 17.

³² Tr. Vol. 9, p. 979; Ex. 101, Sch. 12.

³³ Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia, 262 U.S. 679, 692-93; 43 S.Ct. 675, 679; 67 L.Ed. 1176, 1182-83 (1923) (emphasis supplied).

Economics in 1982, both from New Mexico State University.³⁴ Afterwards, he worked for the New Mexico Public Service Commission Staff before taking his current position as a consultant with Kennedy and Associates.³⁵

Before Mr. Baudino applied a DCF analysis to determine his recommended ROE, he, like Dr. Hadaway and Mr. Barnes, had to construct a proxy group. First, using the July 2006 issue of the AUS Utility Reports, he picked electric companies that were rated either Baa/BBB or A/A by Moody's and Standard and Poor's. He used this criterion because KCPL currently has a split bond rating, BBB from S&P and A2 from Moody's. From that group, he selected companies that had at least 50 percent of their revenues from electric operations and that had long-term earnings growth forecasts from either Zack's or First Call/Thomson.

Then, Mr. Baudino eliminated companies that had cut or eliminated dividends since 2003, were recently or currently involved in merger activities, and had recent experience with significant earnings fluctuations. He found those criteria important because utilities that are undergoing those types of changes are not good candidates for the DCF model.³⁶

Some of the companies he used were Midwestern, and some not; when asked why he excluded a company that both Staff and KCPL included in their proxy groups, Mr. Baudino could not remember.³⁷ This is troubling, considering that he claims that his analysis relies on a proper sample of companies.³⁸

The Commission notes that Mr. Baudino criticizes Dr. Hadaway's use of ValueLine betas (a company or industry risk versus the risk of the market as a whole) instead of First Call/Thomas betas. However, Mr. Baudino testified, "I'll admit that I don't know how they were calculated" and that, compared to ValueLine, he "can't really tell you which is more accurate."³⁹ When asked about his analysis about how much risk KCPL is exposed to for non-firm off-system sales versus other Missouri utilities, Mr. Baudino testified that he had not really looked at it.⁴⁰

The Commission finds Mr. Baudino's analysis less credible than Dr. Hadaway's analysis because Dr. Hadaway has more education and experience than does Mr. Baudino in evaluating cost of capital for regulated utilities. Further, Mr. Baudino could not recollect why he rejected a certain company for his proxy group, and did not know the accuracy of the very information he was using in his analysis. Moreover, in direct conflict with this Commission's "zone of reasonableness" decisions in MGE and Empire, he would have the Commission ignore other jurisdictions' findings on ROE.⁴¹ Again, while the Commission will not "unthinkingly mirror the national average" in this case, the Commission finds that it is simply

³⁴ Ex. 201, p. 1.

³⁵ Id.

³⁶ Id. at 15.

³⁷ Tr. Vol. 11, p. 1107.

³⁸ Id. at 1117.

³⁹ Id. at 1096-97.

⁴⁰ Id. at 1112.

⁴¹ Ex. 203, p. 3.

common sense to use national average ROEs as a reference point because that gives the Commission insight about the capital market in which KCPL must compete for equity dollars.

As stated above, the Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.⁴² The United States Supreme Court, in two frequently cited decisions, has established the constitutional parameters that must guide the Commission in its task.⁴³ In the earlier of these cases, *Bluefield Water Works*, the Court stated that:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.⁴⁴

In the same case, the Court provided the following guidance as to the return due to equity owners:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.⁴⁵

The Court restated these principles in *Hope Natural Gas Company*, the later of the two cases:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough

⁴² C.F. Phillips, Jr., *The Regulation of Public Utilities*, 390 (1993); Goodman, 1 *The Process of Ratemaking*, supra, at 606.

⁴³ *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

⁴⁴ *Bluefield*, supra, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

⁴⁵ *Id.*, 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.⁴⁶

In the final analysis, it is not the method employed, but the result reached, that is important.⁴⁷ The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."⁴⁸

After considering all of the evidence and the arguments of the parties, the Commission determines that the appropriate ROE is 11%. This ROE is within the "zone of reasonableness" and based upon the Commission's finding that Dr. Hadaway's credentials are superior to those of the other ROE expert witnesses, thus making his evidence more credible. Additionally, the Commission finds Dr. Hadaway's comparative group, and his analysis of that group, the most credible.

Also, the Commission finds that the Experimental Regulatory Plan, while allowing KCPL's credit metrics to stay at investment grade, thus pleasing the **bond** community, does not necessarily make KCPL more attractive to **equity** investors.⁴⁹ As KCPL invests in latan 2 and other ERP assets, thereby almost doubling its rate base,⁵⁰ KCPL may need additional amortization of some \$70 to \$80 million even at an 11.5% return on equity.⁵¹ Moreover, out of the roughly \$563.6 million in common equity KCPL's parent, GPE, plans to issue during the ERP, some \$213.6 million, or 37.9% of the total stock issuance, is planned for issuance in 2007.⁵² The extraordinary budgeted cost and magnitude of the construction contemplated in the Experimental Regulatory Plan, coupled with KCPL's compelling cost of capital evidence, dictates that the Commission should find this issue in favor of KCPL.

⁴⁶ *Hope Nat. Gas Co., supra*, 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

⁴⁷ Within a wide range of discretion the Commission may select the methodology. *Missouri Gas Energy v. Public Service Comm'n*, 978 S.W.2d 434 (Mo. App., W.D. 1998), rehearing and/or transfer denied; *State ex rel. Associated Natural Gas Co. v. Public Service Commission*, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981). It may select a combination of methodologies. *State ex rel. City of Lake Lotawana v. Public Service Comm'n of State*, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

⁴⁸ *Fed. Power Comm'n v. Nat. Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

⁴⁹ Tr. Vol. 9, pp. 949-50; see also Tr. Vol. 13, pp. 1306-07, 1310.

⁵⁰ Ex. 33, Sch. SCH-1; Tr. Vol. 12, p. 1305.

⁵¹ *Id.* at 938.

⁵² *In re Kansas City Power & Light Company*, Case No. EO-2005-0329, Stipulation and Agreement, Appendix B (filed March 28, 2005).

The final issue in return on equity is KCPL's requested "adder" of 50 basis point, or 0.5% additional ROE, requested due to the company's construction risk.⁵³ The level of risk that KCPL, and therefore KCPL investors, will endure during its Experimental Regulatory Plan is somewhat, although not completely, ameliorated by the additional amortizations KCPL may book. As Dr. Hadaway himself acknowledged, although the Experimental Regulatory Plan benefits primarily bondholders, it also has some lesser benefit to shareholders as well.⁵⁴ What is more, the Commission will remove considerable risk from KCPL's volatile off-system sales as discussed below. For these reasons, the Commission is of the opinion that KCPL's evidence does not warrant an upward adjustment of 50 basis points. Instead, the Commission will reduce the upward adjustment to only 25 basis points, resulting in a Cost of Common Equity of 11.25%.

Off-System Sales

What level of off-system sales margin should be included in determining KCPL's cost of service?

Inextricably linked to return on equity are off-system sales. KCPL witness Cline explains the link between off-system sales in this manner:

"Each million dollars (of non-firm off-system sales) is worth 9.57 basis points on return on equity. So, yes, every million dollars above the X value or the 25 percentile would result in a 9.57 base (sic) point increase in return on equity, all things equal."⁵⁵

In Case No. EO-2005-0329, the Commission approved a Stipulation among KCPL and the other signatory parties that contemplated an Experimental Regulatory Plan. Under the terms of the Stipulation, KCPL agreed that off-system energy and capacity sales revenues and related costs will continue to be treated "above the line" for ratemaking purposes. KCPL also agreed that it would not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case during the life of the Experimental Regulatory Plan.

Despite this language in the Stipulation, the parties have wildly differing views of what amount of off-system sales should be included in KCPL's revenue requirement. KCPL points out that it derives almost 50% of its earnings from off-system sales, which are far riskier than regulated sales. KCPL sponsored the testimony of Michael Schnitzer, Director of the NorthBridge Group, Inc., a consulting firm for the electric and natural gas industry. Mr. Schnitzer's testimony focused on the risk KCPL faces in the off-system sales market, and offered a probabilistic analysis of what KCPL's non-firm off-system sales would be in 2007. In summary, Mr. Schnitzer opined that the Commission should set the non-firm off-system margin at the 25th percentile, meaning that KCPL would have a 75% chance of achieving or exceeding the predicted level of those sales.

⁵³ Ex. 33, pp. 3-5; Tr. Vol. 12, p. 1248-49, 1297, 1304-05.

⁵⁴ Tr. Vol. 12, p. 1307-10.

⁵⁵ Tr. Vol. 9, p. 746.

Alternatively, KCPL recommends that if the Commission eschews the 25-75 analysis, then the Commission could set rates at the 50th percentile. But, in return, as mentioned by KCPL witness Giles, KCPL states that the Commission should award KCPL 9.57 basis points (or 0.0957%) extra in return on equity (ROE) for each \$1 million of non-firm off-system sales margin between the 25th and 50th percentile.⁵⁶ So, for example, although this is not the evidence in this case, if the difference between the 25th and 50th percentiles were \$10 million in sales, and the Commission sets off-system sales at the 50th percentile, then KCPL argues that the Commission should award KCPL an additional 95.7 basis points (9.57 basis points times 10), or 0.957% ROE, on top of whatever ROE it independently determined KCPL should earn.

Another alternative KCPL proposed was that KCPL would accept a mechanism whereby the Commission would set rates by using the 25th percentile of non-firm off-system sales in the revenue requirement. In addition, the Commission would order KCPL to book as a regulatory liability any amount exceeding the 25th percentile, with said liability to flow back to ratepayers in the next rate case.

Staff recommends that the Commission set the non-firm off-system sales level at the same level of sales KCPL made in 2005, believing that those sales are representative of what KCPL will experience in 2007. The off-system sales that Staff includes in revenue requirement is roughly \$9 million less than other parties' recommended non-firm off-system sales net margin level of the 50th percentile. In addition, KCPL's recommended 25th percentile is some \$28 million less company-wide, and \$15 million less Missouri jurisdictional portion, than Staff's recommendation.

OPC lobbies for a 50th percentile point on Schnitzer's curve, arguing that this is the only point where the Commission has an equal opportunity of estimating KCPL's non-firm off-system sales for 2007 too high or too low. This, argues OPC, is equally fair to shareholders and to ratepayers. DOE largely concurs with OPC's recommendation.

Praxair alleges that the most appropriate level of off-system sales to be put into KCPL's revenue requirement is the 2006 budgeted amount. This level is some \$12 million higher than recommended by Staff. This level of off-system sales margins: (1) reflects KCPL's best estimate of its 2006 level of off-system sales; (2) is comparable to the amount budgeted for the year that rates will be in effect; (3) is consistent with the most likely level of off-system sales margins as reflected in KCPL's statistical modeling; and (4) reflects KCPL's commitment to include all off-system sales margins above the line and for the benefit of ratepayers.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of the alternative KCPL sponsored in which it would agree to book any amount over the 25th percentile as a regulatory liability, and would flow that money back to ratepayers in the next rate case, with a corresponding regulatory asset account for KCPL to book any amount below the 25th percentile to be recovered in the next rate case. Not unlike KCPL's witness Dr. Hadaway, Michael Schnitzer possess impressive qualifications: after receiving

⁵⁶ Id.

degrees from Harvard and Massachusetts Institute of Technology, Mr. Schnitzer has been in private industry, consulting electrical and gas companies on strategic and economic issues since 1979.⁵⁷ No parties disagreed with his analysis or offered counter-analysis.⁵⁸ The disagreement among the parties seems not to be with Mr. Schnitzer's analysis, but KCPL witness Giles' choice to pick the 25th percentile from among the probabilities.⁵⁹ Staff, OPC and Praxair recommend the Commission set off-system sales at a higher level; those recommendations, if adopted, would place more into revenue requirement from off-system sales, thereby lessening the revenue to be collected from Missouri retail customers.

Mr. Giles chose the 25th percentile from Mr. Schnitzer's analysis due to the large portion of riskier, non-firm off-system sales KCPL makes in comparison to less risky regulated sales.⁶⁰ This is true especially in light of KCPL beginning its Experimental Regulatory Plan, which includes, among other things, constructing latan 2, and which was budgeted at some \$1.3 billion.⁶¹ But, as Mr. Giles admits, given the fairly substantial chance that KCPL will meet or exceed that 25th percentile, there are a number of ways to account for KCPL's relatively low risk for non-firm off-system sales, including adjustments to risk sharing and potential refunds.⁶²

When discussing risk, one should keep in mind not only the *probability* of an event coming true (or not coming true) but also the *importance* of the event. For example, the probability of a coin landing on "heads" to decide which team receives the ball at the beginning of a football game is 50%. Likewise, a revolver with six cartridge chambers, three of which have bullets, after the chamber is spun, has a 50% chance of firing a bullet on the first pull of the trigger. Yet, the importance of the result of the coin flip versus the importance of the revolver firing the bullet on the first pull of the trigger hardly needs to be explained.

In this case, the importance of the event of KCPL meeting a certain level of off-system sales is neither as trivial as who gets the ball first, nor as important as whether the gun fires. What is at stake here is the importance to KCPL of a certain level of non-firm, off-system sales put into revenue requirement versus the importance of that same level of non-firm, off-system sales to Missouri ratepayers.

Once the Commission decides return on equity, as well as all other issues outside of additional amortization, those decisions will give KCPL its revenue requirement. Then, in accordance with the additional amortizations allowed in Case No. EO-2005-0329, KCPL will be allowed to book those amortizations to keep itself investment grade. In other words, *in the short term*, regardless of the Commission's decision on return on equity, the revenue requirement, and, therefore, the rates Missouri retail ratepayers must pay, will not change.

⁵⁷ Ex. 30, pp. 1-2.

⁵⁸ Tr. Vol. 7, pp. 459-61; Vol. 8, pp. 885, 917-18.

⁵⁹ See Staff's Post-Hearing and True-Up Brief, p. 32.

⁶⁰ Ex. 3, p. 24.

⁶¹ Id.

⁶² Id. at 28.

Under the Experimental Regulatory Plan, KCPL has the option to file a rate case again on February 1, 2007; all indications are, it will.⁶³ That means that any rates decided in this case likely will be in effect for only one year. Consequently, although Missouri ratepayers would not receive the benefit of corresponding rate base reduction from a higher amortization, *in the short term*, Missouri ratepayers are not harmed by the 25th percentile scenario presented by KCPL, especially in light of the fact that the Commission will order KCPL to account for any sales over that 25th percentile and to flow them back to ratepayers, as KCPL witness Giles suggested. In contrast, the potential importance of not achieving that level during a time when KCPL will be issuing equity and investing hundreds of millions of dollars in infrastructure construction and upgrades could be disastrous to KCPL. In short, in balancing the interests of shareholders and ratepayers, straying from KCPL's recommended 25th percentile might benefit ratepayers some, but might also damage KCPL much, much more than any benefit that might accrue to ratepayers.

Finally, the Commission finds that there is competent and substantial evidence in the record to support KCPL's position that the amount that should go into KCPL's revenue requirement is the 25th percentile "trued-up" number found in a schedule attached to the true-up testimony of KCPL witness Tim Rush.⁶⁴ OPC objects to using this number on the grounds that the Commission excluded the true-up testimony of KCPL witness Schnitzer, who was the sponsor of the study that found that number. But even though the Commission excluded Schnitzer's true-up testimony, the Commission received the testimony of KCPL witness Rush, including the disputed true-up number, without objection.⁶⁵ This is significant because "in fact, all probative evidence received without objection in a contested case must be considered in administrative hearings."⁶⁶ In other words, once Rush's testimony was admitted without objection, which was before Schnitzer's testimony was even offered⁶⁷, the disputed trued-up number for the 25th percentile of off-system sales was in the record, and all parties waived objection to that evidence, even if they made a "specific and laborious objection" to that same evidence later in the hearing.⁶⁸ Furthermore, this evidence is probative, because, again no party objected to KCPL witness Schnitzer's direct, rebuttal or surrebuttal testimony that laid out his probabilistic analysis⁶⁹, and because no party questioned his methodology,⁷⁰ but rather, attacked only KCPL witness Giles' choice to use a certain number on Schnitzer's curve.

⁶³ Tr. Vol. 9, p. 828.

⁶⁴ Ex. 54, p. 3; Sch. 2, p. 4 of 51.

⁶⁵ Tr. Vol. 15, p. 1644.

⁶⁶ See *Dorman v. State Bd. of Registration of Healing Arts*, 64 S.W.3d 446, 454 (Mo.App. 2001); see also Section 536.070(8) ("Any evidence received without objection which has probative value shall be considered by the agency along with the other evidence in the case.")

⁶⁷ Tr. Vol. 15, p. 1653.

⁶⁸ See *Canania v. Director of Revenue*, 918 S.W.2d 310, 313 (Mo. App. 1996).

⁶⁹ Tr. Vol. 12, p. 1375.

⁷⁰ Tr. Vol. 7, pp. 459-61; Vol. 8, pp. 885, 917-18.

How should the off-system sales margin be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?

What parameters do the Commission-approved Stipulation and Agreement in Case No. EO-2005-0329 impose on the treatment of off-system sales revenue in this case?

Should KCPL's customers receive the benefit of all margins of off-system sales or should it be shared between customers and shareholders? Should a mechanism be adopted to ensure that the benefit is received by the appropriate party or parties? If so, what mechanism?

As explained by KCPL witnesses Chris Giles and Don Frerking, KCPL proposes to allocate its margins, or profits, from off-system sales among its Missouri retail, Kansas retail and FERC wholesale jurisdictions using an unused energy allocation methodology. KCPL has never before sought to allocate separately its off-system sales margins among its jurisdictions.⁷¹

KCPL's unused energy allocation methodology "is calculated by subtracting the actual energy usage from the 'available energy.' The available energy is defined as the average of the 12 coincident peak demands multiplied by the total hours in the test period."⁷² The rationale behind the unused energy allocation methodology was to develop "an allocation methodology that correlates with the unused capacity that enables the Company to make the off-system sales" that result in the margins at issue.⁷³

Staff recommends that the Commission continue to use the energy allocator for revenues from non-firm off-system sales of energy, including the margin component thereof. This is the time-tested and widely accepted method for allocating such revenues in this state because it is appropriate for allocating revenues and associated costs that are purely variable with the amount of energy sold.⁷⁴

The Staff opposes the Company's proposal, which would shift some \$4.4 million in revenues from KCPL's Missouri jurisdiction to its Kansas jurisdiction.⁷⁵ Other parties, such as OPC, Praxair, MIEC, and DOE, support the traditional energy allocation mechanism proposed by the Staff.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. A primary concern is the underlying philosophy implied by utilization of the unused energy allocator. Specifically, the unused energy allocator rewards the lower load factor of KCPL's Kansas retail jurisdiction by allocating a greater percentage of the profit from non-firm off-system sales to that jurisdiction.⁷⁶ Load Factor is average energy usage divided by peak demand. The higher the load factor, the closer the average load is

⁷¹ Ex. 5, p. 5.

⁷² Ex. 9, pp. 7-8.

⁷³ Ex. 4, p. 10.

⁷⁴ Ex. 115, p. 6; Tr. Vol. 8, p. 702.

⁷⁵ Ex. 115, p. 5.

⁷⁶ Ex. 125, p. 4.

to peak demand.⁷⁷ The lower load factor of KCPL's Kansas jurisdiction causes the Company to build higher energy cost combustion turbines, which provide KCPL with less opportunity to make off-system sales.

In KCPL's recent Regulatory Plan case (Case No. EO-2005-0329), some \$14 million in expenditures was authorized for demand response programs that should result in increasing KCPL's load factor, and hence, reducing KCPL's need to acquire higher energy cost combustion turbines.⁷⁸ Yet, KCPL proposes to allocate a greater proportion of the off-system sales margin to the lower load factor Kansas jurisdiction. Thus, use of the unused energy allocator creates a possible disincentive to implement projects aimed at increasing load factor.⁷⁹ Furthermore, application of the unused energy allocator ignores the fact that, thanks to Missouri's higher load factor, Kansas is already benefiting to a greater extent than Missouri from a lower overall cost of energy.

The only costs assigned to non-firm off-system sales is the fuel and purchased power costs – the variable costs – hence the appropriateness of using the energy allocator. This is consistent with the way KCPL itself allocates the costs relating to the energy portion of firm capacity contracts – using the energy allocator. The reason is simple – the energy allocator is used to allocate variable costs of fuel and purchased power costs relating to retail sales. Using the same rationale, the energy allocator is equally appropriate to use as the allocation factor for both energy of firm (as KCPL does) and non-firm off-system sales. The demand based unused energy allocator should not be used to allocate off-system sales – either energy from firm capacity sale contracts or non-firm off-system sales. Because plant is not dedicated to support non-firm off-system sales, there is no associated demand charge.⁸⁰

KCPL's settlement of its Kansas case, recently approved by the Kansas Corporation Commission, is a "black box" settlement, meaning that the Commission cannot tell what level of off-system sales are built into KCPL's Kansas rates.⁸¹ This means that any off-system margins that this Report and Order would ostensibly assign to Kansas would not go to Kansas ratepayers, but instead would go to KCPL shareholders. This Report and Order sets KCPL's Missouri rates at a just and reasonable level; any assignment of off-system sales margin away from Missouri using KCPL's proposed allocator would result in a windfall for KCPL shareholders. Thus, the Commission will reject KCPL's novel unused energy allocator, and will use the energy allocator proposed by Staff and other parties.

Rate Base:

Rate base is the second step in determining revenue requirement. To repeat, revenue requirement is usually established based upon a historical test year which

⁷⁷ Ex. 125, p. 3.

⁷⁸ Tr. Vol. 8, pp. 700-01.

⁷⁹ Tr. Vol. 8, p. 701.

⁸⁰ Id. at 588-89, 702.

⁸¹ See In re Kansas City Power & Light Company, Order Approving Stipulation and Agreement, pp. 7-8, Docket No. 06-KCPE-828-RTS (Order issued December 4, 2006).

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focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses the calculation of revenue requirement is expressed in the following formula:

$$RR = C + (V - D) R$$

where: RR = Revenue Requirement;
C = Prudent Operating Costs, including Depreciation Expense and Taxes;
V = Gross Value of Utility Plant in Service;
D = Accumulated Depreciation; and
R = Overall Rate of Return or Weighted Cost of Capital.

The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation. According to the parties' reconciliation, the following are contested rate base issues: regulatory asset – AFUDC on Hawthorn 5; eliminate depreciation related to AFUDC adjustment; regulatory expense; January, 2002 ice storm; STB litigation; LED-LDI project; CORPDP-KCPL.

Hawthorn 5

Should the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion in 1999 have been accounted for differently?

This issue concerns the accounting treatment of moneys recovered from insurance and lawsuits with respect to the destruction of KCPL's Hawthorn Station Unit 5, and the rebuild of that unit.

KCPL's Hawthorn 5 generating unit was originally commissioned into service in 1969. On February 17, 1999 an explosion at Hawthorn 5 destroyed the steam generator. KCPL decided to rebuild Hawthorn 5 after examining alternatives. KCPL needed the unit back in service as soon as possible so demolition of the plant took place in the spring and early summer of 1999 and construction began on the "new" unit in mid-summer 1999.

Hawthorn 5 was substantially rebuilt to a new, state of the art, coal-fired base load generating unit with a completely new steam generator (boiler), feed water system and pumps, air quality control system including the installation of a Selective Catalytic Reduction (SCR) system, scrubber and bag-house, control room, transformer, fuel-handling equipment, and water intakes. The steam turbine generator was substantially rehabilitated and updated.⁸²

KCPL received insurance recoveries and lawsuit settlements amounting to \$247.9 million. (Of this total, insurance recoveries amounted to \$209.75 million and lawsuit settlements amounted to \$38.178 million.). KCPL accounted for the

⁸² Ex. 139, pp. 31-32.

insurance proceeds as salvage and recorded the proceeds to FERC Account 108, Accumulated Provision for Depreciation; KCPL claims it was merely following Uniform System of Accounts' (USOA) protocol in booking the insurance proceeds as it did.

Staff proposes the following adjustment:

One, KCPL booked the insurance recoveries and lawsuit settlements as an increase to depreciation reserve as salvage instead of a reduction of plant in service, results in the plant in service balance being overstated. As a consequence of KCPL's methodology, manual adjustment is required for both financial and regulatory purposes to remove the amount of depreciation relating to the amounts of plant construction received from insurance and lawsuit settlement.⁸³

Staff believes that KCPL should have booked the insurance recoveries and lawsuit settlements received before and during the reconstruction to plant in service as a direct offset to the cost of reconstruction.⁸⁴

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The plain language of Account 108-B of the USOA states:

At the time of retirement of depreciable electric utility plant, this account shall be charged with the book cost of the property retired and the cost of removal and shall be credited with the salvage value and any other amounts recovered, such as insurance.⁸⁵

USOA property retired, as applied to electric plant, is property that has been removed, sold, abandoned, **destroyed**, or which for any cause has been withdrawn from service.⁸⁶ The evidence is abundantly clear that Hawthorn 5 was destroyed. The Commission sees nothing unambiguous; there is no exception for property destroyed "but later rebuilt." Staff's hearsay evidence of FERC employees commenting during a phone conversation that maybe KCPL could have treated the proceeds differently is hardly enough to overcome the plain language found in the USOA.

Is the AFUDC amount overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?

⁸³ *Id.* at 34, 36.

⁸⁴ *Id.* at 35.

⁸⁵ Ex. 139, p. 39.

⁸⁶ 18 C.F.R. Pt. 101, Definitions 28; see also Tr. Vol. 5, p. 208 (emphasis added).

Is the gross plant value of Hawthorne 5 overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?

Should an adjustment be made to KCPL's books and records regarding the amount for AFUDC to fund the Hawthorn 5 reconstruction?

KCPL witness Wright asserts that KCPL did not have excess cash from insurance proceeds to fund the Hawthorn 5 rebuild, and therefore did not need to use as much debt or equity to pay for the project. She states that the Staff's analysis omits that KCPL spent approximately \$162 million in unreimbursed purchased power from the time of the explosion until the rebuild in service date of June 2001 and approximately \$10.0 million on cost of removal, and KCPL incurred approximately \$296 million in cash expenditures related to Hawthorn 5 in excess of insurance proceeds.⁸⁷

Staff frames the issue as follows:

KCPL has overstated the plant in service as a result of calculating AFDC on the entire cost of the reconstruction of Hawthorn 5 instead of treating the funds received from insurance recoveries before and during the reconstruction as an offset to the cost of reconstruction. The total insurance proceeds were reduced by \$5.0 million associated with replacement power and an additional \$2.219 million relating to administrative and general cost offsets. These two amounts were not considered by the Staff as capital expenditures like the reconstruction of Hawthorn 5 costs. The net amount of insurance recoveries after the aforementioned deductions was the amount used as an offset to the cost of reconstruction which is used to calculate the AFDC.⁸⁸

Staff reduced the amount of AFDC for Hawthorn 5 to \$7.63 million from the \$20.64 million calculated by KCPL to eliminate a return on proceeds that was calculated by KCPL on the insurance received. The \$7.63 million recalculates AFDC considering the insurance recoveries that relate to the capital costs, excluding from the insurance recoveries amounts for insurance received of \$5 million for replacement power and \$2.19 million of cost described by KCPL as administrative and general cost offsets.⁸⁹ According to Staff, the books and records of KCPL should be corrected to reflect no allowance of AFDC on the insurance proceeds received by KCPL.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. Staff's subtraction of insurance proceeds from cumulative construction costs to recalculate AFUDC is counter to the AFUDC formula from the USOA, which uses the average balance in

⁸⁷ Ex. 8, pp. 3-4

⁸⁸ Ex. 139, p. 35; 140, p. 16.

⁸⁹ Ex. 140, pp. 5, 16.

construction work in progress.⁹⁰ KCPL's following the USOA does not result in overstating the rate base calculation of Hawthorn 5. Furthermore, KCPL's deposit of the insurance cash into its general corporate account, rather than earmarking the funds for a specific use, was perfectly proper,⁹¹ and earmarking those funds as Staff would have had KCPL do could have resulted in an earlier rate increase.⁹² Because KCPL calculated AFUDC properly, no adjustment is required.

Surface Transportation Board Litigation

Should the deferred expenses associated with the Surface Transportation Board rail rate complaint case that were incurred through June 30, 2006, be included in rate base?

On October 12, 2005, KCPL filed a rate complaint case with the Surface Transportation Board ("STB") against Union Pacific Railroad ("UP"). KCPL's complaint alleges that UP's charges to transport coal from Wyoming's Powder River Basin to KCPL's Montrose plant in Missouri are excessive. As explained by Public Counsel witness Smith:

In the STB rate complaint case identified above, KCPL charged that UP's rates for the movement of coal from the Powder River Basin (PRB) to KCPL's Montrose Generating Station were unreasonably high. KCPL believes that the rates charged by UP exceeded 180% of the variable cost and was greater than the "stand-alone cost" to provide such service.⁹³

KCPL and Staff wish to treat the actual Surface Transportation Board (STB) litigation costs as a regulatory asset, with costs to be amortized to expense over five years beginning in January, 2007. Any refund KCPL receives would first offset any existing balance of STB case costs in the regulatory asset, with the remainder of the refund offsetting fuel costs as determined in a future proceeding.

OPC objects, stating that the Commission should disallow this expense because ratepayers receive no benefit from these estimated costs in this rate case. In the alternative, OPC says that if the Commission includes the costs, then the costs should be spread over a five-year period.

The Commission finds that the competent and substantial evidence supports the position of KCPL and Staff, and finds this issue in their favor. Even OPC, who opposes KCPL on this issue, applauds KCPL for pursuing this litigation, believing it is to the ratepayers' benefit that KCPL tries to recover what it believes to be excessive freight cost for moving coal from Wyoming. The treatment that KCPL and Staff request would first allow KCPL to recover the cost of the STB litigation, with any balance being applied to fuel costs as determined in a future proceeding.⁹⁴ This

⁹⁰ 18 C.F.R. Pt. 101, Electric Plant Instructions (17).

⁹¹ Tr. Vol. 5, p. 201

⁹² *Id.* at 196.

⁹³ Exhibit 210, Smith Direct, p. 18.

⁹⁴ Ex. 118, pp. 22-23; Ex. 13, pp. 3-4.

solution appears just and reasonable, as KCPL, Staff, and OPC could all voice their views in that future proceeding on exactly what STB litigation costs were prudent, and on how much money should flow back to ratepayers.

Corporate Projects and Strategic Initiatives

Should the costs of the LED-LDI and CORPDP-KCPL projects, which are being deferred and amortized over 5 years, be included in rate base?

On December 5, 2006, KCPL and Staff submitted a Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives, along with a Motion for Leave to Late-File said stipulation. The Commission allowed parties until December 11 to object. No parties objected and, therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, affixed to this Report and Order as Appendix A, as if it were unanimous. The Commission finds the above-referenced stipulation reasonable, and therefore, grants the motion to late-file it, and approves the stipulation.

The Signatories have agreed that certain costs incurred by KCPL will have a benefit relating to more than one period and that related non-labor costs should be deferred as a regulatory asset and amortized over the periods to which the benefits will apply. Costs identified to be deferred include all costs incurred after January 1, 2005 related to project LED-LDI, Leadership Development, and CORPDP-KCPL, Corporate Development-KCPL. These non-labor costs were determined to be \$1,781,451 (total Company) and \$1,542,115 (total Company), respectively, for the period January 1, 2005 through September 30, 2006. The LED-LDI projects captured costs to develop an enhanced leadership development program for supervisors and managers and to conduct associated training for eligible employees. The CORP-KCPL project captured costs related to KCPL for corporate-level resource planning, business analysis, strategic planning, development of short and long-term business plans and assessment and adjustment of such plans and business decisions in response to changes in the marketplace.

The Missouri jurisdictional amount of such costs as well as the Missouri jurisdictional amount of additional non-labor costs incurred for these projects through the end of 2006 will be deferred. As agreed upon by the Signatories, the Commission authorizes KCPL to amortize the deferred costs to expense over a five (5) year period beginning January 1, 2007.

Although the Signatories have agreed that these costs should be deferred and amortized over a five (5) year period, the Signatories have not reached an agreement concerning either the rate base treatment of these costs or what percentage of these costs constitute the Missouri jurisdictional amount. Those issues are to be decided by the Commission within the "Corporate Projects and Strategic Initiatives" and the "Jurisdictional Allocations" issues now before the Commission for decision in this proceeding.

For the rate base treatment of these expenses, the Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. In rebuttal testimony, KCPL witness Lori Wright stated that KCPL was supportive of Staff's treatment of these costs, yet, without explaining why these

projects would be an asset, maintained that these costs should be included in rate base.

As explained by Staff witness Hyneman, "In order for an item to be added to rate base, it must be an asset. Assets are defined by the Financial Accounting Standards Board (FASB) as 'probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events' (FASB Concept Statement No. 6, Elements of Financial Statements). Once an item meets the test of being an asset, it must also meet the ratemaking principle of being 'used and useful' in the provision of utility service. Used and useful means that the asset is actually being used to provide service and that it is actually needed to provide utility service. This is the standard adopted by many regulatory jurisdictions, including the Missouri Public Service Commission."⁹⁵

The Commission finds that the competent and substantial evidence supports the position of Staff, and finds this issue in Staff's favor. While KCPL's projects appear to be prudent, KCPL produced insufficient evidence for the Commission to find that these projects rise to the level of an asset, on which the company could earn a rate of return. What is at issue is not whether a project⁹⁶ is a "probable future economic benefit", as KCPL asserts in its brief; what is at issue is the remainder of the FASB definition Mr. Hyneman quoted, which is "obtained or controlled by an particular entity as a result of past transactions or events." In other words, an asset is some sort of possession or belonging worth something. KCPL obtains or controls assets, such as generation facilities and transmission lines. To attempt to turn an otherwise legitimate management expense, such as a training expense, into an asset by dubbing it a "project" makes a mockery of what an asset really is, which is some type of property.⁹⁷ Using KCPL's argument, any expense is potentially an asset by simply calling it a "project", and thus could be included in rate base. KCPL's projects do not rise to the level of rate base.

Depreciation:

What are the appropriate depreciation rates to be used in establishing rates in this proceeding?

Depreciation is an accounting convention under which the value of an asset is reduced proportionately over the course of its useful life. At the end of its life, the asset is considered to have lost all value except residual salvage value. If the accounting convention were perfect, an asset would be fully depreciated at the time it is actually retired, that is, removed from service.⁹⁸ In ratemaking, depreciation is an operating expense, the purpose of which is to return to the investors their original investment in an asset as it is consumed in the public service. "The purpose of the

⁹⁵ Ex. 119, p. 13.

⁹⁶ *Project* – a plan or proposal; scheme; an undertaking requiring concerted effort. The American Heritage Dictionary, Second College Edition, p. 990 (1985).

⁹⁷ Black's Law Dictionary, Sixth Edition, p. 116.

⁹⁸ See *In the Matter of St. Louis County Water Company*, 4 Mo.P.S.C.3d 94, 102-3 (1995); *In the Matter of Depreciation*, 25 Mo.P.S.C. (N.S.) 331.

annual allowance for depreciation and the resulting accumulation of a depreciation reserve is . . . to enable the utility to recover the cost of such property to it."⁹⁹ Depreciation expense is booked to the depreciation reserve, which amount is deducted in ratemaking from the original cost basis of the utility's plant-in-service or rate base. The resulting net rate base is the present value of the investors' capital assets devoted to public service.

The Constitution requires that the investors' original capital outlay be returned to them in rates as the utility's assets are expended in the public service:

A water plant, with all its additions, begins to depreciate in value from the moment of its use. Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs but for making good the depreciation and replacing the parts of the property when they come to the end of their life. . . . [The Company] is entitled to see that from earnings the value of the property invested is kept unimpaired, so that at the end of any given term of years the original investment remains as it was at the beginning.¹⁰⁰

KCPL, relying on the depreciation rates set out in the Experimental Regulatory Plan, did not submit a depreciation study. Staff, on the other hand, relying on language in that same stipulation that said that parties may propose changes to KCPL's depreciation rates, did just that by submitting a depreciation study.

In its current depreciation study, Staff performed a broad-group, average-life depreciation study utilizing the straight-line method, broad-group procedure and whole life technique.¹⁰¹ Staff's current depreciation rates are based on Staff's estimate of average service life and net salvage value for each capital account. Based upon its depreciation study, Staff recommends that the Commission adopt the depreciation rates for the various accounts as set out in Schedule 2 to the Direct Testimony of Staff witness Rosella L. Schad. The depreciation rates determined by the Staff's study would decrease the currently ordered depreciation accrual by approximately \$10 million annually.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission, in Case No. EO-2005-0329, recently approved depreciation rates for KCPL. In contrast to those rates, the Commission has serious concerns about Staff's recent depreciation study. For example, it is unclear what Staff did in its lifespan analysis, and Staff seems to inaccurately presume that certain generation-related assets have an

⁹⁹ St. ex rel. Martigney Creek Sewer Co. v. Pub. Serv. Comm'n, 537 S.W.2d 388, 396-397 (Mo. banc 1976).

¹⁰⁰ *Knoxville v. Knoxville Water Co.*, 212 U.S. 1, 13-14, 29 S.Ct. 148, 152, 53 L. Ed. 371, 381 (1909).

¹⁰¹ Ex. 131, p. 3

indefinite life.¹⁰² Also, it appears that Staff's average service lives for certain transmission, distribution and general plant assets are some 10-20 years too long. Furthermore, Staff's calculation of net salvage rates may be inaccurate, with its attempts to eliminate outliers by excluding the highest and lowest net salvage amounts actually exacerbating, rather than solving, the problem.¹⁰³

What is more, any decrease in depreciation likely would not affect rates in this case, because KCPL would be allowed additional amortization to meet the credit metrics agreed to in Case No. EO-2005-0329.¹⁰⁴

Regulatory Plan Additional Amortizations

What amount of Regulatory Plan additional amortizations should be allowed to maintain KCPL's credit rating?

The Commission discusses this issue in this section of the Report and Order because, as explained by KCPL witness Frerking, amortization is, in fact, the same as depreciation expense.¹⁰⁵ And, this issue, although tied in with return on equity and off-system sales, is actually independent of those, and all other issues.¹⁰⁶ As aptly explained by Staff witness Traxler:

"Once the Commission makes a decision in every rate case (during KCPL's Experimental Regulatory Plan) on the issues, at that point in time, we'll take that scenario and determine whether or not an additional amortization is required. The amortization will result specifically from the Commission's decisions on all the other issues."¹⁰⁷

In addition to Staff, KCPL's counsel and the Public Counsel largely concurred with Mr. Traxler's statement; namely, that once the Commission decides the revenue requirement, that the parties can agree on how to calculate how much, if any, Additional Amortization is required under the Experimental Regulatory Plan approved in Case No. ER-2005-0329.¹⁰⁸ As such, there appears to be no issue for the Commission to explicitly resolve with this Report and Order; the Commission's decision on all other issues will dictate to KCPL and the other parties exactly what additional amortization is needed.

Should a "gross up" for taxes be added to this amount? If so, what amount is appropriate?

¹⁰² Ex. 10, pp. 16-17.

¹⁰³ *Id.* at 19-20.

¹⁰⁴ Tr. Vol. 7, p. 503, 515.

¹⁰⁵ *Id.* at 504.

¹⁰⁶ The Commission notes that, despite the Experimental Regulatory Plan's statement that KCPL would need approximately \$17 million in amortizations in this rate case (Ex. 143, p. 37), the parties present this issue for the Commission to resolve.

¹⁰⁷ Tr. Vol. 11, p. 1179 (parenthetical phrase added); see also Tr. Vol. 9, pp. 858-859.

¹⁰⁸ Tr. Vol. 5, p. 59; Vol. 8, p. 620; see also Ex. 214, p.1, 8.

On December 4, 2006, KCPL, Staff, OPC and Praxair submitted a Nonunanimous Stipulation and Agreement Regarding Regulatory Plan Amortizations. The Commission allowed parties until December 11 to object. No parties objected and, therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, affixed to this Report and Order as Appendix B, as if it were unanimous. The Commission finds the above-referenced stipulation reasonable, and therefore, approves the stipulation.

According to the signatories, this stipulation has the following key points:

1. The entire amount of the Regulatory Plan amortization allowed in rates is to be treated as additional book depreciation for rate and financial statement purposes by KCPL;
2. An additional tax straight-line depreciation deduction in the entire amount of the Regulatory Plan amortization allowed in rates will be assumed for rate purposes and financial reporting purposes; and
3. The accumulated book depreciation reserve resulting from the recognition of the Regulatory Plan amortization as book depreciation will be recognized as an offset (reduction) to rate base in subsequent rate cases. The accumulated reduction in deferred income tax expense resulting from including the Regulatory Plan amortization in the straight line tax depreciation deduction will be reflected on KCPL's tax records and included in subsequent rate cases, as appropriate, along with all other factors included in the determination of deferred income tax expense. The net effect of these changes related to the Regulatory Plan amortizations to the accumulated depreciation reserve and the accumulated deferred tax reserve is an overall reduction to KCPL's rate base. The reduction in deferred taxes will be reflected in the deferred income tax balance in rate base in future rate cases, as well as all other changes affecting the deferred tax balance, including additional deferred taxes resulting from KCPL's plant additions.

The Regulatory Plan amortization is intended to provide KCPL the necessary cash flow to meet the two particular debt coverage ratios identified in the Regulatory Plan based upon KCPL's Missouri jurisdictional cost of service.¹⁰⁹ The entire amount of the Regulatory Plan amortization will be treated as additional book depreciation, and the entire amount of the amortization will be reflected in KCPL's tax calculation as additional tax straight-line depreciation deduction.

¹⁰⁹ Adjusted Funds From Operations Interest Coverage and Adjusted Funds From Operations as a Percent of Average Total Debt. See Paragraph III.B.1.i and Appendix E and Appendix F of the Regulatory Plan.

The Commission finds the stipulation to be a reasonable resolution of the “gross-up” issue among the parties, and will approve it.

What risk factor should be used in calculating the Regulatory Plan additional amortizations for off-balance sheet purchased power agreements?

KCPL and Staff agree that the risk factor that should be used to calculate Regulatory Plan additional amortizations for off-balance sheet purchased power agreements should be 50%, which is the same risk factor that Standard & Poor’s used to analyze KCPL’s debt. In contrast, OPC believes that risk factor does not realistically reflect KCPL’s chance of defaulting on those obligations, and instead, opts for a 10% risk factor.

The Commission finds that the competent and substantial evidence supports KCPL’s position, and finds this issue in favor of KCPL. The Commission is mindful that this rate case, as well as others KCPL likely will file in the next few years, is somewhat dependent upon the Stipulation and Agreement in the Experimental Regulatory Plan case. That stipulation provides that the parties agree that KCPL should remain at investment grade.¹¹⁰ The amount of amortization needed to keep KCPL at investment grade, in turn, is driven largely by Standard & Poor’s credit metrics.¹¹¹ Standard & Poor’s uses a 50% risk factor to rate KCPL’s off-balance sheet obligations, so it seems sensible for the Commission to use that same factor. In contrast, a lower risk factor would result in the additional amortization being determined using a lower level of debt than used by Standard & Poor’s. “This, in turn, would result in (KCPL) failing to meet the thresholds that S&P has established. . . . S&P’s position must be accepted as a given in light of what the amortization mechanism is designed to accomplish.”¹¹² Although OPC’s argument for a 10% risk factor has some merit, OPC’s “belief”¹¹³ that the lowest risk factor should be utilized is less convincing than the argument that S&P actually uses a 50% risk factor.

Over what period of time should the Regulatory Plan additional amortizations be treated as an offset to rate base?

In the stipulation labeled Appendix B, the signatories agreed that pursuant to and in compliance with the provisions of the Stipulation and Agreement that the Commission approved in Case No. EO-2005-0329, any Regulatory Plan additional amortization that is provided to KCPL pursuant to that Stipulation and Agreement shall be used as a reduction to rate base for the longer of (a) at least ten (10) years following the effective date of the July 28, 2005 Report And Order in Case No. EO-2005-0329 or (b) until the investment in the plant in service accounts to which the Regulatory Plan additional amortizations are ultimately assigned by the Commission is retired. The Commission finds this reasonable, and approves of the stipulation’s resolution of this issue.

¹¹⁰ See In re Kansas City Power & Light Company, Case No. EO-2005-0329, Stipulation and Agreement, p. 18 (filed March 28, 2005).

¹¹¹ Tr. Vol. 12, p. 1276, p. 1328.

¹¹² Ex. 25, p. 6.

¹¹³ Ex. 213, pp. 4-5.

Should the capital structure be synchronized with the investment in Missouri jurisdictional electric operations? How should that be accomplished?

Should an amount be added to Missouri jurisdictional rate base to reflect additional investments related to Missouri jurisdictional electric operations?

Again, as mentioned in the stipulation labeled Appendix B, the signatories agree that the additional amortization calculation based upon the revenue requirement resulting from the true-up in this case will reflect an allocation of Great Plain Energy, Inc.'s (GPE's)/KCPL's capital structure to Missouri electric operations. This allocation will exclude the impact of the operations of GPE/KCPL not related to KCPL's Missouri electric operations. The Commission finds this reasonable, and approves of the stipulation's resolution of this issue.

Allowable Operating Expenses

The final variable in the revenue requirement equation that the Commission must resolve is what expenses are prudent, and therefore should be included in KCPL's cost of service.

Capitalization of Certain Costs

On December 5, 2006, KCPL and Staff submitted a Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives, already described above as Appendix A. Again, the Commission approves the stipulation and, as requested by KCPL in the stipulation, and not opposed by Staff, the Commission further makes the following findings:

As agreed to by KCPL and Staff, the Commission authorizes KCPL to capitalize all costs incurred after January 1, 2005 related to project MSC0140, KCPL Strategic Initiatives, and certain advertising costs all incurred by KCPL in the development of various components and informing customers of the features of KCPL's Regulatory Plan Capital Investments, which will be transferred and capitalized to the later 2 construction project. These costs were determined to be \$2,137,705 (total Company) during the 2005 test year.

Furthermore, the Commission approves the agreement between KCPL and Staff to allow KCPL to capitalize certain costs incurred subsequent to the test year, as well as related costs, to the Regulatory Plan Capital Investment project to which they apply. The Commission notes that the parties do not agree on what percentage of those costs constitutes the Missouri jurisdictional amount, and the Commission will address that issue within the "Jurisdictional Allocations" issue pending in this case.

Incentive Compensation

What amount, if any, of incentive compensation should be included in rates?

KCPL requests that all of its incentive compensation be included in cost of service. Staff objects, stating that roughly 35% of the cost should be disallowed on the grounds that it is either tied to earnings per share (EPS), and thus has negligible, if any, benefit to ratepayers, or is awarded for vague reasons.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As far as compensation tied to EPS, the Commission notes that KCPL management has the right to set such goals. However, because maximizing EPS could compromise service to ratepayers, such as by reducing customer service or tree-trimming costs, the ratepayers should not have to bear that expense. What is more, because KCPL is owned by Great Plains Energy, Inc., and because GPE has an unregulated asset, Strategic Energy L.L.C., it follows that KCPL could achieve a high EPS by ignoring its Missouri ratepayers in favor of devoting its resources to Strategic Energy.

KCPL's attempt to state that Staff has no evidence to support its theory that maximizing EPS might not benefit KCPL shareholders misses the point; KCPL has the burden to prove that the Commission should approve the tariffs. Further, KCPL's argument that disallowing any of its incentive compensation costs would put it at a competitive disadvantage fails. KCPL management is free to offer whatever compensation packages it wants. Nevertheless, if the method KCPL chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then those costs should be borne by shareholders, and not included in cost of service.

Pensions

How should the expense and contributions relating to pension benefits for (1) Joint Partners and (2) the Supplemental Executive Retirement Plan (SERP) be accounted for in the tracking of the regulatory asset required by the Stipulation and Agreement in Case No. EO-2005-0329?

Should FAS 88 pension expenses be treated consistently with the KCPL application in this proceeding and its application for an AAO in Case No. EU-2006-0560?

On December 4, 2006, KCPL and Staff submitted a Nonunanimous Stipulation and Agreement Regarding Pension Issues. The Commission allowed parties until December 11 to object. No parties objected and, therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, affixed to this Report and Order as Appendix C, as if it were unanimous. The Commission finds the above-referenced stipulation reasonable, and therefore, approves the stipulation.

According to the signatories, this stipulation has the following key points:

- a. Clarify the pension provisions in KCPL's Regulatory Plan with regard to KCPL's joint partners in the Iatan and LaCygne generating stations.
- b. Identify, for purposes of calculating the tracking mechanism provided for in the method agreed to in the Regulatory Plan, the Regulatory Assets, including the Prepaid Pension Asset and annual Pension Cost resulting from rates established in this rate case, Case No. ER-2006-0314. The tracking mechanism requires that all Regulatory Assets and/or Liabilities, including the Prepaid Pension Asset, and annual Pension Cost be identified as of the established true-up date for

each KCPL rate case during the period covered of the Regulatory Plan.

c. Set out the agreement of the Staff and KCPL regarding the treatment of pension costs which result under Financial Accounting Standard (FAS) 88 for financial reporting and ratemaking purposes during the period of the Regulatory Plan.

Ice Storm Costs

What amount of the amortization of the costs associated with the 2002 ice storm should be included in rates?

On January 30 and 31, 2002, a severe ice storm struck the Kansas City area. As a result, some 305,000 KCPL customers lost electrical service. KCPL used hundreds of outside workers to get service restored and, due to the unusual expenses related to that storm, KCPL applied for an accounting authority order, which the Commission granted.¹¹⁴ That order allowed KCPL to defer the ice storm costs ratably over the period from September, 2002 until January, 2007. One condition in that order stated:

e. That in granting the requested AAO, the Commission makes no findings as to whether deferred expenses are reasonable, whether other factors contributed to the damage to the system and the resulting repair/replacement costs incurred, or whether KCPL would have suffered financial harm (*i.e.* earnings during the period were inadequate to compensate KCPL for the costs incurred) absent deferral. The Commission reserves the right to consider in a future rate case the ratemaking treatment of the costs deferred, as well as any assertions, including the appropriate amortization period, made by parties thereto.

Because the amortization allowed by the AAO case was in effect during the test year and true-up period, KCPL asserts that it should be able to recover those costs.

The United States Department of Energy (DOE) argues that KCPL has already recovered those costs in rates, and that, therefore, the Commission should disallow this expense. According to DOE witness Dittmer, KCPL has recovered those costs due to its robust, if not excessive return on equity during the ice storm amortization period.¹¹⁵

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. DOE complains that KCPL has already recovered those costs in rates. However, DOE witness Dittmer testified that he was unaware of any Staff or Commission action to reduce rates from 2002 to

¹¹⁴ See *In re Kansas City Power & Light Company, Order Granting Accounting Authority Order*, Case No. EU-2002-1048 (July 30, 2002).

¹¹⁵ See Ex. 803, pp. 22-24.

now because of overearnings, which would include the recovery of ice storm costs from ratepayers.¹¹⁶ Regardless of KCPL's prior earnings, the Commission gave KCPL an accounting authority order to defer and amortize its ice storm costs through January 31, 2007, which includes the test year in this case. Because Staff has no position on this issue¹¹⁷, the Commission finds that competent and substantial evidence exists to show that KCPL's ice storm costs were prudent.

EEI Dues

What amount of EEI dues should be included in rates?

According to KCPL and Staff briefs, this issue has been settled. As such, the Commission has no dispute to resolve on this issue.

Severance Costs

What amount, if any, of severance costs should be included in rates?

KCPL wishes to recover severance that it pays to former employees in its cost of service on the grounds that those costs extinguish any possible liability those former employees may have against the company. It also claims that these severance costs are recurring. In contrast, Staff asserts that only KCPL shareholders, and not its ratepayers, receive the benefit of these costs.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. Staff's witness on this issue, Charles Hyneman, testified that KCPL answered one of his data requests by admitting that severance costs protect KCPL against such issues as sexual harassment or age discrimination, and that such costs are not recoverable in rates.¹¹⁸ He contrasted those severance payments, made only to protect shareholders, with severance payments made to decrease payroll, which could be included in cost of service because of the benefit to ratepayers. Moreover, Staff points out that KCPL excluded its 2005 severance costs from its earnings per share calculation that determines its management's incentive compensation payment.¹¹⁹ The Commission sees no equity in allowing KCPL to recover these costs from ratepayers when its own management excludes those same costs from its EPS calculation, to the enrichment of its executives via the incentive compensation plan.

¹¹⁶ Tr. Vol. 9, pp. 898-99.

¹¹⁷ KCPL asserts that Staff believes KCPL should be allowed seven months of amortization from June 30, 2006 until January 31, 2007. DOE alleges that Staff believes that four months of amortization, from September 30, 2006 to January 31, 2007, be allowed. However, Staff states in both of its post-hearing briefs that it has no position on the ice storm costs issue. The Commission finds that Staff has waived any position it might have had on this issue.

¹¹⁸ Tr. Vol. 5, p. 251.

¹¹⁹ Id. at 239.

Bad Debts

Should the bad debt percentage be applied to reflect the total revenues, including any rate increase in Missouri jurisdictional retail revenues awarded in this proceeding?

KCPL and Staff agree that KCPL should apply a 0.61% bad-debt write-off factor to KCPL's Missouri jurisdictional revenue. The contested issue between these parties is what that Missouri jurisdictional revenue should be.

KCPL asserts that the Commission should apply that factor to the actual Missouri jurisdictional revenue that the Commission finds appropriate for this case. In contrast, Staff objects, maintaining that such treatment harms ratepayers because there is no demonstrable correlation between the level of retail sales and the percentage of bad debts. Instead, Staff appears to argue that the Commission should apply the bad debt percentage write-off to its pro forma revenue requirement in its case, rather than the actual revenue requirement the Commission decides.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission understands Staff's argument that there is not a perfect positive correlation between retail sales and the percentage of bad debts. While it's possible that KCPL's bad debt expense could decrease, the Commission finds it more probable, and therefore just and reasonable, that an increase in the amount of revenue that KCPL is allowed to collect from its Missouri retail ratepayers will result in a corresponding increase in bad debt expense.

Fuel & Purchased Power Expense

What is the appropriate level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?

What level of natural gas fuel price should be used in the production cost modeling that is used, along with appropriate fuel adders, to quantify the level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?

KCPL has accepted Staff's fuel and purchased power numbers.¹²⁰ According to KCPL's and Staff's post-hearing briefs, there is no issue for the Commission to resolve.

SO2 Premiums

How should SO2 premiums related to lower-sulfur coal be recorded for book and ratemaking purposes?

What parameters does the Commission-approved Stipulation & Agreement in Case No. EO-2005-0329 impose on the treatment of SO2 premiums in this case?

To understand this issue, it is best that the Commission quote from a Stipulation and Agreement that KCPL, Staff and OPC (among other parties) signed in the

¹²⁰ Tr. Vol. 6, p. 361.

Experimental Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329. The disputed language is:

“To the extent that KCPL pays premiums for lower sulfur coal up until January 1, 2007, it will determine the portion of such premiums that apply to retail sales and will record the proportionate cost of such premiums in Account 254. But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed \$400,000 annually.”¹²¹

As read by KCPL and Staff, any limitation on the amount of Account 254 premiums KCPL can book will expire on December 31, 2006. OPC asserts that the second sentence of the above quote, beginning, “But in no event”, prevents KCPL from **ever** charging more than \$400,000 annually to Account 254 for the Missouri jurisdictional portion of SO2 premiums. As framed by Staff, another way to look at this issue is whether the word ‘but’ “. . . is tantamount to ‘however’, or whether it should be construed as the equivalent of ‘and’ and thus be subordinate to the prior sentence.”¹²²

The Commission finds that the competent and substantial evidence supports KCPL’s position, and finds this issue in favor of KCPL. To analyze these sentences, the Commission will read the disputed language in its entirety, in hopes of gleaning the content of the disputed phrase “But in no event.” The sentence that contains the disputed phrase “But in no event” also contains the clause “for these premiums.” To know what “these premiums” are requires looking back to the preceding sentence. That sentence says “these premiums” are for “lower sulfur coal up until January 1, 2007.”¹²³

Also, it is instructive that these two adjoining sentences both mention Account 254, thus showing some sort of relationship between the two sentences, whereas Account 254 is not only not mentioned anywhere else in that paragraph of the stipulation, but it is also not mentioned in the preceding two paragraphs, either.¹²⁴ The Commission finds that the more reasonable interpretation of the disputed language is to read the two sentences together to mean that any limitation on the amount of Account 254 premiums KCPL can book will expire on December 31, 2006.

Injuries and Damages

What is the appropriate amount of injuries and damages expense to include in rates?

¹²¹ Ex. 143, p 10.

¹²² Staff’s Post-Hearing Brief, p. 14.

¹²³ Although the Commission notes that the first sentence of the disputed sentences uses the phrase “such premiums” and the second sentence uses “these premiums”, the premiums discussed appear to be the same.

¹²⁴ Ex. 143, pp. 9-10.

KCPL calculates its test year costs using the accrual method of accounting; that is, KCPL books probable and expenses before actually outlaying the cash to pay those expenses.¹²⁵ Staff states that although KCPL is following generally accepted accounting principles in using the accrual method of accounting to book these expenses, it prefers that the Commission order KCPL to use a three-year average of cash payments via a cash method of accounting for the purpose of setting rates.¹²⁶

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission finds Staff's position on the cash method of accounting inconsistent with its cash working capital analysis; Staff itself acknowledges that KCPL does not pay its casualty claims until 185 days after they occur.¹²⁷ Due to this lag of paying casualty expenses, ratepayers have provided the cash working capital for those 185 days, and ratepayers receive credit for that money through a reduction in rate base.¹²⁸ Finding this issue in KCPL's favor therefore allows accounting consistency for injuries and damages expense and cash working capital, and provides adequate protection for ratepayers via a reduction in rate base on which KCPL may earn a return on investment.

Rate Case Expense

What amount of rate case expense should be included in rates?

Should rate case expense be normalized or deferred and amortized? If the latter, then what is the appropriate amortization period for the deferred rate case expense?

Should the costs deferred for future amortization be included in rate base?

KCPL argues that the Commission should amortize rate case expenses over two years. In contrast, Staff and OPC ask the Commission to normalize those expenses over a three-year period.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. To normalize an expense is to account for an expense that is not expected to regularly occur by spreading out the cost of the expense over a number of years.¹²⁹ Staff chose the three year number for normalizing because the Experimental Regulatory Plan doesn't require another rate filing for three years.¹³⁰

In contrast, KCPL's choosing of a two-year amortization period more accurately reflects the reality of the Experimental Regulatory Plan. While Staff and OPC point out that the Commission usually normalizes these expenses, the Experimental Regulatory Plan itself, including the construction of Iatan 2, installation of wind generation, and environmental upgrades of other facilities, is hardly normal. KCPL

¹²⁵ Tr. Vol. 6, pp. 290-91.

¹²⁶ *Id.* at 304-05.

¹²⁷ *Id.* at 297.

¹²⁸ Ex. 139, p. 30.

¹²⁹ Tr. Vol. 6, p. 312.

¹³⁰ *Id.*

also acknowledged that the plan anticipates that KCPL could be back for a rate case as early as next year, or as late as 2009, and that a two year amortization was chosen as a reasonable mid-point.¹³¹ KCPL is embarking upon an extraordinary process, and will no doubt need access to several million dollars of capital to accomplish its goals. Further, costs of construction of a coal-based generating unit, as well as the other projects enumerated in the Experimental Regulatory Plan are not easily estimable, and the Commission fully expects KCPL to file rate cases each year during this plan to keep up with its costs.¹³²

Property Taxes

Should property taxes be adjusted to reflect changes in tax jurisdiction assessment values, levy rates, in plant additions, and other factors during the test period, including both the update period and true-up period?

Staff recommends that the Commission calculate property tax expense by multiplying the January 1, 2006 plant-in-service balance by the ratio of the January 1, 2005 plant-in-service balance to the amount of property taxes paid in 2005. KCPL wants the property tax cost of service updated to include 2006 assessments and levies.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As with all issues, KCPL bears the burden of proof. According to KCPL's True-up brief, its September 30 true-up filing had latest available actual 2006 tax levy rates for 96% of Missouri tax liability. As the Commission deciphers KCPL's true-up filing – entitled KCPL's Summary of Adjustments, September Update – line 152 shows a *decrease* in property taxes. To the extent this issue was in play, it was not listed in the Commission-ordered List of Issues for the True-up Proceeding, filed by Staff on November 8, and KCPL did not object to that list, or put on any evidence concerning property taxes at the true-up hearing. As such, the Commission does not find adequate evidence to support KCPL's position on this issue.

Decommissioning Expense

Should decommissioning expense be reduced to reflect the amount of annual accruals expected under a 60-year license?

On December 5, 2006, KCPL and Staff submitted a Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives, along with a Motion for Leave to Late-File said stipulation. The Commission allowed parties until December 11 to object. No parties objected and, therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, attached as Appendix A, as if it were unanimous.

The Commission finds the above-referenced stipulation reasonable, and therefore, grants the motion to late-file it, and approves the stipulation. As

¹³¹ Ex. 7, p. 12.

¹³² Tr. Vol. 9, p. 828.

requested by KCPL in the stipulation, and not opposed by Staff, the Commission further makes the following findings:

1) KCPL's annual Missouri retail jurisdictional decommissioning cost accrual shall be \$1,281,264, commencing January 2007 and KCPL's decommissioning trust fund payments shall be at that annual level;

2) Decommissioning cost accruals, as a consequence of "1)," will continue to be included in KCPL's cost of service and will continue to be included in KCPL's rates for ratemaking purposes;

3) The decommissioning cost accrual schedule identified in the direct testimony of Don A. Frerking in this proceeding, Schedule DAF-5, shows an annual Missouri jurisdictional decommissioning cost accrual of \$1,281,264, commencing January 2007, and;

4) The earnings rate assumed by KCPL for the decommissioning trust, as shown in Schedule DAF-5 of the direct testimony of Don A. Frerking, takes into consideration the tax rate change and the removal of the investment restrictions resulting from the federal Energy Policy Act of 1992.

True-Up

What elements of Cost of Service and Rate Base should be updated in the September True Up?

At the November 16 true-up hearing, a contested issue was whether 113 employees to be added after the September 30 true-up date should be included in cost of service.

KCPL states that a typical employee payroll annualization would look at an employee count at the end of the test period to determine payroll expense. However, KCPL claims that method is not appropriate here because of circumstances surrounding the last several months of the periods. Specifically, KCPL experienced significant workforce reductions in April, 2006, and again in August and September, 2006, so that KCPL's employee numbers on September 30, 2006 are artificially low.¹³³ That artificially low number comes from KCPL's workforce realignment, occurring in March, 2005, and from the annual exodus of employees from KCPL due to retirement. KCPL announces interest rate changes every August, giving KCPL employees information and time to decide if they want to retire with a lump-sum payment from the company.¹³⁴ In 2006, some 50 employees decided to retire.

Staff counters that the driver for the September 30 true-up date was the project in-service date of KCPL's \$85 million, 100 MW wind generation facility at Spearville, Kansas.¹³⁵ Staff says that it gave fair warning to KCPL that only employees actually employed and on the KCPL payroll as of September 30, 2006 would be placed into cost of service.¹³⁶ Further, Staff states that including these 113 employees, who

¹³³ Ex. 54, p. 9

¹³⁴ Ex. 56, pp. 4-5.

¹³⁵ Ex. 163, pp. 10, 17.

¹³⁶ Ex. 163, pp. 9-10.

were not actually working for KCPL as of September 30, 2006, would violate the "matching principle". That principle is an attempt to match cost of capital, rate base, revenues and expenses as of a certain date; setting rates when these variables are not matched could result in a company either over-earning or under-earning, and thereby the Commission would not be setting just and reasonable rates if it did not use the matching principle. OPC concurs in Staff's proposal.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. The Commission agrees with Staff that it is important to match revenues and expenses as of a date certain. As Staff points out, should the Commission accept KCPL's 113 employees in cost of service, then the Commission would also need to insert additional revenue from customer growth occurring after the known and measurable date of June 30.

While KCPL's employee numbers as of September 30, 2006 may be deceptively low, those numbers are, in fact, accurate as of that date. KCPL is on the cusp of a comprehensive construction plan, and needs capital and employees to meet the commitments embodied in the Experimental Regulatory Plan. But KCPL management signed off on the stipulation that called for the true-up date in this case to be September 30. And KCPL management set up its retirement plan such that employees may leave in droves in August and September of each year, with replacements not being hired until after September 30. KCPL management largely created this problem, and must live with the consequences of those 113 employees being excluded from cost of service. If the Commission does not take a snapshot of a company's revenues and expenses as of the known and measurable date, the true-up date, or any date, for that matter, then what? KCPL's employee count, as well as a host of other revenues and expenses, has no doubt changed since the true-up hearing; the Commission will get yet another snapshot of those changes when KCPL files its next rate case. To set just and reasonable rates, the Commission simply must match revenues and expenses as of a certain date.

Weather Normalization

What methodology should be used to compute Large Power class kWh sales and revenues?

KCPL maintains that its Large Power (LP) class of customers is weather-sensitive due to those customers' having substantial air-conditioning loads that vary with temperature, with typical weekday loads of about 250 MWs up to about 55 degrees, rising steadily with temperature, reaching about 300 MW at 80 degrees. On the other hand, Staff dismisses the argument, saying, among other things, that the LP class is more influenced by seasonal rather than day-to-day fluctuations.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. The LP class consists of a fairly small number of large businesses engaged in wildly different enterprises; hotels, office buildings, manufacturing, and hospitals are examples.¹³⁷ These businesses' electricity needs vary more due to the type of commerce they are in than due to day-to-day temperature changes. Furthermore, if the Commission were

¹³⁷ Ex. 121, p. 3

to weather normalize this class, it would also need to weather normalize their revenues that this class produces, a process that, because of the complexities of the class, is extremely difficult to do; in fact, the Commission's Staff does not weather normalize the LP class for any Missouri electric utility.¹³⁸

Finally, the Commission considers Dr. McCollister's statistical regression analysis. He used that analysis to estimate the effect of cooling degree days with a base temperature of 55 degrees. The statistical significance of the coefficient for this variable as measured by the t-statistic was 17.7. According to Dr. McCollister, any value above 2.0 is *usually* considered significant, so 17.7 is extremely significant.

In response to Dr. McCollister's claim that any t-statistic of 2 or more is indicative of weather sensitivity, Staff witness Lange responded that he used random numbers to arrive at a t-statistic of over 2, thus calling into question the reasonableness of Dr. McCollister's analysis; in fact, the Commission reconciles this evidence by finding that while Dr. McCollister's analysis *usually* would mean that a t-statistic of 2.0 or more is significant, it is not significant in this case due to Staff witness Lange's evidence that random numbers would also produce a t-statistic of over 2.0.¹³⁹

Jurisdictional Allocations

What is the appropriate method (4 CP v. 12 CP) to use for allocating generation and transmission costs among jurisdictions?

How should A&G expenses be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?

KCPL operates in both Kansas and Missouri. Instead of maintaining separate systems, KCPL's sole system serves both jurisdictions. To set just and reasonable rates for each jurisdiction requires allocating various generation and transmission capital costs properly between these states. KCPL and other parties disagree over which coincident peak method to use to allocate those costs.

Coincident peak refers to the load of each jurisdiction that coincides with the hour of a utility's overall system peak. KCPL asserts that its operating and capacity planning realities, which take into account all hours of the year, and not just peak hour or seasonal peak needs, dictate use of the 12 CP demand allocator. Staff and other parties assert that KCPL has historically used the 4 CP method, that the 12 CP method would allocate more plant investment and costs to Missouri and less to Kansas, and that KCPL's high peak demand from June until September is more akin to a 4 CP than a 12 CP system.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As on all issues, KCPL bears the burden of proof. KCPL's witness on this issue, Don Frerking: (1) had never conducted a jurisdictional allocation analysis prior to this proceeding; (2) had never taken any classes or attended any conferences related to jurisdictional allocations; (3) had never had any training regarding jurisdictional allocations; (4) had not consulted any textbooks or treatises related to jurisdictional allocations; (5) had not

¹³⁸ Id. at 4

¹³⁹ Id. at 4-5.

reviewed any testimony filed in other jurisdictions related to jurisdictional allocations; and (6) had not reviewed any FERC decisions on the issue of jurisdictional allocations. KCPL's witness readily admits that the 12 CP methodology was not the result of any "independent analysis", but rather was a decision made elsewhere.

In contrast, not only Staff, but Praxair, Ford, and Missouri Industrial Energy Consumers support the 4 CP methodology. Their evidence showed that a 4 CP methodology for a utility such as KCPL is appropriate because its non-summer peak demands are significantly lower than the summer peak demands. Moreover, Praxair witness, Maurice Brubaker, has testified hundreds of times on cost allocation issues, and his testimony was that the Commission should use the 4 CP method. In addition, Staff witness Maloney convincingly disputed KCPL's claim that its system is similar to The Empire District Electric Company's system, for which Staff recommended a 12 CP method. Maloney testified that Empire's winter peaks are higher in relation to its summer peaks than are KCPL's peaks. The less developed gas distribution system in Empire's more rural service area results in more electric space-heating use in Empire's area, accounting for a higher winter load for Empire than for KCPL. KCPL's lower winter load suggests that a 4 CP allocation is more appropriate than a 12 CP method.

Weatherization

Should the weatherization program be modified so that KCPL's Call Center will refer customers to the program?

Should LIHEAP recipients be directed to the weatherization program and be required to participate in it?

As addressed by the parties' post-hearing briefs, any issues between the City of Kansas City, Missouri, the Missouri Department of Natural Resources, and KCPL have been resolved, and an order from the Commission on these issues will not be required. Accordingly, at the behest of the parties, the Commission will not address these issues.

Should KCPL participate in an "Energy Conservation Program" that will provide consultation, weatherization materials and installation? If so, should the cost of the program to be underwritten by KCPL and charged to the customer? (DNR and KC object to this issue.)

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. W. Bill Dias¹⁴⁰ brings up several issues outside of the List of Issues the parties filed on October 6, to which he failed to object, and to which parties object as being not only properly before the Commission, but outside the Commission's jurisdiction regardless of whether they were timely presented.

¹⁴⁰ Mr. Dias' pleadings list him as such sundry entities as, "W. Bill Dias"; "W. Bill Dias and W. Bill Dias D/B/A 1.Paystation .com"; and "Dias Capital Growth Corporation, Inc." For simplification's sake, the Commission will refer to these entities as Mr. Dias.

Commission Rule 4 CSR 240-2.080(15) allows parties ten days to respond to any pleading. Mr. Dias failed to timely respond. As a consequence, the Commission will not address any issues outside the October 6 List of Issues.

Furthermore, Mr. Dias' attempts to represent Dias Capital Growth Corporation, Inc., as well as such groups as The Baptist Minister's Union¹⁴¹, "the community", "the urban community", etc., are tantamount to the unauthorized practice of law, as some parties have pointed out.¹⁴² To the extent that Mr. Dias purports to represent any entity other than himself, including Dias Capital Growth Corporation, Inc., such representation appears to be the unauthorized practice of law; therefore, the Commission finds that any evidence or argument that Mr. Dias makes on anyone's behalf other than his very own should not be considered.

Moreover, KCPL objects to the concerns that W. Bill Dias brings up to the extent that they are on the List of Issues, saying it is patently unfair for the Commission to order KCPL to contract with him and to order shareholders to simply hand him \$5 million for the programs that he wants.¹⁴³ For example, his surrebuttal asks for the Commission to force KCPL into a contractual relationship, and asks for compensation for confidential information he's shared with KCPL. Mr. Dias does not cite, and the Commission cannot find, any legal authority to give him the various forms of relief that he requests. What is more, Mr. Dias' evidence, which included hearsay evidence such as newspaper articles from the Kansas City Call and USA Today, hardly rises to the level of competent and substantial evidence. As a result, to the extent that Mr. Dias' concerns are within the October 6 List of Issues, the Commission will deny those requests.

Class Cost-of-Service and Rate Design

Class Cost-of-Service

On what basis should distribution costs be allocated to classes? Should the allocation of primary distribution costs include any customer-related component? What type of demand should be used to allocate the cost of distribution substations and distribution lines?

On what basis should production capacity and transmission costs be allocated to classes?

What is the appropriate method to use for allocating margins on off-system sales among Missouri retail customer classes?

Do KCPL's computation of coincident peak demands and class peak demands properly recognize line losses?

¹⁴¹ KCPL witness John Marshall testified that the Baptist Ministers Union separated its interest from Mr. Dias (Tr. Vol. 6, p. 401)

¹⁴² Despite being a *pro se* litigant, in his post-hearing briefs, remarks and testimony before the Commission, Mr. Dias purports to speak on behalf of such entities as "the Urban Community of Greater Kansas City"; "the Urban Community"; the Baptist Ministers' Union of Kansas City; Dias, the company; and churches that will partner with Mr. Dias and/or his company.

¹⁴³ Tr. Vol. 14, p. 1535.

To what extent, if any, are current rates for each customer class generating revenues that are greater or less than the cost of service for that customer class?

What is the appropriate basis for allocating Administrative and General Expense Account Numbers 920, 933, 923, 930.2 and 931 among Missouri retail customer classes?

Should revenue adjustments among classes be implemented in order to better align class revenues to class cost-of-service? If so, what percentage increase or decrease should be assigned to each customer class?

Should class revenue adjustments be implemented even if no increase or decrease in revenue requirement is granted?

Should revenue adjustments be phased in over multiple years?

Should revenue adjustments among the non-residential classes be applied uniformly or non-uniformly?

How should any increase in the revenue requirement be implemented?

Rate Design

Should a comprehensive analysis of KCPL's class cost-of-service issues and rate design be conducted after the conclusion of the regulatory plan and the in-service date of Iatan 2? Should the cost-basis of general service all-electric rates be included in this analysis?

Should KCPL's proposed changes to the General Service customer charge be implemented?

By way of reminder, the rates that KCPL will be allowed to charge its customers are based on a determination of the company's revenue requirement. KCPL's revenue requirement is calculated by adding the company's operating expenses, its depreciation on plant in rate base, taxes, and its rate of return multiplied by its rate base. The revenue requirement can be expressed as the following formula:

$$\text{Revenue Requirement} = E + D + T + R(V-AD+A)$$

Where: E = Operating expense requirement
 D = Depreciation on plant in rate base
 T = Taxes including income tax related to return
 R = Return requirement
 (V-AD+A) = Rate base
 For the rate base calculation:
 V = Gross Plant
 AD = Accumulated depreciation
 A = Other rate base items

The Commission has resolved issues regarding revenue requirement; now, what remains is what class of customers must pay what share of that revenue requirement.

On November 9, KCPL, Staff, OPC, Explorer Pipeline, Praxair, DOE, Ford, MIEC and Wal-Mart filed a Stipulation and Agreement Regarding Class Cost of Service and Rate Design Issues. No party objected; Trigen responded timely, and specifically stated that it did not object because the stipulation carved out contested issues that Trigen and KCPL present to the Commission for resolution.

Therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, affixed to this Report and Order as Appendix D, as if it were unanimous. The Commission finds the above-referenced stipulation reasonable, and therefore, approves the stipulation.

The Signatories agree to overall company rate revenue neutral interclass changes in class revenue responsibilities that have the effect of increasing current residential customer class rates by about 2.00%; decreasing current small, medium and large general service class rates by about 0.45%; decreasing current large power service class rates by about 2.54%; and making no change to current lighting class rates as more particularly described Appendix A attached to the stipulation. Further, the Signatories agree new rates will be developed based on the "Post-Shifted Class Rate Revenues," and then each rate element of those rates will be factored up by multiplying them by the sum of one plus the result of dividing any overall increase in company revenue requirement the Commission orders in this case by total KCPL Missouri revenue at present rates as trued-up to generate final rates from this case.

Availability of General Service Space-Heating Rate Discounts

In this case, should the qualification provision of the existing general service all-electric rate schedules be expanded as proposed by KCPL, and the all-electric winter energy rate increased an additional 5%, to make rate discounts available to existing and future customers who are not all-electric customers?

As stated above, several parties filed a Stipulation and Agreement Regarding Class Cost of Service and Rate Design on November 9. Trigen responded, stating that it did not object to the stipulation because it did not address the two above-listed issues, leaving them instead to be litigated and resolved by the Commission.

KCPL and the other signatories to the November 9 class cost of service stipulation want to increase the general service space heating and all-electric winter energy rate by five percentage points more than each class' general applications rates.¹⁴⁴ In addition, KCPL wishes to expand the qualifications provision to establish electric heating as the primary heating sources, rather than the requirement that the customer qualifications is all-electric. Trigen objects, stating that KCPL has failed to produce any cost of service study to support its proposal.

The Commission finds that the competent and substantial evidence supports Trigen's position, and finds this issue in favor of Trigen. KCPL has not provided adequate proof that its proposal is supported by any cost of service, incremental or marginal cost analysis, or any other underlying study.¹⁴⁵ Instead, KCPL's evidence rolled together standard tariff customers within each general service category, so that the cost of service study results are inconclusive as to the all-electric and separately metered space heating customers.¹⁴⁶

¹⁴⁴ Ex. 21, pp. 4-5;

¹⁴⁵ Tr. Vol. 11, p. 1028.

¹⁴⁶ Ex. 701, pp. 28-29.

Should the existing general service all-electric rate schedules and the separately metered space heating provisions of KCPL's standard general service tariffs be eliminated or restricted to existing customers only until there is a comprehensive class cost of service study and/or cost-effectiveness study which analyzes and supports such tariffs and provisions as well as KCPL's Affordability, Energy Efficiency and Demand Response programs?

KCPL asserts that its general service rate design has been in place for years, and that the Commission should reject Trigen's request to dismantle such a design, especially in light of the fact that Trigen is a competitor of KCPL, and has not done its own analysis to study the impact such a proposal would have on KCPL customers in the downtown Kansas City, Missouri area. Trigen states, again, that KCPL has inadequate cost support for either its existing general service all-electric rate discount or its existing separately metered space heating discount.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission is concerned that during KCPL's winter season, commercial and industrial customers under the all-electric general service tariffs pay about 23% less for the entire electricity usage than they would otherwise pay under the standard general service tariff, and that commercial and industrial customers under the separately metered space heating provision would pay about 54% less for such usage than they would pay under the standard general service tariff.¹⁴⁷

However, the Commission recognizes that KCPL participated in an extensive class cost of service study in 1996, and that KCPL has reached an agreement for class cost of service and rate design in the present case. The Commission will adopt Staff's suggestion, and Trigen's alternative suggestion, that the Commission restrict the existing general service all-electric rate schedules and the separately metered space heating provisions of KCPL's standard general service tariffs to existing customers until there is a comprehensive class cost of service study. This appears to be a reasonable solution, since no one has performed a cost study of the impacts of eliminating the current rates.¹⁴⁸

CONCLUSIONS OF LAW

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

Jurisdiction, Burden of Proof, and Duty of Commission

KCPL is a public utility, and an electrical corporation, as those terms are defined in Section 386.020(42) and (15), RSMo 2000. As such, KCPL is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

Section 393.140(11), RSMo 2000, gives the Commission the authority to regulate the rates that KCPL may charge its customers for electricity. In determining the rates that MGE may charge its customers, the Commission is required to

¹⁴⁷ Ex. 701, pp. 8-9; 14-15.

¹⁴⁸ KCPL Final Post-Hearing Brief, p. 56; Staff Final Post-Hearing Brief, pp. 75-76.

determine that the proposed rate is just and reasonable.¹⁴⁹ KCPL has the burden of proving that its proposed increase is just and reasonable.¹⁵⁰

In determining whether rates are just and reasonable, the Commission must balance the interests of the investor and the consumer.¹⁵¹ The Commission's failure to establish just and reasonable rates would, in fact, violate the United States Constitution. In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.¹⁵²

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.¹⁵³

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

¹⁴⁹ Section 393.150.2, RSMo 2000.

¹⁵⁰ Section 393.150.2, RSMo 2000.

¹⁵¹ Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1943).

¹⁵² Bluefield, 262 U.S. at 690 (1923).

¹⁵³ Id. at 692-93.

Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.¹⁵⁴

As stated above, the Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.¹⁵⁵ The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must guide the Commission in its task.¹⁵⁶ In the earlier of these cases, *Bluefield Water Works*, the Court stated that:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.¹⁵⁷

In the same case, the Court provided the following guidance as to the return due to equity owners:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.¹⁵⁸

The Court restated these principles in *Hope Natural Gas Company*, the latter of the two cases:

¹⁵⁴ Federal Power Commission v. Natural Gas Pipeline Co. 315 U.S. 575, 586 (1942).

¹⁵⁵ Phillips, *The Regulation of Public Utilities*, supra, 394; Goodman, 1 *The Process of Ratemaking*, supra, 606.

¹⁵⁶ *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176.

¹⁵⁷ *Bluefield*, supra, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

¹⁵⁸ *Id.*, 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.¹⁵⁹

In the final analysis, it is not the method employed, but the result reached, that is important.¹⁶⁰ The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."¹⁶¹

Applicable Statutes and Legal Standards:

The Missouri Public Service Commission was created by the General Assembly in 1913.¹⁶² The General Assembly delegated to the Commission the police power to establish utility rates, subject to judicial review of the question of reasonableness.¹⁶³ The Commission's purpose is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.¹⁶⁴ While "the dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental,"¹⁶⁵ the Commission must also permit the utility to recover a "just and reasonable" return on the assets it has

¹⁵⁹ *Hope Nat. Gas Co., supra*, 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

¹⁶⁰ Again, within a wide range of discretion, the Commission may select the methodology. *Missouri Gas Energy*, 978 S.W.2d at 434; *State ex rel. Associated Natural Gas Co.*, 706 S.W.2d at 880, 882; *Fraas*, 627 S.W.2d at 888; *Lake Lotawana*, 732 S.W.2d at 194.

¹⁶¹ *Nat. Gas Pipeline Co.*, 315 U.S. at 586; 62 S.Ct. at 743; 86 L.Ed. at 1049-50.

¹⁶² *State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 47 (Mo. banc 1979).

¹⁶³ *State ex rel. City of Harrisonville v. Public Service Commission of Missouri*, 291 Mo. 432, 236 S.W. 852 (1922); *City of Fulton v. Public Service Commission*, 275 Mo. 67, 204 S.W. 386 (1918), error dis'd 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; *City of St. Louis v. Public Service Commission of Missouri*, 276 Mo. 509, 207 S.W. 799 (1919); *Kansas City v. Public Service Commission of Missouri*, 276 Mo. 539, 210 S.W. 381 (1919), error dis'd 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348 (1951).

¹⁶⁴ *Id.*; *May Dep't Stores Co. v. Union Electric Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 48 (1937).

¹⁶⁵ *State ex rel. Crown Coach Co. v. Public Service Commission*, 179 S.W.2d 123, 126 (1944)

devoted to the public service.¹⁶⁶ “There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment.”¹⁶⁷

In 1925, the Missouri Supreme Court stated:

The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. * * * These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.¹⁶⁸

The Public Service Commission has exclusive jurisdiction to establish public utility rates.¹⁶⁹ A public utility has no right to fix its own rates and cannot charge or collect rates that have not been established by the Public Service Commission¹⁷⁰; neither can a public utility change its rates without first seeking authority from the Commission.¹⁷¹ A public utility may submit rate schedules or “tariffs,” and thereby suggest to the Commission rates and classifications which it believes are just and reasonable.¹⁷²

Section 393.130, in pertinent part, requires a utility company's charges to be just and reasonable and not in excess of charges allowed by law or by order of the commission. It also prohibits electrical corporations from discriminating against customers by charging different prices for the same or similar services.

Section 393.140 authorizes the Commission to determine just and reasonable rates. Section 393.150, in pertinent part, authorizes the Commission to suspend for a period of time any schedule stating new rates, charges, rules, regulations, or practices, and to hold “a hearing concerning the propriety of such rate, charge, . . . rule, regulation or practice.” Section 393.270 provides in paragraph 4 that in determining the price to be charged, “the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question” The courts have held that this statute means that the Commission’s determination of

¹⁶⁶ Utility Consumers' Council, 585 S.W.2d at 49.

¹⁶⁷ *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

¹⁶⁸ *State ex rel. Washington University et al. v. Public Service Commission et al.*, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (en banc).

¹⁶⁹ *May Department Stores Co. v. Union Electric Light & Power Co.*, 107 S.W.2d 41, 57 (1937).

¹⁷⁰ *Id.*

¹⁷¹ *Deaconess Manor Ass'n v. Public Service Com'n*, 994 S.W.2d 602, 610 (Mo. App., W.D. 1999).

¹⁷² *May Department Stores*, *supra*, 107 S.W.2d at 50.

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the proper rate must be based on consideration of all relevant factors.¹⁷³ Section 393.230.1 authorizes the Commission to value the property of water and sewer utilities in Missouri.

Finally, Section 393.270 provides:

* * *

2. After a hearing and after such investigation as shall have been made by the commission or its officers, agents, examiners or inspectors, the commission within lawful limits may, by order, fix the maximum price of . . . electricity . . . not exceeding that fixed by statute to be charged by such corporation or person, for the service to be furnished; and may order such improvement . . . in the manufacture, transmission or supply of electricity . . ., or in the methods employed by such persons or corporation as will in its judgment be adequate, just and reasonable.

3. The price fixed by the commission under sections 393.110 to 393.285 shall be the maximum price to be charged by such corporation or person for . . . electricity for the service to be furnished within the territory and for a period to be fixed by the commission in the order, not exceeding three years, except in the case of a sliding scale, and thereafter until the commission shall, upon its own motion or upon the complaint of any corporation or person interested, fix a higher or lower maximum price of . . . electricity . . . service to be thereafter charged.

4. In determining the price to be charged for . . . electricity . . . the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable average return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

The dominant purpose in creation of the Commission is public welfare.¹⁷⁴ Section 386.610 reads, in relevant part, that “[t]he provisions of this chapter shall be liberally construed with a view to the public welfare, efficient facilities and substantial

¹⁷³ State ex rel. Missouri Water Co. v. Public Service Comm'n, 308 S.W.2d 704, 719 (Mo. 1957); State ex rel. Midwest Gas Users' Ass'n v. Public Service Commission, 976 S.W.2d 470, 479 (Mo. App., W.D. 1998); State ex rel. Office of Public Counsel v. Public Service Com'n of Missouri, 858 S.W.2d 806 (Mo. App., W.D. 1993).

¹⁷⁴ *Alton R. Co. v. Public Service Commission*, 110 S.W.2d 1121, 1125 (Mo. App. 1937).

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justice between patrons and public utilities.” The Commission must weigh the benefits and detriments to all the groups affected by its decision.

Section 386.250, jurisdiction of Commission, reads, in relevant part, as follows:

The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter: (1) To the manufacture, sale or distribution of gas, natural and artificial, and electricity for light, heat and power, within the state, and to persons or corporations owning, leasing, operating or controlling the same; and to gas and electric plants, and to persons or corporations owning, leasing, operating or controlling the same . . .

Section 393.140, general powers of Commission in respect to gas, water, electricity and sewer services, reads, in relevant part, as follows:

The commission shall:

(1) Have general supervision of all gas corporations, electrical corporations, water corporations and sewer corporations having authority under any special or general law or under any charter or franchise to lay down, erect or maintain wires, pipes, conduits, ducts or other fixtures in, over or under the streets, highways and public places of any municipality, for the purpose of furnishing or distributing water or gas or of furnishing or transmitting electricity for light, heat or power, or maintaining underground conduits or ducts for electrical conductors, or for the purpose of collecting, carrying, treating, or disposing of sewage, and all gas plants, electric plants, water systems and sewer systems owned, leased or operated by any gas corporation, electrical corporation, water corporation, or sewer corporation.

(2) Investigate and ascertain, from time to time, the quality of gas or water supplied and sewer service furnished by persons and corporations, examine or investigate the methods employed by such persons and corporations in manufacturing, distributing and supplying gas or electricity for light, heat or power and in transmitting the same, and in supplying and distributing water for any purpose whatsoever, and in furnishing a sewer system, and have power to order such reasonable improvements as will best promote the public interest, preserve the public health and protect those using such gas, electricity, water, or sewer system, and those employed in the manufacture and distribution thereof, and have power to order reasonable improvements and extensions of the works, wires, poles, pipes, lines, conduits, ducts and other reasonable devices, apparatus and property of gas corporations, electrical corporations, water corporations, and sewer corporations.

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Section 393.140 conveys upon the Commission broad supervisory powers and provides that the Commission shall have general supervision over all electric utilities operating in Missouri.¹⁷⁵

IT IS ORDERED THAT:

11. All pending motions and requests for relief not otherwise granted are denied.
12. The proposed tariff sheets filed by Kansas City Power & Light Company on February 1, 2006, Tariff No. YE-2006-0594, are rejected.
13. The Stipulation and Agreement Regarding Class Cost-of-Service and Rate Design Issues filed on November 9, 2006 is approved.
14. The Nonunanimous Stipulation and Agreement Regarding Pension Issues filed on December 4, 2006 is approved.
15. The Nonunanimous Stipulation and Agreement Regarding Regulatory Plan Additional Amortizations filed on December 4, 2006 is approved.
16. The Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives is approved, and Staff's Motion for Leave to Late-File Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives is granted.
17. Kansas City Power & Light Company may file tariffs that comport with this Report and Order.
18. This Report and Order shall become effective on December 31, 2006.
19. This case may be closed on January 1, 2007.

Davis, Chm., Murray, and Appling, CC., concur;
Gaw and Clayton, CC., dissent, with separate
dissenting opinion(s) to follow;
and certify compliance with the provisions of
Section 536.080, RSMo.

***NOTE:** The Stipulation and Agreement regarding class cost-of-service and rate design as well as nonunanimous stipulation and agreement on other various issues in this case have not been published. If needed, these documents are available in the official case files of the Public Service Commission.

The Commission, in an order issued on January 18, 2007, denied motions for rehearing in this case. See page 200 for that order.

Dissenting Opinion of Commissioners
Robert M. Clayton III and Steve Gaw

¹⁷⁵ State ex rel. Atmos Energy Corp. v. Public Service Commission, 103 S.W.3d 753 (Mo. banc 2003).

These Commissioners dissent from the majority's decision. The decision awards KCPL with one of the highest returns on equity (ROE) awarded in the nation, it is contrary to the Regulatory Plan that was earlier agreed to by numerous parties and approved by the Commission, and it under-accounts for the off-system sales historically made by the company. These decisions by the majority cause KCPL customers to pay rates far in excess of that which is just and reasonable.

Prior to this rate case, this Commission entertained a request from KCPL to assist in the financial challenge of building a new coal fired generation unit called Iatan II and improving the environmental performance of the existing unit. Rather than engage in an adversarial contested case, the Commission pursued a more collaborative process. After months of discussions, the Staff of the Commission, Office of the Public Counsel, industrial customers and others entered into a Stipulation and Agreement which was proclaimed as the consensus-produced roadmap to be followed to allow KCPL to proceed toward construction of the plant with protections for ratepayers. One of the principal parts of the plan provided for accelerated depreciation of KCPL plant at a level required to protect KCPL's credit rating.

The Staff of the Commission and consumer advocates believed this methodology was preferable to artificially and arbitrarily raising the ROE for KCPL. This was in part due to the fact that with accelerated depreciation, while consumers would pay higher rates during the early years, they would effectively pay lower rates in the long term. Ratepayers would be made whole for their early contributions over time. In effect, KCPL will be loaned or advanced additional revenues by ratepayers. Raising the ROE, on the other hand, simply increases the amount consumers will pay and, in turn, increase the revenues of the company. By choosing that alternative, ratepayers never receive any benefit for this increased contribution. A statutory prohibition enacted by initiative petition precludes the company from collecting revenues for construction work in progress. There is a question as to whether the attempts to avoid this provision could be declared unlawful.

By granting a return of 11.25% in this case, the majority has in effect repudiated the agreement struck by the parties in the regulatory plan. The majority is giving KCPL what it sought in open negotiations, but which was ultimately conceded in the final regulatory plan. The majority has essentially provided further protection, some would argue excessive protection, to its Commission-approved agreement. Why the majority would award such generosity at the expense of consumers is a mystery.

The majority further raises rates on KCPL customers by failing to give consumers full credit for the company's off-system sales. The majority significantly lowered the amount of off-system sales revenues that are used to offset KCPL's cost of service. KCPL has done very well in maximizing profits from extra capacity on its system. Ratepayers have funded all of the costs of KCPL's generating units and deserve 100% of the estimated profits from off-system sales as determined from historical numbers. Based on the majority's decision, it appears that consumers will be short changed. Additionally, the method used appears to provide for a tracking of off-system sales. Two issues arise from this untested methodology. If the tracking mechanism allows for consumers to recoup money for off-system sales greater than that set in base rates, then, on the surface (intergenerational

inequities aside), ratepayers could be made whole. However, the arrangement potentially provides for a lessened financial incentive to make beneficial off-system sales. Another consideration is, if off-system sales are merely tracked for purposes of setting rates in the next case, then consumers are significantly damaged by the underestimation of off-system sales.

KCPL should be recognized for its proactive, collaborative approach in dealing with the Iatan II project and its other environmental improvements. The work of all parties in the regulatory plan case as well as the subsequent negotiations, which included the Sierra Club, while the case was on appeal, should be commended. However, the actions of the majority in this rate case undercut the previous efforts of parties in the Commission-approved regulatory plan. Further, it sends the wrong signal about the Commission's commitment to such plans in the future. It would be interesting to see the reactions of the utility and credit rating agencies if the commission had repudiated the regulatory agreement in the opposite direction by granting a lower, more appropriate ROE and refusing to allow accelerated depreciation. Consistency in follow-up to long-term regulatory plans may not be legally required, but it can be important in evaluating regulatory risk which is one of the principal reasons for the regulatory plan to begin with.

Overall, the deal struck by consumer representatives in the regulatory plan case was renegotiated by the Commission itself in this rate case to consumers' detriment. This coupled with higher rates from the underestimation of off-system sales result in unjust and unreasonable rates.

Therefore, these Commissioners must dissent.

In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area.

Case No. GR-2006-0422

Gas §18. Missouri Gas Energy filed tariff sheets with the Missouri Public Service Commission to implement a general rate increase for natural gas service in the annual amount of \$41,651,345. The Commission approved the Partial Nonunanimous Stipulation and Agreement filed by Missouri Gas Energy on December 8, 2006.

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: December 28, 2006

Effective Date: December 28, 2006

On May 2, 2006, Missouri Gas Energy, a division of Southern Union Company, filed tariffs sheets with the Missouri Public Service Commission to implement a general rate increase for natural gas service in the annual amount of \$41,651,345. The case is now progressing as ordered in the Procedural Schedule and the evidentiary hearing will begin on January 8, 2007. On December 8, 2006, Missouri Gas Energy, the Staff of the Commission, the Office of the Public Counsel, Missouri Gas Users Association, the University of Missouri – Kansas City, Central Missouri State University and the County of Jackson, Missouri submitted a Partial Nonunanimous Stipulation and Agreement for Commission approval. Although the City of Kansas City and Trigen-Kansas City Energy Corporation are the only parties who did not join in the agreement, they do not oppose it.

The signatories agree on the following with regard to class cost of service:

- Any increase in revenue shall be spread among all customer classes as an equal percentage of the normalized present non-gas revenues of each customer class without any interclass revenue shifts. Normalized present non-gas revenues of each customer class shall be the amount determined by the Commission representing the weather-normalized class test year revenues.
- The revenue increase so allocated to the Large Volume Class shall be collected from customers by increasing the monthly charges as described in the following subparagraphs:
- The present charge of \$204.65 shall receive the same percentage increase as is applied to overall system revenue. The additional revenue generated shall be the product of the increase in the charges [multiplied by] the billing units of 318.

- The remainder of the increase in the LV class revenue shall be collected via an increase in the present \$478.75 Customer Charge. Such Customer Charge increase shall be determined by dividing the difference between the revenue increase for the LV class increase and revenue to be derived from the multi-meter increase divided by the Customer Charge billing units of 5632.

Discussion

Although the partial stipulation and agreement represents that it is nonunanimous and was not signed by all the parties, Commission rule 4 CSR 240-2.115(2) provides that other parties have seven days in which to object. If no party files a timely objection, then the Commission may treat it as a unanimous stipulation and agreement. No party has so objected. Further, the signatories indicate in the stipulation and agreement that the nonsignatories have stated that they do not oppose the agreement.

Staff filed suggestions in support of the partial stipulation and agreement on December 14. The signatories agree that Staff may answer any Commission question during any agenda meeting at which this agreement is noticed.

Conclusion

After reviewing the partial stipulation and agreement and Staff's suggestions in support thereof, the Commission finds that the partial stipulation and agreement should be approved as a resolution of the issues therein addressed.

IT IS ORDERED THAT:

1. The Partial Stipulation and Agreement filed on December 8, 2006, between Missouri Gas Energy, the Staff of the Commission, the Office of the Public Counsel, Missouri Gas Users Association, the University of Missouri – Kansas City, Central Missouri State University and the County of Jackson, Missouri is approved as a resolution of the issues therein addressed.

2. This order shall become effective on December 28, 2006.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur.

Jones, Senior Regulatory Law Judge

Staff of the Public Service Commission of Missouri, Complainant, v. Laclede Gas Company, Respondent.

Case No. GC-2006-0318

Gas §1. The Commission ordered that the Joint Recommendation Regarding Disconnection of Service Based on Unauthorized Consumption of Natural Gas at a Multi-Dwelling Unit Residential Building filed by Laclede Gas Company, Staff, and the Office of the Public Counsel is accepted. The Commission further stated that, if Laclede is unable to gain access to the meter after reasonable attempts to contact the landlord, it is to follow the procedures outlined in Commission Rule 4 CSR 240-13.050 and Sections 392.550 through 392.565, RSMo 2000.

**ORDER APPROVING JOINT RECOMMENDATION REGARDING
DISCONNECTION OF SERVICE BASED ON UNAUTHORIZED
CONSUMPTION OF NATURAL GAS AT MULTIPLE-DWELLING UNIT
RESIDENTIAL BUILDINGS**

Issue Date: January 9, 2007

Effective Date: January 19, 2007

The Commission approved a Stipulation and Agreement on December 21, 2006. Part of that agreement provided that that as part of the resolution of the locked meter showing consumption issue raised by the Commission's Staff, Laclede Gas Company, Staff and the Office of the Public Counsel would collaborate to develop terms by which service could be disconnected when there is unauthorized consumption of natural gas at a multi-tenant building. The Stipulation and Agreement required Laclede, Staff, and Public Counsel to file their recommendations regarding those terms by January 1, 2007. Those parties filed their joint recommendations on December 29.

Laclede, Staff, and Public Counsel recommend that Laclede attempt to gain access to the meter by visiting the multi-unit residential building and by attempting to contact the landlord of the building by telephone. If Laclede is unable to gain access to the meter after reasonable attempts to contact the landlord, it is to follow the procedures outlined in Commission Rule 4 CSR 240-13.050 and Sections 392.550 through 393.565, RSMo 2000. The cited regulation establishes the steps that a utility must take to provide notice to a residential customer before discontinuing service. The cited statutes establish a procedure by which a utility can seek a court order to obtain access to a meter located in a multi-family residential dwelling.

The joint recommendations of Laclede, Staff, and Public Counsel are reasonable and will be accepted by the Commission.

IT IS ORDERED THAT:

1. The Joint Recommendation Regarding Disconnection of Service Based on Unauthorized Consumption of Natural Gas at a Multi-Dwelling Unit Residential Building filed by Laclede Gas Company, Staff, and the Office of the Public Counsel is accepted.

2. This order shall become effective on January 19, 2007.

Davis, Chm., Murray, Gaw, Clayton and Appling, CC., concur
Woodruff, Deputy Chief Regulatory Law Judge

In the Matter of The Empire District Electric Company of Joplin, Missouri for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company.

Case No. ER-2006-0315

Electric §1. The Commission concluded that the Staff's position on off-balance sheet obligations is reasonable and appropriate using the Standard and Poor's, Research Report dated May 18, 2006.

**ORDER SUPPLEMENTING AND
CLARIFYING REPORT AND ORDER**

Issue Date: January 9, 2007

Effective Date: January 19, 2007

On December 21, 2006, The Missouri Public Service Commission issued its Report and Order in this case. The Commission determined a supplement and clarification was needed in the following issue:

4. Regulatory Plan Amortizations: Should Empire's revenue requirement include regulatory plan amortizations? If so, (i) how should Empire's off-balance sheet obligations be valued for purposes of the amortizations and (ii) should the amortized amount be subject to an income tax gross-up?

The first sub-issue (i) was not adequately addressed in the Report and Order. The sub-issue was whether the March 31, 2006 discounted present values of the two purchased power contracts should be further adjusted by a 10% risk factor. The Office of Public Counsel (see Robertson Rebuttal at 23-24) asserts that the off-balance sheet obligations should be discounted back to their individual present values by applying a 10% risk factor. This would, according to the OPC, serve to determine the debt-equivalent value of each off-balance-sheet obligation.

The Staff notes that off-balance sheet obligations are considered fixed obligations (i.e., debt) by credit rating agencies for calculating leverage and coverage ratios and are included in credit rating agencies' analyses of debt levels. Standard and Poor's, in its Research Report dated May 18, 2006, established the current value of Empire's off-balance sheet obligations. The Staff notes that S&P makes numerous adjustments in its determination of that amount, including those necessary to bring the value current. To be conservative, Staff used that amount in its calculations, without further adjustment (see Oligschlager Supplemental Direct at 9-10).

Finding: We find the Staff's present calculation of the regulatory plan amortizations to be correct, including the use of the S&P valuation of off-balance sheet obligations without further adjustment. We find that the adjustment recommended by the OPC would result in an unreasonably low valuation of the off-balance sheet obligations.

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Conclusion: The Commission concludes that the Staff's position on off-balance sheet obligations is reasonable and appropriate. As to the other sub-issues of regulatory plan amortizations, the Staff has revised its position and recalculated the amounts to be included in the regulatory plan amortizations. Having reviewed those revisions, the Commission finds the Staff's position to be reasonable. The Commission concludes that the total regulatory plan amortization amounts submitted by the Staff are appropriate.

IT IS ORDERED THAT:

1. The Commission supplements and clarifies its Report and Order issued on December 21, 2006, as stated above.
2. This order shall become effective on January 19, 2007.

Davis, Chm., Murray, and Appling, CC., concur;
Gaw and Clayton, CC., dissent.

Dale, Chief Regulatory Law Judge

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of its Regulatory Plan.

Case No. ER-2006-0314

Electric §1. The Commission clarified that its' December 21, 2006 Report and Order is still in full force and effect besides the clarification to exclude Explorer Pipeline as a party in this case and as a party to the above-referenced stipulation.

ORDER REGARDING MOTIONS FOR REHEARING

Issue Date: January 18, 2007

Effective Date: January 18, 2007

Syllabus: This order clarifies the Commission's Report and Order and denies the pending motions for rehearing.

On December 21, 2006, the Commission issued its Report and Order. The Commission received motions for rehearing from W. Bill Dias, Trigen-Kansas City Energy Corporation, Jackson County, Missouri, the United States Department of Energy/National Nuclear Security Administration, Praxair, Inc., and the Office of The Public Counsel.

Section 386.500.1, RSMo 2000, provides that the Commission shall grant an application for rehearing if "in its judgment sufficient reason therefor be made to appear." The Commission finds that, except as discussed below, the above named movants have failed to establish sufficient reason to grant their motions.

However, in response to some parties' argument that the Commission erred on return on equity, the Commission will clarify its Report and Order regarding its

decision on that issue. The Commission relied upon the Hope¹ and Bluefield² cases as its ultimate authority for determining ROE. In its Hope and Bluefield analysis, the Commission stated that there are some numbers that the Commission can use as guideposts in establishing an appropriate return on equity; nowhere did the Commission limit itself to a “zone of reasonableness” or end its analysis with that zone, despite its statutory charge to set just and reasonable rates, and despite the Supreme Court of the United States finding that the Federal Power Commission, in setting just and reasonable rates, could use a “zone of reasonableness” as well.³ In fact, “(n)ot only can the Commission select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances, but it also may adopt or reject any or all of any witnesses’ testimony.”⁴ What is more, “. . . the statute (giving the Commission authority to set rates) neither prescribes nor limits the methodology that the Commission may use in determining rates.”⁵

Furthermore, the Commission reconsiders its off-systems sales decision, in which it allowed KCPL to put the projected 25th percentile from KCPL witness Schnitzer’s curve into revenue requirement. Depending upon actual 2007 actual non-firm off-system sales, the Commission’s Report and Order required KCPL to establish either a regulatory asset account to recover any deficit from that 25th percentile from ratepayers, or a regulatory liability account to return the surplus over that 25th percentile to ratepayers. Upon reviewing the motions for rehearing from Praxair and OPC, and KCPL’s response, the Commission concludes that the regulatory asset mechanism could provide a disincentive to KCPL to make off-system sales up to the 25th percentile, which could result in rates that are not just and reasonable to the detriment of Missouri ratepayers. Therefore, the Commission will no longer allow KCPL to use the regulatory asset mechanism described in its December 21, 2006 Report and Order, but will continue to require KCPL to book any amounts above the 25th percentile as a regulatory liability. Relying upon the same rationale as it did in its Report and Order, the Commission still concludes that the true-up, 25th percentile amount of non-firm, off-system sales from KCPL witness Schnitzer’s curve is the appropriate amount off-systems sales to include in revenue requirement.

Finally, counsel for Praxair points out that the Commission listed Explorer Pipeline Company as a party to this case and to a partial stipulation when, in fact, Explorer Pipeline was not a party in this case or the stipulation. The Commission notes that the Stipulation and Agreement Regarding Class Cost of Service and Rate Design, filed on November 9, 2006, lists Explorer Pipeline as a party. However, Explorer Pipeline did not intervene in this case, and is not listed as a party allowed

¹ *Fed. Power Comm’n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943)

² *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm’n of West Virginia*, 262 U.S. 679, 692-93; 43 S.Ct. 675, 679; 67 L.Ed. 1176, 1182-83 (1923).

³ *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767, 770; 88 S.Ct. 1344, 1360, 1361; 20 L.Ed.2d. 312 (1968); *reh’g denied*, 392 U.S.2d 917, 88 S.Ct. 2050, 20 L.Ed.2d 1379.

⁴ *State ex rel. Associated Natural Gas Co. v. Pub. Svc. Comm’n.*, 706 S.W.2d 870, 880 (Mo.App. W.D. 1985).

⁵ *Id.*

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automatic intervention in this case by virtue of being a signatory party to Case No. EO-2005-0329.

Commission Rule 4 CSR 240-2.080(15) allows parties ten days to respond to pleadings. No party timely contested Praxair's allegation concerning Explorer Pipeline. Therefore, the Commission finds that Explorer Pipeline was inadvertently included as a party to the above-referenced stipulation, and the Commission will clarify its Report and Order to exclude Explorer Pipeline as a party in this case and as a party to the above-referenced stipulation.

IT IS ORDERED THAT:

1. The Commission's December 21, 2006 Report and Order is clarified as stated above, but is otherwise in full force and effect.
2. That the Motions for Rehearing filed by Praxair, Inc., and the Office of The Public Counsel are granted in part, as discussed above, and denied in part.
3. The Motions for Rehearing filed by W. Bill Dias, Trigen-Kansas City Energy Corporation, Jackson County, Missouri, the United States Department of Energy/National Nuclear Security Administration are denied.
4. All other pending motions and requests for relief are denied.
5. This order shall become effective on January 18, 2007.
6. This case shall be closed on January 19, 2007.

Davis, Chm., Murray, and Appling, CC., concur.
Gaw and Clayton, CC., dissent.

Pridgin, Senior Regulatory Law Judge

SOUTHWESTERN BELL TELEPHONE COMPANY

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In the Matter of the Investigation of the State of Competition in the Exchanges of Southwestern Bell Telephone Company.

Case No. TO-2001-467

Telecommunications §40. The Commission ordered that Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri's; intraLATA toll service, intraLATA private line/dedicated services, Wide area Telecommunications Services (WATS) and 800 services, special access services and station-to-station, person-to-person and calling card operator services be classified as competitive in all of its Missouri exchanges.

Appearances

Robert J. Gryzmala, Attorney, Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri, One AT&T Center, Room 3516, St. Louis, Missouri 63101, for Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri.

Michael F. Dandino, Deputy Public Counsel, Office of the Public Counsel, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

William K. Haas, Deputy General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Nancy Dippell, Deputy Chief.

REPORT AND ORDER ON REMAND

Issue Date: January 25, 2007

Effective Date: January 18, 2007

Syllabus: This Report and Order on Remand finds that Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri's intraLATA private line/dedicated services, intraLATA toll services, Wide Area Telecommunications Services (WATS), 800 services, special access services, station-to-station, person-to-person, and calling card operator services are classified as competitive in all of AT&T Missouri's exchanges in Missouri.

Procedural History and Overview

This case began in 2001 when the Commission opened an investigation into whether any of AT&T Missouri's¹ services in any of its exchanges could be classified as competitive under Section 392.245.5, RSMo, based on a finding of "effective competition" from alternative companies. The Commission's *Report and Order* held, *inter alia*, that certain services previously classified as "transitionally competitive" had converted to "competitive" status in 1999 by operation of law under Section 392.370, RSMo. Those services consist of interLATA private line/dedicated services, intraLATA toll services, WATS and 800 services, special access services,

¹ AT&T Missouri was previously known as Southwestern Bell Telephone Company or SWBT.

and certain operator services. The Office of the Public Counsel sought judicial review of the *Report and Order*.

The Court of Appeals determined that the Commission had misinterpreted the law. The Court stated, "When SWB[T] became subject to price-cap regulation in 1997, all its services became subject to price-cap regulation at that time, and the Commission erred in finding competitive status under the old statutes." The Court directed:

In remanding, we ask the Commission to re-examine the competitive status of these particular services by applying the "effective competition" factors to the evidence the Commission has already accumulated with regard to these services both from the 1993 "transitionally competitive" hearing in Case No. TO-93-116 as well as from the hearing in this underlying case. Consistent with the requirements of section 392.245.5, it will be necessary for the Commission to determine whether these services are effectively competitive on an exchange-by-exchange basis. Since the original finding of transitionally competitive applied to the entire service area, we assume sufficient evidence for such a finding is available.²

On March 18, 2005, the Circuit Court of Cole County entered its Order Remanding Case wherein the Court remanded the case to the Commission for further proceedings in accordance with the Court of Appeals' opinion.

On August 28, 2005, Senate Bill 237 became effective. Following the new provisions set out by S.B. 237, the Commission issued its orders in Case Nos. TO-2006-0093 and TO-2006-0102. In those cases, the Commission found that the business and residential services in many of AT&T Missouri's exchanges meet the new statutory standards for competitive classification.

The Commission also conducted an investigation of the competitive status of Sprint Missouri, Inc.'s³ services in Case No. IO-2003-0281 and issued its determination in that case on December 4, 2003.

In reviewing the evidence taken during the hearing in this matter and the hearing in Case No. TO-93-116, the Commission finds sufficient evidence to make its determination. Therefore, the Commission makes the following findings of fact and conclusions of law.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically

² State of Missouri ex rel. Acting Public Counsel Coffman v. Public Service Commission, 154 S.W.3d 316, 329 (Mo. App. W.D. 2004).

³ Sprint Missouri, Inc., is now known as Embarq Missouri, Inc., d/b/a Embarq.

address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision. The Commission adopts the Findings of Fact in its previous *Report and Order* except as modified by these findings.

The Court of Appeals has remanded this case to the Commission to make findings as to whether certain AT&T Missouri services were competitive under the "effective competition" analysis set out in Section 392.245.5, as it existed at the time of the Commission's 2001 *Report and Order*. Effective competition is determined by analyzing the extent to which services are available and are functionally equivalent or substitutable, whether the purposes and policies of Chapter 392 are being advanced, and an evaluation of the existing economic or regulatory barriers to entry. In making its determination of "effective competition," the Commission looks to the evidence provided in the transitionally competitive classification case, TO-93-116, and the current case, TO-2001-467.

I. Pre-1996 Developments – H.B. 360/Case No. TO-93-116

House Bill 360, passed in 1987, directed the Commission to reduce regulatory requirements as competition expanded in the various telecommunications markets. With the passage of H.B. 360, the Missouri legislature provided the Commission with the authority to begin recognizing services and service providers as competitive. The legislature enacted procedures to allow a company to seek classification as either transitionally competitive or as competitive. Companies began seeking transitionally competitive classification for services in 1987.⁴

In September 1992, AT&T Missouri filed a petition seeking classification of its own Digital Private Line and Special Access Services, Message Toll Service (MTS), 800 and Maximizer[®] 800 services, WATS, and certain Operator Services (i.e., Station-to-Station, Person-to-Person and Calling Card) as transitionally competitive.⁵ In its petition, AT&T Missouri stated that these services met the requirements of Section 392.370.1 in that they were the same as, substitutable for, or equivalent to competitive services provided by other telecommunications carriers within its service territory.⁶

In its resulting December 21, 1992 *AT&T Missouri Reclassification Order*, the Commission granted AT&T Missouri's petition.⁷ The Commission first found that while an earlier *IXC Service Classification Order*⁸ had spoken "largely in terms of

⁴ Ex. 16, Hughes Direct, p. 7. All references to exhibits and testimony herein shall mean to refer to exhibits and testimony admitted into the record in Case No. TO-2001-467 unless otherwise indicated.

⁵ Ex. 16, Hughes Direct, p. 10.

⁶ Ex. 16, Hughes Direct, p. 10.

⁷ See, In the Matter of Southwestern Bell Telephone Company's application for classification of certain services as transitionally competitive, Case No. TO-93-116, Report and Order, December 21, 1992, 1992 Mo. PSC LEXIS 23 ("AT&T Missouri Reclassification Order"), p. 4 (emphasis added).

⁸ Case No. TO-88-142, issued September 15, 1989.

interLATA service,” not intraLATA service, the Commission nevertheless “was addressing a *statewide* market.”⁹ Thus, focusing on the first element of Section 392.370.1, the Commission found that “[t]he services for which [AT&T Missouri] is seeking transitionally competitive classifications were addressed and found to be subject to sufficient competition to justify a lesser degree of regulation in [the *IXC Service Classification Order*].”¹⁰

Focusing on the second element of Section 392.370.1, the Commission found that AT&T Missouri’s Digital Private Line and Special Access Services were “equivalent” services to IXCs’ provided services.¹¹ It noted that “[t]he private line services and virtual private networks (VPNs) of IXCs, including those IXCs considered competitive access providers (CAPs), have been classified as competitive by the Commission.”¹² It found that services “which are functionally equivalent and completely interchangeable in use are equivalent under the statute”¹³ and that “[b]ased upon the finding that the dedicated private line services of IXCs and [AT&T Missouri’s] dedicated private line services and special access service are equivalent, the Commission will classify these [AT&T Missouri] services as [transitionally competitive].”¹⁴

In addition, the Commission found that AT&T Missouri’s MTS was substitutable for IXCs’ state-wide MTS Service.¹⁵ Noting, among other things, that “[t]here are at least seventy IXCs authorized to provide intraLATA MTS[,]”¹⁶ the Commission recounted the extensive evidence that AT&T Missouri’s MTS and the IXCs’ MTS are substitutable: “Customer acceptance of one service for another as indicated by market share, customer perceptions that the services are substitutable, economic analysis of the markets, the number of providers in the market, the revenues generated by each provider, all provide important information. In this instance, none of the criteria individually is determinative, but when all are considered they indicate that IXC MTS and [AT&T Missouri] MTS are substitutable services for purposes of complying with Section 392.370 and the Commission will grant [AT&T Missouri transitionally competitive] classification for its MTS service.”¹⁷

The Commission also found that AT&T Missouri’s 800 and Maximizer® 800 services were substitutable for IXCs’ 800 service.¹⁸ The Commission noted that 59 IXCs provided 800 service and that “[t]hese 800 services have all been classified

⁹ AT&T Missouri Reclassification Order, p. 11. (emphasis added).

¹⁰ AT&T Missouri Reclassification Order, p. 12.

¹¹ AT&T Missouri Reclassification Order, pp. 31-33.

¹² AT&T Missouri Reclassification Order, p. 31.

¹³ AT&T Missouri Reclassification Order, p. 32.

¹⁴ AT&T Missouri Reclassification Order, p. 33.

¹⁵ AT&T Missouri Reclassification Order, pp. 18-24.

¹⁶ AT&T Missouri Reclassification Order, p. 19.

¹⁷ AT&T Missouri Reclassification Order, p. 24.

¹⁸ AT&T Missouri Reclassification Order.

as competitive and are being provided within [AT&T Missouri's] service territory.¹⁹ The Commission determined "that [AT&T Missouri's] 800 services and the IXCs' are substitutable for each other and that because of [AT&T Missouri's] restriction to intraLATA, [AT&T Missouri's] 800 services could arguably be found to be an inferior product for those customers seeking a statewide 800 service." The Commission classified the two 800 services of [AT&T Missouri] as transitionally competitive. The Commission also noted that "without the . . . restriction these services would be at least equivalent."²⁰ The restriction referenced by the Commission was removed in 2001.²¹

The Commission further found that AT&T Missouri's WATS Service was substitutable for the IXCs' WATS Service.²² The Commission noted that 60 IXCs had tariffs in place to provide WATS and that "[t]hese IXC WATS services have been classified as competitive and are provided both intraLATA and interLATA."²³ The Commission determined that "[c]ustomer acceptance of the IXC services as a suitable alternative to [AT&T Missouri] WATS is demonstrated by the decrease in hours, lines and revenue of [AT&T Missouri] while IXCs' volumes have increased and the market has expanded." The Commission therefore classified AT&T Missouri's WATS as transitionally competitive.²⁴

Finally, the Commission found that certain of AT&T Missouri's Operator Services (i.e., Station-to-Station, Person-to-Person and Calling Card) were substitutable for comparable services provided by IXCs.²⁵ It noted that "[t]here are eight IXCs which offer only credit card billing and there are thirty-one IXCs which offer station to station, person to person, and credit card billing."²⁶ Relying primarily upon, among other things, evidence indicating that "[c]ustomer perception that the services are substitutable" and that "IXC operator services providers market their products as substitutable for [AT&T Missouri's] services[.]"²⁷ the Commission determined that these factors demonstrate "that IXC operator services and [AT&T Missouri] operator services (Station to Station, Person to Person and Calling Card) are substitutable." Thus, the Commission classified those services as transitionally competitive.²⁸

¹⁹ AT&T Missouri Reclassification Order, p. 26.

²⁰ AT&T Missouri Reclassification Order, p. 26.

²¹ Joint Application by S.B.C Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Arkansas and Missouri, Memorandum Opinion and Order, 16 FCC Rcd 20719 (2001).

²² AT&T Missouri Reclassification Order, pp. 28-29.

²³ AT&T Missouri Reclassification Order, p. 28.

²⁴ AT&T Missouri Reclassification Order, p. 29.

²⁵ AT&T Missouri Reclassification Order, pp. 34-39.

²⁶ AT&T Missouri Reclassification Order, p. 34.

²⁷ AT&T Missouri Reclassification Order, pp. 37-38.

²⁸ AT&T Missouri Reclassification Order, p. 39.

In keeping with the Court of Appeals' direction, the Commission finds that each of the above evidence and findings made in the *AT&T Missouri Reclassification Order* are relevant and probative to a determination that each of the services meet the "effective competition" factors identified in Section 386.020(13), discussed in greater detail below.

Since its 1992 *AT&T Missouri Reclassification Order*, the Commission has routinely classified CLECs as competitive carriers when approving each CLEC's basic local certification.²⁹ IXCs are also routinely classified as competitive carriers in Missouri.³⁰ With a competitive carrier classification, CLECs and IXCs are able to change their prices (up or down) on short notice to the Commission without the need of providing cost support for the change.³¹

II. Post-1996 Developments – S.B. 507/Case No. TO-2001-467

In 1996 Senate Bill 507 was enacted. S.B. 507 authorized CLECs to begin providing basic local telecommunications service in competition with ILECs. S.B. 507 also included provisions which allowed ILECs the opportunity to no longer be regulated by traditional rate of return regulation. S.B. 507 provided for a phased-in approach.

Under Section 392.245.2, a large ILEC becomes subject to price cap regulation when an alternative local exchange telecommunications company has been certified to provide basic local telecommunications service, and is providing such service, in any part of a large ILEC's service area. In Case No. TO-97-397, the Commission approved AT&T Missouri as a price cap regulated company, effective September 26, 1997.³²

S.B. 507 also contemplated that after the initiation of competition in an ILEC's exchange, price cap regulation could be eliminated. Section 392.245.5, RSMo 2000, directed the Commission to determine "whether effective competition exists *in the exchange* for the various services of the incumbent local exchange telecommunications company."³³

The services previously found to be transitionally competitive are not the type of services provided on an exchange-by-exchange basis. Nor are the competitive providers providing those services that way. Rather, those services are provided on a statewide basis. The services and providers are equally available, as the evidence in not only this case, but also Case No. TO-93-116 shows. Staff agreed that the Commission should confirm a competitive classification for these services pursuant to Section 392.200.8,³⁴ and no party presented any evidence supporting a different conclusion. Because each of the services was competitive on a statewide basis, they necessarily were competitive in each exchange. Thus, as explained

²⁹ Ex. 16, Hughes Direct, p. 12.

³⁰ Ex. 16, Hughes Direct, p. 13.

³¹ Ex. 16, Hughes Direct, p. 13.

³² Ex. 16, Hughes Direct, p. 14.

³³ Emphasis added.

³⁴ Ex. 18, Voight Rebuttal, pp. 3-4, 54, 65-67, 73-74.

more fully below, the Commission specifically finds that for each of the services which are the subject of this case on remand, effective competition existed in all exchanges for these services both when the Commission issued its *Report and Order* in this case and when the Court of Appeals issued its mandate. Further, the evidence establishes that these services should be classified as competitive in all of AT&T Missouri's exchanges pursuant to Section 392.245.5.³⁵

In making its determination of effective competition, the Commission examined the following factors for each service as provided by the legislature.

The Extent to Which Services are Available and are Functionally Equivalent or Substitutable

The first two factors which the Commission must consider when determining whether "effective competition" exists for AT&T Missouri's services are "the extent to which services are available from alternative providers in the relevant market," and "the extent to which these services of alternative providers are functionally equivalent or substitutable at comparable rates, terms and conditions." For the reasons explained above in connection with H.B. 360/Case No. TO-93-116, and described in the remainder of these Findings of Fact, the Commission finds that for each of the services which are the subject of this case on remand, there existed alternative providers who were providing functionally equivalent or substitutable services throughout AT&T Missouri's exchanges, at comparable rates, terms and conditions, both when the Commission issued its December 27, 2001 *Report and Order* and the Court of Appeals issued its March 3, 2005, mandate in this case.

Private Line/Dedicated Services

The Commission recognized the existence of competition for each of the services at issue in its December 1992 *AT&T Missouri Reclassification Order*, when it found that services provided by IXCs were "equivalent" and completely interchangeable with AT&T Missouri's services, and thus classified AT&T Missouri's private line services as transitionally competitive.³⁶

Other evidence demonstrates that competition in the private line market has existed for years. Significant competition in the retail intraLATA private line market in Missouri dates back to the emergence of competitive access providers (CAPs) in the mid-1980s. CAPs initially focused on providing alternative access to long distance companies. They also targeted commercial business customers as they completed their fiber ring build-outs and gained access to multi-tenant buildings with their own facilities. In the late 1980s, the major interexchange carriers also began to compete for retail intraLATA private line services as they bid on data networks covering intrastate services as well as interstate long haul services.³⁷

³⁵ These services are more fully described above in connection with Case No. TO-93-116 and in the Commission's December 27, 2001 *Report and Order*, p. 29.

³⁶ *AT&T Missouri Reclassification Order*, pp. 29-33; Ex. 3, DeHahn Direct, p. 6; Ex. 16, Hughes Direct, pp. 9-10.

³⁷ Ex. 3, DeHahn Direct, p. 5.

Undisputed evidence at the hearing showed that many alternative providers such as AT&T Communications of the Southwest, Inc., Sprint, MCI, and numerous CLECs offer nonswitched, dedicated private line type services, and the services and functionality they provide are substitutable for or functionally equivalent to AT&T Missouri's private line services. These alternatives, against which AT&T Missouri competes, are either not regulated by the Commission or at least not price regulated in the same manner as AT&T Missouri.³⁸

In addition to direct competition for traditional private line services, there are many service providers in the marketplace offering a variety of networking solutions, with different technologies, that can meet the same transport needs as AT&T Missouri's wireline private line services. For example, traditional private line networks, such as those offered by AT&T Missouri and numerous other providers, are rapidly being replaced by fast-packet, frame relay and cell relay services. Internet based access for branch offices or small businesses are being used to substitute for analog and DS0 private line circuits as customers are increasingly sending files via the Internet, rather than incurring the monthly expense of maintaining a private line circuit. The availability of fixed wireless CPE solutions also has been displacing wireline DS1s in campus settings, such as school districts, in the education market.³⁹

IntraLATA Special Access

The additional considerations reflected in the findings of fact directed to private line services equally demonstrate that competition in the special access market has existed for years.⁴⁰ AT&T Missouri's and Staff's testimony, and the Commission's discussion in its 1992 *AT&T Missouri Reclassification Order* directed to the category of private line services, specifically included special access, i.e., nonswitched High-Capacity Service.⁴¹

IntraLATA Toll/MTS Services

Competition in the intraLATA toll market has existed for many years. Competition has existed in the intraLATA toll market since July 24, 1986, when the Commission authorized intraLATA toll competition in Missouri.⁴² There, the Commission found that intraLATA toll competition was in the public interest and would result in new and improved services, lower prices and faster responses to customers' needs.⁴³

³⁸ Ex. 3, DeHahn Direct, pp. 2, 5-11 and Schedules 1 and 2.

³⁹ Ex. 3, DeHahn Direct, pp. 8-9.

⁴⁰ These services are more fully described above in connection with Case No. TO-93-116 and in the Commission's December 27, 2001, *Report and Order*, in Case No. TO-2001-467. *Report and Order*, pp. 53-56.

⁴¹ Ex. 7, Douglas Direct, pp. 6-9; Ex. 3, DeHahn Direct, pp. 5-11; Voight Rebuttal, pp. 4, 54; *AT&T Missouri Reclassification Order*, pp. 29-33.

⁴² Case No. TO-94-222, et al., *Report and Order*, issued July 24, 1986.

⁴³ *Id.*; Ex. 16, Hughes Direct, p. 5.

The record also establishes that there are many regulated providers, including IXCs and CLECs and unregulated/nontraditional providers (such as wireless and Internet providers) offering interexchange services that are functionally equivalent to and/or substitutable for AT&T Missouri's intraLATA toll services.⁴⁴ Evidence in this case demonstrated that there were over 600 interexchange carriers certified to provide intrastate interexchange service in Missouri.⁴⁵ The intraLATA toll services provided by these companies and other IXCs are equivalent to or substitutable for AT&T Missouri's intraLATA toll service, in that all these services provide customers with the ability to place intraLATA toll calls.⁴⁶ This large number of certified IXCs indicates that customer choices are widely available and reflects the relative ease of entry for firms wishing to enter the intraLATA toll market.⁴⁷

With the July 1999 implementation of intraLATA presubscription, IXCs began offering their customers the ability to make intraLATA toll calls without dialing extra digits. (Even prior to presubscription, customers had the ability to program their PBXs and key systems to automatically route intraLATA toll calls to the IXC of their choice or to dial around the incumbents' interLATA toll services by using 10XXX dialing. Now, customers can dial around using 10XXX to use the IXC of their choice, even if they retain AT&T Missouri as their 1+ intraLATA toll provider.)⁴⁸ The evidence showed, in every AT&T Missouri exchange, a minimum of 73 IXCs available to be selected by the customer as a 1+ intraLATA toll provider. Thus, robust competition exists for AT&T Missouri's intraLATA toll services.⁴⁹

In addition to more traditional forms of competition from IXCs and CLECs, AT&T Missouri's customers have several nontraditional choices for intraLATA toll. These include wireless service, prepaid telephone cards, and the Internet. The ability to make free, or at least very inexpensive, calls to other people outside a person's local calling scope, but within the LATA, makes Internet telephony an attractive substitute for AT&T Missouri's intraLATA toll service.⁵⁰

Wide Area Telecommunications Services (WATS) and 800 Services

Competition has long existed in the WATS and 800 service markets. IXCs are the dominant WATS and 800 service competitors. The evidence indicated over 600 certified IXCs authorized to provide interexchange services in Missouri. As part of their interexchange services, IXCs typically provide WATS and 800 services to customers. CLECs can also offer WATS and 800 service. These services provided by IXCs and CLECs are functionally equivalent to and substitutable for AT&T Missouri's WATS and 800 service. This large number of certified companies

⁴⁴ Ex. 9, Jablonski Direct, pp. 3, 6-10.

⁴⁵ Ex. 9, Jablonski Direct, p. 6 and Schedule 2.

⁴⁶ Ex. 9, Jablonski Direct, p. 9.

⁴⁷ Ex. 9, Jablonski Direct, pp. 6-7.

⁴⁸ Ex. 9, Jablonski Direct, p. 7.

⁴⁹ Ex. 9, Jablonski Direct, p. 9 and Schedule 3, which is a list of the number of IXCs that are available in each AT&T Missouri exchange.

⁵⁰ Ex. 9, Jablonski Direct, pp. 8-9.

indicates that customer choices are available and reflects the relative ease of entry for firms wishing to enter the WATS and 800 markets.⁵¹

In addition to IXC's and CLECs, WATS and 800 service faces competition from nontraditional competitors. Many companies are utilizing various e-commerce methods to communicate with their customers. For instance, consumers can purchase airplane tickets, rent cars, or check the balance on their credit card via the Internet, making calls to a company's 800 number unnecessary.⁵²

Station-to-Station, Person-to-Person and Calling Card Operator Services

The evidence demonstrated numerous competitive alternatives to AT&T Missouri's operator services which are available throughout AT&T Missouri's exchanges.⁵³ These alternatives are provided by numerous local and toll telecommunication providers, as well as wireless service providers, specialized operator service providers, pay telephone providers, prepaid and post-paid calling card providers and others.⁵⁴ Considering both function and price, end-users throughout Missouri have substitutable and functionally equivalent alternatives for operator services, offered by numerous providers, including cellular telephone service, pre-paid calling cards, and personal 800 numbers. These services compete directly with AT&T Missouri's operator services.⁵⁵

For example, "00" service was established as a dialing pattern in order to route calls to the operator of a customer's presubscribed interexchange carrier.⁵⁶ "00" service may be used to provide end-users throughout the state of Missouri with the complete range of calling card, third number billing, collect and person-to-person calling options, as well as other types of operator assistance, such as busy line, verify and interrupt services, and call completion services. The evidence showed over 600 interexchange service providers certificated to provide service in Missouri.⁵⁷

The evidence also showed that competitive alternatives are offered by MCI and Sprint. MCI's 1-800-Collect Service is also available to all end-users throughout Missouri, irrespective of their choice of local or toll carrier.⁵⁸ This service provides end-users the ability to make collect calls from anywhere in the United States. Callers also have access to a complete range of other services including calling cards, bill to a third number, person-to-person service, line status verification, and busy interrupt. Sprint's 1-800-2Sprint is similar to the MCI competitive alternatives.⁵⁹

⁵¹ Ex. 9, Jablonski Direct, p. 16.

⁵² Ex. 9, Jablonski Direct, pp. 16-17.

⁵³ Ex. 5, Moore Direct, p. 21.

⁵⁴ Ex. 5, Moore Direct, p. 21.

⁵⁵ Ex. 5, Moore Direct, p. 22.

⁵⁶ Ex. 5, Moore Direct, p. 22.

⁵⁷ Ex. 5, Moore Direct, p. 22.

⁵⁸ Ex. 5, Moore Direct, p. 22.

⁵⁹ Ex. 5, Moore Direct, pp. 22-23.

Both MCI and Sprint extensively promote their operator services, which compete directly with AT&T Missouri's operator services.⁶⁰

Operator services, including collect, bill-to-a-third-number, person-to-person service, line status verification, and busy interrupt are also available from wireless carriers throughout Missouri. Typically, wireless customers access their wireless carrier's operator services by dialing "0" from their wireless phone.⁶¹ Moreover, wireless service, itself, has become a significant, competitive alternative to operator services, particularly for operator services originating from pay telephones.⁶² Before wireless services became ubiquitous, customers who are away from their home or business telephone frequently used the alternative billing arrangements through operator services to place calls.⁶³

Another competitive alternative for operator services is "0+" and "0-" services from pay telephones.⁶⁴ Pay telephone providers have the option of selecting the operator service provider of their choice for specific pay telephone locations.⁶⁵ Customers can, in effect, choose an operator service provider through their choice of a payphone provider.⁶⁶ Prepaid calling cards have also become an increasingly popular choice for alternative billing arrangements historically provided by operator service providers.⁶⁷ Prepaid calling cards are sold at a variety of outlets.⁶⁸ Live or automated operator assistant is typically available as required to assist in call completion relating to prepaid calling cards.⁶⁹ Prepaid cards are frequently branded in the name of well known retail establishments, and are offered by all major telecommunication carriers, as well as hundreds of other lesser known companies.⁷⁰ Examples of prepaid card providers were provided in Schedule 12 to Ms. Moore's direct testimony in the prior proceedings in this case.

Finally, irrespective of the presubscribed carrier on a particular telephone line, end-users can always reach the operator service provide of their choice by dialing "10-10-XXX-00." The XXX selected by the end-user routes the call to the appropriate IXC.⁷¹ Many telecommunication carriers, including MCI and Sprint also offer personal 800 numbers. These numbers function as a competitive alternative to one type of operator services, i.e., collect calls.⁷²

⁶⁰ Ex. 5, Moore Direct, p. 23: See Scheds. 10-11.

⁶¹ Ex. 5, Moore Direct, p. 23.

⁶² Ex. 5, Moore Direct, p. 23.

⁶³ Ex. 5, Moore Direct, p. 23.

⁶⁴ Ex. 5, Moore Direct, p. 24.

⁶⁵ Ex. 5, Moore Direct, p. 24.

⁶⁶ Ex. 5, Moore Direct, p. 24.

⁶⁷ Ex. 5, Moore Direct, p. 24.

⁶⁸ Ex. 5, Moore Direct, p. 24.

⁶⁹ Ex. 5, Moore Direct, p. 25.

⁷⁰ Ex. 5, Moore Direct, p. 25.

⁷¹ Ex. 5, Moore Direct, p. 25.

⁷² Ex. 5, Moore Direct, p. 26.

Most if not all of the competitive alternatives described above are available to an end-user customer, irrespective of whether that customer is an AT&T Missouri local customer or a CLEC's local customer. However, if the customer is a CLEC local customer, the customer will likely also have a competitive alternative of operator services provided by that CLEC.⁷³ Moreover, operator services are provided by facilities-based interexchange carriers, resale and switched-base CLECs and specialized operator service providers that utilize their own facilities to provide operator services directly to end-users or other providers, pay telephone providers, and places of public accommodation. All of these operator services directly compete with AT&T Missouri's operator services throughout Missouri, and offer substitutable or functionally equivalent operator services to the operator services provided by AT&T Missouri.

The FCC has found the operator services market place to be competitive.⁷⁴ In its *UNE Remand Order*, the FCC eliminated operator services from the list of unbundled network elements based on the competitive nature of the operator services market place.⁷⁵ In the *UNE Remand Order*, the FCC stated that incumbent LECs "need not provide access to its operator services and directory assistance as an unbundled network element."⁷⁶ The evidence also demonstrated that operator services had been price deregulated in Arkansas, Texas and Kansas, among other states.⁷⁷

Finally, the evidence demonstrated that the highly competitive nature of the operator services market place had directly impacted AT&T Missouri's operator services call volumes. The evidence showed that since 1996, AT&T Missouri's operator services call volumes had declined 71 percent.⁷⁸ This decline can be directly attributed to competitive alternatives that exist in the market place, described above.⁷⁹

Other Evidence of Effective Competition

With the advent of local competition under S.B. 507, functionally equivalent or substitutable services being provided by alternative providers have increased substantially. As this Commission found in Case No. TO-99-227, CLECs are currently providing service to customers in all of AT&T Missouri's exchanges.⁸⁰ In addition, IXCs provide services that are also functionally equivalent to or substitutable for some of AT&T Missouri's services, including interexchange services

⁷³ Ex. 5, Moore Direct, p. 26.

⁷⁴ Ex. 5, Moore Direct, p. 28.

⁷⁵ Ex. 5, Moore Direct, p. 28.

⁷⁶ *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 9698, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696 (1999) ("*UNE Remand Order*"), para. 442.

⁷⁷ Ex. 5, Moore Direct, p. 28.

⁷⁸ Ex. 6(HC), Moore Surrebuttal(HC), Sched. 1(HC).

⁷⁹ Ex. 6, Moore Surrebuttal, p. 6.

⁸⁰ Ex. 16, Hughes Direct, p. 19.

(e.g., interLATA Toll, 800 Services), operator and directory services, and dedicated services (e.g., private line and special access).⁸¹ Furthermore, there are a number of alternate providers of functionally equivalent or substitutable services that are not under the jurisdiction of this Commission. Some of these alternate providers include, but are not limited to, wireless carriers, cable TV providers, Internet service providers, fixed satellite providers and customer premises equipment manufacturers.⁸²

Other indicators likewise demonstrate effective competition. Neither Section 392.245.5 nor 386.020(13) required any quantitative market share loss test to determine whether "effective competition" existed for AT&T Missouri's services in Missouri. Nevertheless, the record in this case reflects AT&T Missouri's belief that there were facilities-based CLECs in more than 80 percent of AT&T Missouri's exchanges in Missouri.⁸³ AT&T Missouri presented evidence that for the period from the first quarter of 1998 through the second quarter of 2001, E-911 listings had increased 8,546 percent and the growth in "ported" numbers was 26,392 percent.⁸⁴

Attached to AT&T Missouri witness Thomas Hughes' Surrebuttal Testimony as Schedules 1-1, 1-2 and 1-3 were maps identifying the number of active CLECs competing in each AT&T Missouri exchange throughout Missouri. These maps depict the extensive level of CLEC competition faced by AT&T Missouri throughout its Missouri exchanges. In his Surrebuttal Testimony, Mr. Hughes also identified, by exchange, the total lines served by AT&T Missouri, and the minimum number of lines served by CLECs.⁸⁵ The Commission finds that the lines identified as CLEC lines by Mr. Hughes represent only a minimum number and, therefore, CLEC market share is likely greater than reported in Mr. Hughes' Schedules.⁸⁶ The reason for this is simple. AT&T Missouri knows when a CLEC resells AT&T Missouri's service and when a CLEC purchases unbundled network elements from AT&T Missouri. Additionally, AT&T Missouri can identify the number of E-911 listings that CLECs place in 911 databases, but as Mr. Hughes and Dr. Aron explained in their testimony, the number of CLEC E-911 listings likely significantly understates the number of access lines served by facilities-based CLECs.⁸⁷ For example, only outbound lines have 911 listings associated with them.⁸⁸ Complex voice services may be only partially represented in the E-911 database.⁸⁹ DSL and cable modem

⁸¹ Ex. 16, Hughes Direct, p. 19.

⁸² Ex. 16, Hughes Direct, p. 19.

⁸³ Ex. 16, Hughes Direct, p. 27.

⁸⁴ Ex. 17, Hughes Surrebuttal, p. 7.

⁸⁵ Ex. 17 HC, Hughes Surrebuttal, Schedule 4-1, 4-2, 4-3 and 4-4 HC.

⁸⁶ Ex. 17 HC, Hughes Surrebuttal, pp. 5-6.

⁸⁷ Ex. 17 HC, Hughes Surrebuttal, pp. 5-6; Ex. 2, Aron Surrebuttal, p. 16.

⁸⁸ Ex. 17 HC, Hughes Surrebuttal, pp. 5-6; Ex. 2, Aron Surrebuttal, p. 16.

⁸⁹ Ex. 17 HC, Hughes Surrebuttal, pp. 5-6; Ex. 2, Aron Surrebuttal, p. 16.

lines may not be reported in the E-911 database.⁹⁰ Furthermore, AT&T Missouri does not know the number of lines served by CLECs utilizing only CLEC facilities.⁹¹

Additional evidence of effective competition from CLECs was produced by AT&T Missouri. Over the 18-month period prior to November 2001, AT&T Missouri had experienced a declining trend for retail access lines.⁹² Over the three quarters prior to November 2001, AT&T Missouri had experienced a decrease in the total number of retail lines sold.⁹³ During this same time period, the number of CLEC lines continued to grow.⁹⁴ In addition, there were 23 CLEC switches deployed throughout the state of Missouri, and these switches deployed by CLECs in Missouri had the capacity to serve 100 percent of AT&T Missouri's customers.⁹⁵

Purposes and Policies of Chapter 392

The third factor which the Commission is required to consider in connection with its evaluation of whether effective competition exists is the extent to which the purposes and policies of Chapter 392, RSMo, including the reasonableness of rates, as set out in Section 392.185, are being advanced. The Commission finds that for each of the services which are the subject of this case on remand, both when the Commission issued its *Report and Order* and the Court of Appeals issued its mandate in this case, competitive classification advances the purposes and policies of Chapter 392, including: the reasonableness of rates, as set out in Section 392.185; that there are no economic or regulatory barriers to entry that prevent competitors from offering alternatives to these services anywhere in AT&T Missouri's exchanges; and that competitive classification would be consistent with certain other deregulatory factors deemed relevant by the Commission.

Section 392.185 outlines that the provision of telecommunications services should be maintained and advanced. An important purpose specified in the statute is to allow for full and fair competition to function as a substitute for regulation.⁹⁶ The statute the Commission is implementing in this proceeding is the mechanism that legislators gave to the Commission to permit this express purpose to be achieved.

Existing Economic or Regulatory Barriers to Entry

The fourth factor which the Commission is required to consider in its evaluation of whether effective competition exists is existing economic or regulatory barriers to entry. As noted above, AT&T Missouri is providing competing carriers nondiscriminatory access to all of the checklist items contained in the federal Act, and thus, each of these carriers has a meaningful opportunity to compete with AT&T Missouri. Furthermore, given the multitude of providers providing functionally equivalent or substitutable services that are described in the testimony of AT&T

⁹⁰ Ex. 17 HC, Hughes Surrebuttal, p. 6.

⁹¹ Ex. 17HC, Hughes Surrebuttal, p. 6.

⁹² Ex. 17, Hughes Surrebuttal, p. 14.

⁹³ Ex. 17, Hughes Surrebuttal, p. 14.

⁹⁴ Ex. 17, Hughes Surrebuttal, p. 14.

⁹⁵ Ex. 17, Hughes Surrebuttal, p. 14.

⁹⁶ Section 392.185(6).

Missouri's witnesses in this case, it is clear that there are no barriers to entry that are preventing competitors from offering alternatives in the market place.⁹⁷

The Commission's findings in Case No. TO-99-227 concerning AT&T Missouri's compliance with Section 271 of the Act are instructive in this regard. In that case, the Commission determined that AT&T Missouri had complied with the Act, and that AT&T Missouri's local markets were open to competition. In its March 15, 2001 Order the Commission determined that AT&T Missouri had met the "competitive checklist" requirements set forth by Section 271 of the Act⁹⁸ and, in particular, that AT&T Missouri "is providing competing carriers with all of the requisite checklist items in a nondiscriminatory fashion."⁹⁹

III. Post-1996 Developments - The Sprint Report and Order

On December 4, 2003, the Commission issued its *Sprint Report and Order*¹⁰⁰ in which it concluded, among other things, that several services that are the subject of this case (i.e., intraLATA private line services, intraLATA toll services, WATS, and 800 services) and which are likewise provided by Sprint throughout its Missouri exchanges are subject to effective *statewide* competition. The Commission also determined that those services may be classified as competitive pursuant to Section 392.245 and are no longer subject to price cap regulation. The Commission relied on the existence of statewide, not exchange-specific, competition for these services and granted Sprint competitive classification for them in all of its Missouri exchanges.

Just as the existence of statewide competition supports the determination of effective competition in Sprint's exchanges, the same statewide competition supports a finding of effective competition for the same services in all of AT&T Missouri's exchanges. The conclusions in the *Sprint Report and Order* mirror those the Commission should reach based on the evidence adduced and the conclusions reached by the Commission in its *AT&T Missouri Reclassification Order* and its Report and Order in this case. Equally important, Sprint retains the competitive classifications it obtained in the *Sprint Report and Order*, even though, as is discussed below, Section 392.245 (the statute on which Sprint relied) has been amended and even though Sprint (like AT&T Missouri) also has a number of exchanges which qualify as competitive under the new law.¹⁰¹

⁹⁷ Ex. 16, Hughes Direct, pp. 21-22.

⁹⁸ Case No. TO-99-227, In the Matter of the Determination of Prices, Terms, and Conditions of Line Splitting and Line Sharing (issued March 15, 2001) (Mo PSC 271 Order), p. 6.

⁹⁹ Mo PSC 271 Order, p. 91.

¹⁰⁰ In the Matter of the Investigation of the State of Competition in the Exchanges of Sprint Missouri, Inc., Case No. IO-2003-0281, December 4, 2003 ("*Sprint Report and Order*"), pp. 2, 23.

¹⁰¹ See, e.g., Embarq Missouri, Inc. P.S.C. MO.-No. 22, General Exchange Tariff, Third Revised Page 23 and P.S.C. MO.-No. 23, Message Telecommunications Service, Statement of Service Classifications, Sixth Revised Page 36 (both referencing competitive service classifications "pursuant to [the Commission's] Order of December 4, 2003, in Case No. IO-2003-0281").

IV. S.B. 237/Case Nos. TO-2006-0093 and TO-2006-0102

In 2005, the legislature revised the law relating to competitive classification. On August 28, 2005, S.B. 237 became effective. Following the passage of S.B. 237, AT&T Missouri applied for competitive classification pursuant to its various provisions. In Case No. TO-2006-0093, the Commission determined that competitive classification should be granted for business services in 45 AT&T Missouri exchanges and residential services in 26 AT&T Missouri exchanges. In Case No. TO-2006-0102, the Commission determined that competitive classification should be granted for business services in an additional 30 AT&T Missouri exchanges (i.e. 75 in total) and for residential services in an additional 51 AT&T Missouri exchanges (i.e. 77 in total).

Consequently, pursuant to Section 392.245.5, RSMo Cum. Supp. 2005, all of the AT&T Missouri business services other than exchange access are deemed competitive in the 75 exchanges where basic local business services have been declared competitive and all residential services other than exchange access are deemed competitive in the 77 exchanges where basic local residential have been declared competitive. These exchanges, and the applicable type of competitive classification associated with each, are listed on Exhibit 1 to AT&T Missouri's proposed findings of fact and conclusions of law attached to this order.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law. The Commission adopts its conclusions of law as determined in its previous Report and Order except with regard to the transitionally competitive services in accordance with the mandate of the Court. For the reasons presented herein, the Commission determines that the services at issue are competitive on a statewide basis pursuant to the criteria in Section 392.245.5, RSMo, as it existed when the mandate issued.

The Commission rejects the CLECs' and OPC's assertion that AT&T Missouri should be directed to file revised tariffs to revise its prices to the extent necessary to comply with the maximum prices that existed as of the effective date of the Commission's *Report and Order*, subject to any intervening adjustments to such maximum prices under the price cap statute.

The Court of Appeals' decision did not address the rates for any service offered by AT&T Missouri, nor did it direct the Commission to review any rate for service offered by AT&T Missouri. Instead, the Court of Appeals directed the Commission to consider whether the services at issue should have been classified as competitive pursuant to the "effective competition" standard of Section 392.245.5. Furthermore, since no rates were established in Case No. TO-2001-467 and the appeal did not address the rates for any service, it would not have been appropriate for the Court to address rates. Moreover, rates for the services that are the subject of this proceeding were changed in subsequent tariff filings over the last several years,

none of which were the subject of any appeal or any request for stay by either the CLECs or any other party.

As a result of the Commission's decisions in Case Nos. TO-2006-0093 and TO-2006-0102, the vast majority of AT&T Missouri's lines have now been declared competitive. Clearly, any Commission action that would purport to require rate adjustments could not be imposed in exchanges which have been declared to be competitive under the provisions of S.B. 237.

Under Section 392.361, enacted as part of H.B. 360, a telecommunications company seeking either transitionally competitive or competitive classification is required to show, based upon all relevant factors, that the service is subject to sufficient competition to justify a lesser degree of regulation. Once a service is found to be competitive or transitionally competitive, the Commission must classify the same telecommunications services of another company as transitionally competitive or competitive by relying on the finding of fact made in the original proceedings.¹⁰² Under Section 392.370.1, the petitioning telecommunications company is required to show: (1) an order had been issued under 392.361 that finds the service has been classified as competitive or transitionally competitive; (2) that the service of the petitioning company is the same as, substitutable for, or equivalent to the service classified as either transitionally competitive or competitive; and (3) the competitive or transitionally competitive service is authorized to be provided in the petitioning company's service area.

Under Section 392.245.5, RSMo, as it existed at the time of the Commission's 2001 *Report and Order* and the mandate of the Court of Appeals, the Commission was required to determine whether effective competition exists for each telecommunications service of AT&T Missouri in each of its exchanges. Prior to amendment, the first two sentences of subsection 5 of this statute read:

Each telecommunications service of an incumbent local exchange telecommunications company shall be classified as competitive in any exchange in which at least one alternative local exchange telecommunications company has been certified under Section 392.455 and has provided basic local telecommunications service in that exchange for at least five years, unless the Commission determines, after notice and a hearing, that effective competition does not exist in the exchange for such service. The commission shall, from time to time, on its own motion or motion by an incumbent local exchange telecommunications company, investigate the state of competition in each exchange where an alternative local exchange telecommunication company has been certified to provide local exchange telecommunications service and shall determine, no later than five years following the first certification of an alternative local exchange telecommunications company in such exchange, whether effective competition exists in the

¹⁰² Section 392.370, RSMo.

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exchange for the various services of the incumbent local exchange telecommunications company.

Senate Bill 237, Laws 2005, amended Section 392.245.5 to create an expedited two-track procedure when a price cap regulated local exchange company seeks competitive classification for its services within one or more exchanges. Amended Section 392.245 takes away a price cap regulated telecommunications company's right to a competitive classification of its services in those exchanges where the services face effective competition. This is a substantive statute. Substantive statutes have prospective application. *Pierce v. State Dept. of Social Services*, 969 S.W.2d 814, 822-23 (Mo. App. W.D. 1998). Therefore, the Commission applies the prior version of Section 392.245 to its determination in this case.

Section 386.020(13) provides:

(13) "Effective competition" shall be determined by the commission based on:

(a) The extent to which services are available from alternative providers in the relevant market;

(b) The extent to which the services of alternative providers are functionally equivalent or substitutable at comparable rates, terms and conditions;

(c) The extent to which the purposes and policies of chapter 392, RSMo, including the reasonableness of rates, as set out in section 392.185, RSMo, are being advanced;

(d) Existing economic or regulatory barriers to entry; and

(e) Any other factors deemed relevant by the commission and necessary to implement the purposes and policies of chapter 392, RSMo;

Section 392.185 states that the provisions of this chapter shall be construed to:

(1) Promote universally available and widely affordable telecommunications services;

(2) Maintain and advance the efficiency and availability of telecommunications services;

(3) Promote diversity in the supply of telecommunications services and products throughout the state of Missouri;

(4) Ensure that customers pay only reasonable charges for telecommunications service;

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- (5) Permit flexible regulation of competitive telecommunications companies and competitive telecommunications services;
- (6) Allow full and fair competition to function as a substitute for regulation when consistent with the protection of ratepayers and otherwise consistent with the public interest;
- (7) Promote parity of urban and rural telecommunications services;
- (8) Promote economic, educational, health care and cultural enhancements; and
- (9) Protect consumer privacy.

Although Section 392.245.5, as it existed at the time of the Court's mandate, requires the Commission to make a determination of effective competition on an exchange basis, the services at issue are not exchange services. Rather, those services are offered on a statewide basis. The Commission has found, after analyzing each of the relevant factors, that effective competition existed for each of the services on a statewide basis at the time of the Commission's 2001 *Report and Order* and at the time of the Court's mandate. Thus, it follows that these services were also under effective competition in each exchange. Therefore, the Commission determines that effective competition exists for AT&T Missouri's intraLATA private line/dedicated services, intraLATA toll services, WATS and 800 services, special access services, and station-to-station, person-to-person, and calling card operator services.

These services remain classified as competitive even after the 2006 legislative changes to Section 392.245. AT&T Missouri's intraLATA private line/dedicated services, intraLATA toll services, WATS and 800 services, special access services, and station-to-station, person-to-person, and calling card operator services, shall be classified as competitive in all of AT&T Missouri's exchanges pursuant to Section 392.245.

IT IS ORDERED THAT:

1. The Report and Order issued on December 27, 2001, is readopted by the Commission except as modified by the additional findings of fact and conclusions of law set out in this Report and Order on Remand in compliance with the mandate of the Court.
2. Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri's intraLATA private line/dedicated services are classified as competitive in all of its Missouri exchanges.
3. Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri's intraLATA toll services are classified as competitive in all of its Missouri exchanges.
4. Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri's Wide Area Telecommunications Services (WATS) and 800 services are classified as competitive in all of its Missouri exchanges.

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5. Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri's special access services are classified as competitive in all of its Missouri exchanges.

6. Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri's station-to-station, person-to-person and calling card operator services are classified as competitive in all of its Missouri exchanges.

7. This Report and Order on Remand shall become effective on February 4, 2007.

Davis, Chm., Murray, and Appling, CC., concur;
Gaw and Clayton, CC., concur, with separate
concurring opinion(s) to follow;
and certify compliance with the provisions
of Section 536.080, RSMo.

Concurring Opinion of Commissioner Steve Gaw

I disagree with the Majority's analysis in reaching this decision. However, I concur in the result of this Report and Order on Remand.

The company-provided services in question in this case are not local exchange telecommunications services but are rather akin to long distance service. As such, the services are generally offered by Interexchange Carriers or the original Bell Companies on an intralata basis¹ rather than local exchange companies. Competition in Missouri between carriers offering long distance is and has been significantly robust in comparison to that between local exchange companies.

Based upon the requirements of Missouri law, the services in question meet the requirements to be declared competitive on a statewide basis. The Court of Appeals found that it is necessary to analyze the competitive status of the services on an exchange by exchange basis. While it does not seem clear that the court's record for these services was developed in this manner, because the nature of the services at issue is long distance, it would not seem inappropriate to find these services competitive for Missouri exchanges served by Southwestern Bell Telephone Company, L.P., d/b/a AT&T Missouri since the services meet the requirements on a statewide basis. However, this Commissioner disagrees with the analysis provided in the Commission Order in arriving at the same conclusion because it sets too low a threshold for a finding of competitive classification.

*Note: At the time of publication, no other concurrence has been issued.

¹ Subsequent to the original Order in this case SBC was granted authority to offer long distance interlata service as well.

In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area.

Case No. GR-2006-0422

Gas §18. The Commission approved the tariff sheets filed by Missouri Gas Energy to implement a general rate increase for natural gas service in the annual amount of \$41,651,345.

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: January 30, 2007

Effective Date: January 30, 2007

On May 2, 2006, Missouri Gas Energy, a division of Southern Union Company, filed tariffs sheets with the Missouri Public Service Commission to implement a general rate increase for natural gas service in the annual amount of \$41,651,345. The case is now progressing as ordered in the Procedural Schedule and the evidentiary hearing began on January 8, 2007. On January 3, 2007, Missouri Gas Energy and the Staff of the Commission submitted a Partial Nonunanimous Stipulation and Agreement for Commission approval. Although no other party joined in the agreement, none oppose it.

The signatories have agreed on the depreciation rate, average service life, net salvage, life only rate and net salvage rate on the following accounts included in Appendix A, attached to the agreement.

Discussion

Although the partial stipulation and agreement represents that it is nonunanimous and was not signed by all the parties, Commission rule 4 CSR 240-2.115(2) provides that other parties have seven days in which to object. If no party files a timely objection, then the Commission may treat it as a unanimous stipulation and agreement. No party has so objected. Further, the signatories indicate in the stipulation and agreement that the nonsignatories have stated that they do not oppose the agreement.

Staff filed suggestions in support of the partial stipulation and agreement on January 5, 2007. The signatories agree that Staff may answer any Commission question during any agenda meeting at which this agreement is noticed.

Conclusion

After reviewing the partial stipulation and agreement and Staff's suggestions in support thereof, the Commission finds that the partial stipulation and agreement should be approved as a resolution of the issues therein addressed.

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IT IS ORDERED THAT:

1. The Partial Stipulation and Agreement filed on January 3, 2007, between Missouri Gas Energy and the Staff of the Commission is approved as a resolution of the issues therein addressed.
2. This order shall become effective on January 30, 2007.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur.

Jones, Senior Regulatory Law Judge

In the Matter of the Application of The Empire District Electric Company and Ozark Electric Cooperative for Approval of a Written Territorial Agreement Designating the Boundaries of Exclusive Service Areas for Each within Two Tracts of Land in Greene County and Christian County, Missouri.

In the Matter of the Application of The Empire District Electric Company for a Waiver of the Provisions of its Tariff and 4 CSR 240-14.020 with Regard to The Lakes at Shuyler Ridge Subdivision in Conjunction with a Proposed First Territorial Agreement with Ozark Electric Cooperative.

**Case No. EO-2007-0029
Case No. EE-2007-0030**

Electric §11. The Commission ordered that the proposed Territorial Agreement, although not detrimental to the public interest, not be approved since the Territorial Agreement was contingent upon the approval of a requested waiver of Chapter 14 of the Commission's rules, which was also denied.

Appearances

Gary W. Duffy, Attorney at Law, Brydon, Swearingen & England, P.C., 312 East Capitol Avenue, P.O. Box 456, Jefferson City, Missouri 65102, for The Empire District Electric Company.

Rodric A. Widger, Attorney at Law, Andereck, Evans, Milne, Peace & Widger, 1111 Glenstone, Springfield, Missouri 65804, for Ozark Electric Cooperative.

Lewis R. Mills, Jr., Public Counsel, 200 Madison Street, Suite 650, P.O. Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

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Nathan Williams, Deputy General Counsel, 200 Madison Street, P.O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Colleen M. Dale, Chief Regulatory Law Judge

REPORT AND ORDER

Issue Date: January 30, 2007

Effective Date: February 9, 2007

On July 18, 2006, The Empire District Electric Company and Ozark Electric Cooperative filed a joint application for approval of a territorial agreement. Concurrently, Empire filed a request for variance. The Commission has determined good cause has been shown for purposes of Section 394.312.3, RSMo 2000, for the Commission to take more than 120 days from the filing of the Application for the Commission to approve or disapprove the territorial agreement.

Findings of Fact

On November 22, 2006, the parties filed a joint Stipulation of Facts, which provided, in pertinent part:

3. Empire is an "electrical corporation" and a "public utility" as those terms are defined in §386.020 RSMo 2000, and is subject to the jurisdiction and supervision of the Commission as provided by law.

5. Ozark Electric Cooperative ("Ozark") is a rural electric cooperative organized and existing pursuant to Chapter 394 RSMo [...]. Although certain safety aspects of its operations are subject to the jurisdiction of the Commission, the Commission does not have jurisdiction over the terms and conditions of the electrical service Ozark offers to its members.

6. Ozark is engaged in the distribution of electric energy and service to its members within certain counties in Missouri, including Greene and Christian Counties.

8. Empire and Ozark have entered into an agreement titled "First Territorial Agreement" ("Agreement") that is dated June 29, 2006 and a copy of which was filed as part of Appendix A to their joint application that initiated the above captioned Case No. EO-2007-0029. That Agreement is admissible as evidence in these consolidated cases.

9. Under the Agreement, Empire would have a service area located in unincorporated areas of both Greene and

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Christian Counties, Missouri, and abutting the City of Republic, Missouri, exclusive of retail electric competition from Ozark and comprising approximately 4.5 square miles; and Ozark would have a service area exclusive of retail electric competition from Empire in a part of unincorporated Christian County, Missouri, comprising approximately 4.0 square miles, that does not abut the present corporate limits of the City of Republic, Missouri. Both Empire and Ozark currently have authority to serve all of the area that is the subject of the Agreement.

10. Concurrently with Empire and Ozark's filing of the joint application to the Commission for approval of the Agreement, Empire filed an application with the Commission, which initiated Case No. EE-2007-0030, for variances from Commission rule 4 CSR 240-14.020 and Empire's tariff regarding installation costs for electric service and the costs for installation of decorative street lighting for one specific platted subdivision located near Republic, Missouri— The Lakes at Shuyler Ridge.

14. Ozark and the developer of The Lakes at Shuyler Ridge [...] entered into a contract [...] dated September 15, 2005 ("Contract"). ***

16. Empire's current electric tariff provisions ... require that a developer pay Empire all installation costs in advance. [...] the developer is then entitled to receive a rebate for each lot that receives permanent power from Empire within a five-year period. The rebate ... has a value of \$2,679 per lot [...]. ... Empire's current estimate ... to extend service to Phase I is \$591,772.74. Under Empire's tariff, the developer would only be eligible for \$436,677.00 (163 lots in Phase I x \$2,679 per lot) in rebates; therefore, a balance of \$155,095.74 would be nonrefundable to the developer.

17. The second aspect of the Empire variance request deals with the costs for installation of decorative street lighting [...]. *** Empire's current estimate to install the desired decorative street lighting ... is \$60,800.00, based on an estimated cost of \$1,600.00 per light for 38 decorative street lights.

18. Ozark has contracted with the developer to install \$57,000.00 of street lighting for Phase I of The Lakes at Shuyler Ridge at no cost to the developer.

19. The Staff has quantified the projected cost to Empire if the Commission grants the requested variances for installation

costs for electric service to be \$322,499.74 (for the entire subdivision), that, otherwise, the developer would contribute. *** The Staff has quantified the projected cost to Empire if the Commission grants the requested variances for decorative street lighting to be \$163,500 for the 109 decorative street lights for the entire subdivision. Empire has projected in its application, subject to the noted assumptions, that after ten years, Empire's service (priced at current prices) would produce approximately \$5.6 million in revenue compared to \$1.8 million in installation costs for the entire subdivision.

20. No party is seeking an express ratemaking determination on the cost of the variance in this proceeding, or is any party asserting that a ratemaking determination in this case would be appropriate. ***

21. The variances sought by Empire here would apply only to The Lakes at Shuyler Ridge subdivision [...].

On December 7, the Commission held a hearing in this matter to determine whether the territorial agreement should be approved and whether Empire could be given a waiver of its tariff provisions and the provisions of 4 CSR 240-14.020, which governs promotional practices by electric utilities. The Staff opposes the proposed variance on two grounds. First, it asserts that the variance would permit Empire to discriminate against customers not subject to the variance. Second, it asserts that, while the Commission unquestionably has the authority to waive a rule provision, it does not have the authority to waive a tariff provision. Empire agrees that, if the Commission were to grant the variance, Empire would file a compliance tariff that established a new class of customers to allow for the charges it proposes in this matter.

The territorial agreement between Empire and Ozark appears to be reasonable and could be approved. Specifically, the Commission finds that the proposed territorial agreement is not detrimental to the public interest. However, those parties have indicated an unwillingness to proceed with the territorial agreement if the waiver is not granted.

Conclusions of Law

Prior to determining whether the requested waiver from the Commission's regulations may be granted, the Commission must determine whether the proposed activity contravenes §393.130 RSMo, which provides:

2. No gas corporation, electrical corporation, water corporation or sewer corporation shall directly or indirectly by any special rate, rebate, drawback or other device or method, charge, demand, collect or receive from any person or corporation a greater or less compensation for gas, electricity, water, sewer or for any service rendered or to be rendered or in connection

therewith, except as authorized in this chapter, than it charges, demands, collects or receives from any other person or corporation for doing a like and contemporaneous service with respect thereto under the same or substantially similar circumstances or conditions.

3. No gas corporation, electrical corporation, water corporation or sewer corporation shall make or grant any undue or unreasonable preference or advantage to any person, corporation or locality, or to any particular description of service in any respect whatsoever, or subject any particular person, corporation or locality or any particular description of service to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

The Commission's interpretation of these subsections of §393.130 is that Empire's proposal constitutes an undue preference for developers of a single subdivision. While the Commission recognizes the need for utilities to charge different classes of customer based on difference in types of service (for example, customers willing to accept interruptible service are usually given a lower rate) or differences in the utility's cost to provide service, there seems to be insufficient justification for giving a special rate to the developer of this single subdivision. No evidence was provided to support the contention that it will be less costly to provide the proposed installation services to this particular development; on the contrary, it is a stipulated fact in this case that Empire's cost of installation will exceed the price charged to the developer.

The Commission has promulgated rules to allow regulated utilities to charge lower rates in order to meet the demands of competition. Chapter 14 includes two provisions at issue:

14.010(2) On written application by a utility the commission may grant variances from the rules contained in this chapter for good cause shown. The utility filing the application shall show proof of service of a copy of the application on each public utility providing the same or competing utility service in all or any portion of the service area of the filing utility.

14.020 Generally prohibits a utility from providing installation or equipment at a price that is "less than actual cost or value." The Commission has the authority to allow utilities the flexibility to charge different classes of customers differently, but would not allow a utility to create an artificial class to facilitate rate discrimination. Moreover, that flexibility specifically excludes the ability to price services below their cost. Even if the Commission were to find that the discrimination was justified, the provisions of 4CSR 240-14.010 et seq, would preclude Empire from providing the installation services as requested. Therefore, the Commission shall not grant Empire's waiver request.

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The territorial agreement, which in isolation appears to be reasonable, is contingent upon the grant of the requested waiver. As the waiver request is denied, the territorial agreement will not be approved.

IT IS ORDERED THAT:

1. The proposed territorial agreement is not approved.
2. The requested waiver of the provisions of Chapter 14 of the Commission's rules is denied.
3. This order shall become effective on February 9, 2007.

Davis, Chm., Murray, Gaw and Appling, CC., concur;
Clayton, C., dissents;
all certify compliance with the provisions of
Section 536.080, RSMo 2000.

In the Matter of Southwestern Bell Telephone, L.P. d/b/a AT&T Missouri's Revision to its General Exchange Tariff, PSC Mo. No. 35, Regarding Provision of 811 Service.

Case No. IT-2007-0187

Telecommunications §1. The Commission ordered that Southwestern Bell Telephone, L.P. d/b/a AT&T Missouri's revision to its General Exchange Tariff, PSC Mo. No. 35, Regarding Provision of 811 Service is approved and is effective as of February 16, 2007.

Appearances

Robert J. Gryzmala, Attorney for Southwestern Bell Telephone, L.P. d/b/a AT&T Missouri, One SBC Center, Suite 3520, St. Louis, Missouri 63101.

Mark W. Comley, Attorney for Missouri One Call System, Inc., Newman, Comley & Ruth P.C., 600 Monroe Street, Suite 301, P.O. Box 537, Jefferson City, Missouri 65102.

David Meyer, Senior Counsel, General Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Harold Stearley, Judge

REPORT AND ORDER

Issue Date: February 1, 2007

Effective Date: February 16, 2007

Procedural History

On October 19, 2006,¹ Southwestern Bell Telephone, L.P. d/b/a AT&T Missouri ("AT&T") filed a proposal to revise its General Exchange Tariff by adding a new section; Section 59. The new section described AT&T's intent to offer 811 Service pursuant to the Federal Communications Communication's ("FCC") March 14, 2005 Sixth Report and Order in the Matter of the Use of N11 Codes and Other

¹ All dates throughout this order refer to the year 2006 unless otherwise noted.

Abbreviated Dialing Arrangements, 20 FCC Rcd 5539 (2005) ("Order"). The provision of 811 Service utilizes the abbreviated dialing code of 811, as reserved by the FCC, to assist excavators with notifying underground facility operators of upcoming excavation activities. AT&T's tariff delineated, *inter alia*, the rates AT&T intends to charge for the 811 Service and bore an effective date of November 18.

On November 16, the Commission granted Missouri One Call System, Inc.'s ("MOCS") request to intervene and suspended AT&T's tariff until January 17, 2007. In its request to intervene, MOCS contended that AT&T's tariff was unjust, unreasonable and inconsistent with the FCC's Order. MOCS claimed that the FCC's Order requires call centers to provide a telephone number to the telecommunications providers so that the provider may forward calls received on 811 to the call center, not that the call centers have to pay for the forwarding of such calls.

Because AT&T's tariff was originally filed as a non-case tariff, MOCS's intervention request required the Commission to establish a case and issue notice. Notice was issued on November 16 with an intervention deadline set for November 30. No other requests for intervention were filed. On December 19, after initially participating in this matter, the Office of the Public Counsel filed a notice of withdrawal stating, "the issue in the case does not have any direct effect on telecommunications customers of AT&T Missouri and the outcome of the case does not appear to have broad application to consumers."

An evidentiary hearing was held on December 21, and on December 28, by the parties' agreement, the Commission suspended AT&T's tariff for an additional 30 days, or until February 16, 2007, to give the parties adequate time for post-hearing briefing and adequate time for the Commission to decide the merits of the case.

Findings of Fact

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

1. On March 14, 2005, in response to the Pipeline Improvement Safety Act's mandate to provide for the establishment of a 3-digit nationwide toll-free telephone number to be used by state one-call notification systems, the FCC released its Sixth Report and Order in the Matter of the Use of N11 Codes and Other Abbreviated Dialing Arrangements ("Order").²

2. The FCC's Order was published in the Federal Register on April 13, 2005.³

3. The FCC's Order states that: "811 is assigned as the national abbreviated dialing code to be used exclusively for access to Once [sic] Call Centers, effective thirty days after publication of this Order in the Federal Register."⁴

² Pipeline Safety Improvement Act, Pub. L. No. 107-355, 116 Stat. 2985 (2002), Section 17; Federal Communications Commission, CC Docket No. 92-105, 20 FCC Rcd 5539 (2005); Hearing Exhibit 2; Hearing Exhibit 3; Transcripts p. 55, lines 21-25, and p. 56, lines 1-5.

³ 70 Fed. Reg. 19321-19330 (2005) (to be codified at 47 C.F.R. Part 52); Transcript p. 109, lines 20-25, and p. 110, lines 1-3.

4. The FCC's Order states that: "... two years from publication of this Order in the Federal Register is a reasonable period for implementing an N11 code, specifically 811, for access to One Call Centers."⁵

5. The FCC's Order states that: "Thus, such requirement [the implementation of 811 for access to One Call Centers] applies to all carriers on a nationwide basis and is not dependent upon whether there has been a request for such service."⁶

6. The FCC's order states that: "To ensure that calls to One Call Centers are toll-free, we conclude that One Call Centers shall provide to carriers its toll-free number, which can be an 8YY number or any number that is not an IntraLATA toll call, from the area to be served for use in implementing 811. Thus, when a caller dials 811, the carriers will translate 811 into the appropriate number to reach the One Call Center."⁷

7. The FCC's Order states that: "We direct carriers to use either the NPA-NXX or the originating switch to determine the appropriate One Call Center to which a call should be routed."⁸

8. The FCC's Order states that: "We therefore delegate authority to the state commissions, pursuant to section 251(e), to address the technical and operational issues associated with the implementation of 811."⁹

9. The FCC's Final Regulatory Flexibility Analysis, in Appendix B to its Order, states: "While we recognize that there may be some costs associated with implementation of the 811 code, we have not specified parameters for cost recovery in this Order. The Pipeline Safety Act did not provide for federal financial support as part of the mandate for a nationwide abbreviated dialing arrangement for access to One Call Centers. Therefore, we find that the Congressional mandate and benefits of a national N11 code assignment, specifically 811, outweigh any concerns regarding cost recovery on the federal level. These issues are most appropriately addressed by the state and local governments. As indicated above, we believe that state commissions are in the best position to address issues associated with implementing 811 because many of the One Call Centers were developed by, or under the auspices of, the state commissions."¹⁰

⁴ Hearing Exhibit 3; Federal Communications Commission's Sixth Report and Order in the Matter of the Use of N11 Codes and Other Abbreviated Dialing Arrangements, Paragraph 41 of Section V, Ordering Clauses; CC Docket No. 92-105, 20 FCC Rcd 5539 (2005); Transcript p. 140, lines 2-11.

⁵ *Id.*; FCC's Order, Paragraph 32 of Section II, Discussion; Transcripts p. 25, lines 15-21.

⁶ *Id.*; FCC's Order, Footnote 120, referencing Paragraph 32 of Section III, Discussion.

⁷ *Id.*; FCC's Order, Section III, Discussion, Paragraph 26; Transcript p. 44, lines 8-13, p. 97, Lines 1-13, p. 100, lines 7-25, and p. 101, lines 1-3.

⁸ *Id.*; FCC's Order, Section III, Discussion, Paragraph 29.

⁹ *Id.*; FCC's Order, Section III, Discussion, Paragraph 35; The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996), 47 U.S.C. Section 251(e)(1); Transcripts p. 181, lines 23-25.

¹⁰ Hearing Exhibit 3; *In the Matter of the Use of N11 Codes and Other Abbreviated Dialing Arrangements*, Docket No. 92-105, Sixth Report and Order, Appendix B, Final Regulatory

10. The FCC has designated the use of other N11 Codes as abbreviated dialing arrangements including: 211 Service for information and referral services; 311 Service to allow customers to reach non-emergency local government services; 511 Service for the Department of Transportation; 711 Service for hearing impaired individuals to obtain operator assistance with placing phone calls; and 911 Service for emergency assistance.¹¹

11. Southwestern Bell Telephone, L.P. d/b/a AT&T Missouri ("AT&T"), is a Texas corporation authorized by the Commission to provide telecommunications service to the public in the State of Missouri.¹²

12. AT&T's principal offices and place of business in Missouri are located at One AT&T Center, Room 3520, St. Louis, Missouri 63101.¹³

13. AT&T is a "public utility" and a "telecommunications company" as defined in Section 386.010(42), and (51), RSMo 2000.¹⁴

14. AT&T admits that it is a price-cap company subject to the provisions of Section 392.245, RSMo Cum. Supp. 2005.¹⁵

15. On October 19, 2006, AT&T filed a proposal to revise its General Exchange Tariff by adding a new section, Section 59, offering 811 Service for a nonrecurring set-up charge of \$235.12 per host or stand alone switch.¹⁶

16. AT&T will configure its switches to implement 811 Service regardless if it has subscribers for that service.¹⁷

17. Missouri One Call System, Inc. ("MOCS") is a not-for-profit Missouri corporation that serves as a "notification center", as defined in Section 319.015(4), providing statewide notification to participant owners and operators of underground facilities of information concerning intended excavation activities.¹⁸

18. Missouri One Call System, Inc.'s ("MOCS") principal offices are located at 728 Heisinger Road, Jefferson City, Missouri.¹⁹

19. MOCS is the only notification center of its kind in the State of Missouri.²⁰

Flexibility Analysis, Paragraph 39, 20 FCC Rcd 5539 (2005), Transcript p. 57, lines 22-25, p. 58, lines 1-10, p. 181, lines 6-25, and p. 182, lines 1-8; AT&T's Post-Hearing Brief, p. 3.

¹¹ Transcript pp. 64-67, p. 89, lines 13-25, p. 90, lines 1-2, p. 91, lines 2-18, p. 182, lines 16-25, and p. 183, lines 1-25; Staff's Response to Motion to Suspend, p. 2, para 5, filed November 15, 2006.

¹² See Case No. TO-2006-0093.

¹³ Id. See also Hearing Exhibit 1.

¹⁴ All statutory references are to RSMo 2000 unless otherwise noted.

¹⁵ Transcript p. 33, lines 5-12, and p. 36, lines 17-24; AT&T's Post-Hearing Brief, p. 3.

¹⁶ Hearing Exhibit 1.

¹⁷ Transcript p. 95, lines 7-25, and p. 96, line 1.

¹⁸ Missouri One Call System, Inc.'s Motion to Suspend Tariffs and Application to Intervene, paragraph 1; Transcript p. 112, lines 19-25, p. 113, line 1, p. 142, lines 23-25, and p. 160, lines 1-3.

¹⁹ Missouri One Call system, Inc.'s Motion to Suspend Tariffs and Application to Intervene, paragraph 1.

²⁰ Transcript p. 113, lines 5-10.

20. Contractors, utility companies, municipalities or any other person can notify all participant owners and operators of underground facilities of their intent to excavate by making a single toll-free call to MOCS at 1-800-DIG-RITE.²¹

21. MOCS is a One Call Notification System Operator as listed in Section 17 of the Pipeline Safety Improvement Act of 2002.²²

22. MOCS's member participants are facility operators as listed in Section 17 of the Pipeline Safety Improvement Act of 2002.²³

23. Once a call is placed to MOCS, it notifies each participant and that entity dispatches a crew to mark the location of its underground facility prior to the excavation.²⁴

24. The implementation of AT&T's tariff coupled with requiring MOCS to subscribe to AT&T's 811 Service would cost MOCS approximately \$70,000.²⁵

25. MOCS estimates that if AT&T's tariff were applied statewide, as opposed to only AT&T's service area, requiring MOCS to subscribe to 811 Service would cost MOCS approximately \$200,000.²⁶

26. Although MOCS asserted that AT&T's tariff for 811 Service was unjust and unreasonable and inconsistent with the FCC's Order in its Motion to Suspend Tariffs and Application to Intervene, at hearing, John Landsford, Executive Director of MOCS, testified that MOCS had no position on the reasonableness of the rates AT&T has placed in its tariff because it has not ordered the 811 service.²⁷

27. MOCS provided AT&T the toll-free number of 866-DIG-RITE to comply with the FCC's Order.²⁸

28. MOCS does not regard its compliance with the FCC Order requiring it to submit an 800 number to AT&T as an order for the 811 service.²⁹

29. MOCS does not intend to subscribe with AT&T for 811 Service.³⁰

30. The Commission has previously approved AT&T tariffs to implement 211 Service and 311 Service allowing AT&T to recover reasonable rates for the

²¹ Transcript p. 114, lines 8-25, p. 115, lines 1-5, p. 116, lines 9-15, p. 117, lines 1-25, and p. 118, lines 1-4.

²² Hearing Exhibit 2; Transcript p. 130, lines 16-19.

²³ Hearing Exhibit 2; Transcript p. 130, lines 12-15.

²⁴ Missouri One Call System, Inc.'s Motion to Suspend Tariffs and Application to Intervene, p. 2, para. 4. Transcripts p. 114, lines 3-25, and p. 115, lines 1-5.

²⁵ Transcript p. 124, lines 11-18.

²⁶ Transcript p. 165, lines 19-25, and p. 166, lines 1-11.

²⁷ Transcript p. 38, lines 4-18, and p. 128, lines 13-23.

²⁸ Transcript p. 118, lines 13-22, p. 121, lines 11-18, and p. 128, lines 8-12.

²⁹ Transcript p. 128, lines 8-25, p. 129, lines 1-25, and p. 130, line 1.

³⁰ Transcript p. 118, lines 13-15, p. 124, lines 19-25, p. 125, line 1, and p. 138, lines 7-17.

provision of those services from the entity providing the service that corresponds to the N11 number, not the telecommunications company.³¹

31.The 811 Service is analogous in nature to 211 Service and 311 Service in that they allow a single point of contact to receive calls and act as a clearinghouse to direct callers to the needed service.³²

32.The Staff of the Missouri Public Service Commission surveyed 21 states implementing 811 Service, and of those states that responded, five allowed the telecommunications companies to recover costs associated with 811 Service, those states being Florida, Minnesota, Nebraska, Tennessee, and Washington.³³

33.Staff's survey also revealed that in Mississippi the One Call Centers voluntarily accepted the costs, in Texas the costs were not directed to the One Call Center, and in Iowa the costs associated with 811 Service were imposed upon the telecommunications company.³⁴

34.The rates for 811 Service provided in AT&T's tariff are comparable to the rates it has charged for the same service in tariffs that have been approved by other state commissions, specifically Kansas, Oklahoma, California, Nevada, and Illinois.³⁵

35.No party to this action has claimed that AT&T's proposed charges exceed its costs to implement the FCC's Order.³⁶

36.No party to this action asserts that AT&T's 811 Service tariff rates are unjust or unreasonable.³⁷

Conclusions of Law

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

Jurisdiction and Authority

AT&T is a "public utility" and a "telecommunications company" as defined in Section 386.010(42), and (51), is subject to the jurisdiction, control and regulation of the Commission. MOCS is a not-for-profit Missouri corporation that serves as a "notification center", as defined in Section 319.015(4). MOCS is not a "public utility," or a "telecommunications company" or any other defined regulated entity pursuant

³¹ Hearing Exhibits No. 5 and 6; Transcript p. 103, lines 12-18, Staff's Post-Hearing Brief, p. 4. See also Commission Rule 4 CSR 240-32.200(2)(C) (directing companies to submit a tariff to the commission for the provision of 211 service).

³² Transcript p. 104, lines 8-14.

³³ Transcript p. 184, lines 5-24, p. 194, lines 15-25, and p. 195, lines 1-25.

³⁴ Transcript p. 184, lines 5-24, p. 196, lines 1-25, and p. 197, lines 1-17.

³⁵ Hearing Exhibits 7, 8 (public) and 9, 10, 11, 17, 19, and 20 (highly confidential); Transcript p. 64, lines 4-25, pp. 65-75, and p. 76, lines 1-2.

³⁶ Transcripts p. 16, lines 22-25, p.26, lines 3-7, p. 30, lines 12-15, p. 34, lines 8-14, p. 35, lines 6-14, p. 38, lines 3-18, p. 63, lines 19-25, p. 79, lines 17-21, p. 128, lines 18-23, and p. 182, lines 1-8.

³⁷ *Id.*

to Section 386.020; nor does it provide “telecommunications services” or own “telecommunications facilities.”³⁸ Consequently, MOCS is not subject to the jurisdiction, control and regulation of the Commission.

Obligations Pursuant to the FCC’s Order

The FCC’s Order mandates the use of 811 as the national abbreviated dialing code for providing advanced notice of the excavation activities to underground facility operators within two years after publication of its Order in the Federal Register, i.e. by April 13, 2007.³⁹ In order to implement the 811 dialing code, the FCC requires carriers to use either the Numbering Plan Area (NPA)-NXX or the originating switch to determine the appropriate One Call Center to which a call should be routed.⁴⁰ Finally, the FCC delegated authority to the state commissions, pursuant to Section 251(e) of the Telecommunications Act of 1996, to address the technical and operational issues, including cost allocation, associated with the implementation of the 811 code.⁴¹

The net result of the FCC’s Order in the context of this matter is that AT&T must implement its 811 Service no later than April 13, 2007, and the Commission is charged with the authority to determine the propriety of AT&T’s tariff for the federally mandated provision of 811 Service. While the FCC’s Order states that One Call Centers must notify carriers of the toll-free or local number the Center uses so the carriers may forward the calls, the Order does not require One Call entities to subscribe to 811 Service.⁴²

³⁸ Sections 386.020(42), (51), (52), and (53) RSMo 2000.

³⁹ Hearing Exhibit 3; *In the Matter of the Use of N11 Codes and Other Abbreviated Dialing Arrangements*, Docket No. 92-105, Sixth Report and Order, Paragraphs 2 and 32-34, 20 FCC Rcd 5539 (2005).

⁴⁰ *Id.* at Paragraphs 2 and 29; Appendix B, Final Regulatory Flexibility Analysis, Paragraph 39.

⁴¹ *Id.* at Paragraphs 2, 35 and Appendix B, Final Regulatory Flexibility Analysis, Paragraph 39; The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996); 47 U.S.C. Section 251(e)(1).

⁴² Transcript p. 80, lines 2-17, and p. 182, lines 9-12. The FCC’s Order states that One Call Centers must notify carriers of the toll-free or local number the One Call Center uses in order to ensure that callers do not incur toll charges. Hearing Exhibit 3; *In the Matter of the Use of N11 Codes and Other Abbreviated Dialing Arrangements*, Docket No. 92-105, Sixth Report and Order, Paragraphs 2 and 26, 20 FCC Rcd 5539 (2005), *citing to*, Pub. L. No. 107-355, Section 17, 116 Stat. 2985, 3008 (2002) (the “Pipeline Safety Improvement Act”). However, it should be noted that even though MOCS provided AT&T with a toll free number, it is disputed whether the FCC has the authority to direct MOCS to provide a phone number to AT&T for the provision of 811 Service. Transcript p. 97, lines 14-21, p. 122, lines 24-25, and p. 123, lines 1-2; MOCS’s Post-Hearing Brief, p. 4.

Commission's Standards for Approving AT&T's Tariff

AT&T is a price-cap company subject to the provisions of Section 392.245.⁴³ Section 392.245.11 provides, in pertinent part: "This subsection shall not preclude an incumbent local exchange telecommunications company from proposing new telecommunications services and establishing prices for such services."⁴⁴ This section further provides that incumbent local exchange telecommunications companies may change the rates for its services, not to exceed the maximum allowable price, subject to the provisions of subsections 2 through 5 of Section 392.200.⁴⁵ AT&T, however, is also a competitive telecommunications company, having been so classified by the Commission pursuant to 392.245.⁴⁶ Approval of its tariffs as a competitive company is also subject to the provisions of Sections 392.200.2 through .5 as directed in Section 392.500.⁴⁷

Section 392.500, as amended in 2005, provides that proposed changes in rates or charges, or any classification or tariff provision affecting rates or changes, for any competitive telecommunications service, are subject to subsections 2 to 5 of Section 392.200. Consequently, AT&T's tariff for 811 Service, a tariff provision affecting rates for a competitive telecommunications service, is subject to approval based upon the standards articulated in Section 392.200, subsections 2 through 5, and these subsections prohibit tariffs that create undue or unreasonable prejudice or disadvantage.⁴⁸

Section 392.200.2 provides in pertinent part:

No telecommunications company shall directly or indirectly or by any special rate, rebate, drawback or other device or method charge, demand, collect or receive from any person or corporation a greater or less compensation for any service rendered or to be rendered with respect to telecommunications or in connection therewith, except as authorized in this chapter, than it charges, demands, collects or receives from any other person or corporation for doing a like and contemporaneous service with

⁴³ RSMo Cum. Supp. 2005.

⁴⁴ *Id.*

⁴⁵ Section 392.245.11, RSMo Cum. Supp. 2005.

⁴⁶ RSMo Cum. Supp. 2005. See Case Nos. TO-2006-0093 and TO-2006-0102.

⁴⁷ RSMo Cum. Supp. 2005; In the Matter of AT&T Communication of the Southwest, Inc.'s Proposed Tariff to Establish a Monthly Instate Connection Fee and Surcharge, Case No. TT-2002-129, 2005 WL 3425546*5 (Mo. P.S.C.).

⁴⁸ *Id.* Section 392.200.1, RSMo Cum. Supp. 2005, which requires that rates be just and reasonable, no longer applies to rate changes made by competitive companies. Instead, the legislature has determined that competition will ensure that the rates charged by competitive companies will be just and reasonable. Case No. TT-2002-129, 2005 WL 3425546 at *5. It should be noted that regardless of AT&T's status as a price-capped company, or as a competitive company, Section 392.200.2 through 5 would apply to determining the propriety of AT&T's tariff.

respect to telecommunications under the same or substantially the same circumstances and conditions.⁴⁹

Section 392.200.3 provides:

No telecommunications company shall make or give any undue or unreasonable preference or advantage to any person, corporation or locality, or subject any particular person, corporation or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever except that telecommunications messages may be classified into such classes as are just and reasonable, and different rates may be charged for the different classes of messages.⁵⁰

Sections 392.200.4 and .5 involve geographic classification or market segregation and charges per minute for interexchange services respectively. Neither of these subsections apply to AT&T's 811 Service Tariff.⁵¹

Decision

In making this decision, the Commission has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive in reaching this decision. After applying the facts, as it has found them, to its conclusions of law, the Commission has reached the following decision.

While MOCS is currently the only notification center of its type in Missouri, it was created pursuant to Chapter 319. Chapter 319, however, does not designate any individual entity to be a notification center and places no limit on the number of notification centers that can operate within the state. AT&T's tariff would apply to any and all notification centers ordering 811 Service and does not give any undue or unreasonable preference or advantage to any person, corporation or locality, or subject any particular person, corporation or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.⁵² Nor does AT&T's tariff directly or indirectly or by any special rate, rebate, drawback or other device or method charge, demand, collect or receive from any person or corporation a greater or less compensation for any service than it charges, demands, collects or receives from any other person or corporation for doing a like and contemporaneous service with respect to telecommunications under the same or substantially the same

⁴⁹ RSMo Cum. Supp. 2005.

⁵⁰ RSMo Cum. Supp. 2005.

⁵¹ *Id.*

⁵² Section 392.200.3, RSMo Cum. Supp. 2005.

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circumstances and conditions.⁵³ In short, AT&T's tariff for 811 Service does not create undue or unreasonable prejudice or disadvantage and it shall be approved.

Although no party has challenged the reasonableness of AT&T's rates for implementation of 811 Service, and although the "just and reasonable" standard is not applicable in this instance, the Commission notes that rates established by the Commission must not be confiscatory and a utility must be able to recover its proper expenses and also a reasonable return on its prudent investment.⁵⁴ Mandating that AT&T provide this service for free is without question potentially confiscatory and the Commission declines MOCS's invitation to do so.⁵⁵

MOCS does not fall under the jurisdiction of the Commission and the Commission lacks authority to require it to subscribe to AT&T's 811 Service. However, whether MOCS subscribes to AT&T's 811 Service is irrelevant to the issue of whether if AT&T can charge for the service.

IT IS ORDERED THAT:

1. Southwestern Bell Telephone, L.P. d/b/a AT&T Missouri's revision to its General Exchange Tariff, PSC Mo. No. 35, Regarding Provision of 811 Service, assigned tariff number JI-2007-0260, is approved to become effective on February 16, 2007. The tariff sheets approved are:

P.S.C. Mo. No.35

General Exchange Tariff

Section 59

Original Sheet No. 1 – Original Sheet No. 3

2. All objections not ruled on are overruled and all motions not granted are denied.

3. This order shall become effective on February 16, 2007.

4. This case may be closed on February 17, 2007.

Davis, Chm., Murray, Gaw,
Clayton and Appling, CC., concur
and certify compliance with the
provisions of Section 536.080, RSMo 2000.

⁵³ Section 392.200.2, RSMo Cum. Supp. 2005.

⁵⁴ State ex rel. Union Elec. Co. v. Public Service Com'n, 687 S.W.2d 162, 166 (Mo. banc 1985).

⁵⁵ State ex rel. Sprint Spectrum L.P. v. Missouri Public Service Com'n, 112 S.W.3d 20, 26 (Mo. App. 2003); See also Smith v. Ill. Bell Tel. Co., 270 U.S. 587, 591-92 (1926); Bluefield Water Works & Improv. Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 690 (1923); In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of its Regulatory Plan, Case No. ER-2006-0314.

**Union Electric Company's 2005 Utility Resource Filing Pursuant to 4 CSR
240 - Chapter 22***

Case No. EO-2006-0240

Electric §40. The Commission accepted the Stipulation and Agreement filed by Union Electric Company on January 5, 2007 outlining Union's integrated resource plan.

**ORDER APPROVING STIPULATION AND AGREEMENT AND
ACCEPTING 2005 INTEGRATED RESOURCE PLAN**

Issue Date: February 8, 2007

Effective Date: February 18, 2007

Union Electric Company, d/b/a AmerenUE, filed its integrated resource plan (IRP), as required by 4 CSR 240 – Chapter 22, on December 5, 2005. On January 5, 2007, after a year of back and forth pleadings and negotiations, AmerenUE; the Staff of the Commission; the Office of the Public Counsel; the Missouri Department of Natural Resources; Missouri Industrial Energy Consumers (MIEC); and the Sierra Club, the Missouri Coalition for the Environment, Mid-Missouri Peaceworks, and the Association of Community Organizations for Reform Now (collectively the Sierra Club) filed a non-unanimous stipulation and agreement that purports to resolve all alleged deficiencies in AmerenUE's 2005 IRP filing.

The stipulation and agreement is identified as non-unanimous because two parties, Missouri Energy Group and Noranda Aluminum, Inc., did not sign. However, Commission Rule 4 CSR 240-2.115 provides that if no party objects to a non-unanimous stipulation and agreement within seven days of its filing, the stipulation and agreement may be treated as unanimous. Since no party has filed a timely objection to the stipulation and agreement, it will be treated as a unanimous agreement.

The purpose of the Commission's integrated resource planning rule is to require Missouri's electric utilities to undertake an adequate planning process to ensure that the public interest in a reasonably priced, reliable, and efficient energy supply is protected. The stipulation and agreement promotes that policy by establishing a participatory process that will involve interested parties in AmerenUE's planning for its next IRP filing. In particular, the agreement requires AmerenUE to host a series of meetings and conference calls to facilitate discussion on various aspects of the planning process. AmerenUE also agrees to make its next IRP filing by February 5, 2008; ten months earlier than that filing would otherwise be due. Furthermore, the stipulation and agreement specifies particular information that AmerenUE will be required to compile and include in its 2008 IRP filing.

Commission Rule 4 CSR 240-22.080(13) requires that after considering an electric utility's IRP filing, the Commission issue an order containing findings that the

filing "either does or does not demonstrate compliance with the requirements of this chapter, and that the utility's resource acquisition strategy either does or does not meet the requirements stated in 4 CSR 240-22.010(2)(A)-(C)."¹ Furthermore, 4 CSR 240-22.010(1) provides that a Commission finding that a utility is in compliance with these rules is not to be construed as Commission approval of the utility's resource plans, resource acquisition strategies or investment decisions.

Based on the unopposed stipulation and agreement, the Commission finds that AmerenUE's 2005 IRP filing, as modified and clarified by the stipulation and agreement, demonstrates compliance with the requirements of Commission Rule 4 CSR 240-22. Furthermore, the Commission finds that AmerenUE's resource acquisition strategy described in its 2005 IRP filing meets the requirements stated in Commission Rule 4 CSR 240-22.010(2)(A)-(C). Finally, the Commission finds that the stipulation and agreement filed by the parties is consistent with the public interest and shall be approved.

IT IS ORDERED THAT:

1. The Stipulation and Agreement filed on January 5, 2007, is approved and the signatory parties are ordered to comply with its terms.
2. Union Electric Company, d/b/a AmerenUE's 2005 integrated resource plan is accepted as being in compliance with Commission Rule 4 CSR 240 – Chapter 22.

¹ 4 CSR 240-22.010(2) provides as follows:

(2) The fundamental objective of the resource planning process at electric utilities shall be to provide the public with energy services that are safe reliable and efficient, at just and reasonable rates, in a manner that serves the public interest. This objective requires that the utility shall –

(A) Consider and analyze demand-side efficiency and energy management measures on an equivalent basis with supply-side alternatives in the resource planning process;

(B) Use minimization of the present worth of long-run utility costs as the primary selection criterion in choosing the preferred resource plan; and

(C) Explicitly identify and, where possible, quantitatively analyze any other considerations which are critical to meeting the fundamental objective of the resource planning process, but which may constrain or limit the minimization of the present worth of expected utility costs. The utility shall document the process and rationale used by decision makers to assess the tradeoffs and determine the appropriate balance between minimization of expected utility costs and these other considerations in selecting the preferred resource plan and developing contingency options. These considerations shall include, but are not necessarily limited to, mitigations of –

1. Risks associated with critical uncertain factors that will affect the actual costs associated with alternative resource plans;
2. Risks associated with new or more stringent environmental laws or regulations that may be imposed at some point within the planning horizon; and
3. Rate increases associated with alternative resource plans.

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3. The Commission's acceptance of Union Electric Company, d/b/a AmerenUE's 2005 integrated resource plan does not indicate Commission approval of the utility's resource plan, resource acquisition strategies or investment decisions.

4. This order shall become effective on February 18, 2007.

Davis, Chm., Murray, Gaw,
Clayton and Appling, CC., concur

Woodruff, Deputy Chief Regulatory Law Judge

*NOTE: The Stipulation and Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission

In the Matter of the Application of Central Jefferson County Utilities, Inc. for an Order Authorizing the Transfer and Assignment of Certain Water and Sewer Assets to Jefferson County Public Sewer District and in Connection Therewith, Certain Other Related Transactions*

Case No. SO-2007-0071, et al.

Sewer §4. The Commission ordered that the application of Central Jefferson County Utilities, Inc., for an order authorizing the transfer and assignment of certain water and sewer assets to Jefferson County Public Sewer District, filed on August 15, 2006, is approved.

Water §4. The Commission ordered that the application of Central Jefferson County Utilities, Inc., for an order authorizing the transfer and assignment of certain water and sewer assets to Jefferson County Public Sewer District, filed on August 15, 2006, is approved.

APPEARANCES

William R. England, Attorney for Central Jefferson County Utilities, Inc., Brydon, Swearingen & England, P.C., 312 East Capitol Avenue, P.O. Box 456, Jefferson City, Missouri 65102

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Mark. W. Comley, Attorney for Raintree Plantation Property Owners Association, Newman, Comley & Ruth P.C., 600 Monroe Street, Suite 301, P.O. Box 537, Jefferson City, Missouri 65102

Stanley Schnaare, Attorney for Raintree Plantation Property Owners Association, 321 Main Street, P.O. Box 440 Hillsboro, Missouri 63050

Michael J. Schmid, Attorney for the Missouri Department of Natural Resources, Schreimann, Rackers, Francka, & Blunt, LLC, 2316 St. Mary's Boulevard, Suite 130, Jefferson City, Missouri 65109

Christina L. Baker, Assistant Public Counsel, Office of the Public Counsel, P.O. Box 2230, Jefferson City, Missouri 65102

*This case was reversed and remanded by the Circuit Court of Cole County. Case No. 07AC-CC00444.

Keith R. Krueger, Deputy General Counsel, General Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission

REGULATORY LAW JUDGE:Harold Stearley, Judge

REPORT AND ORDER

Issue Date: February 8, 2007

Effective Date: February 28, 2007

Procedural History

On August 15, 2006, Central Jefferson County Utilities, Inc. ("Central Jefferson") filed applications seeking authorization to transfer and assign certain assets of its water and sewer operations to the Jefferson County Public Sewer District ("Sewer District"), Case Nos. SO-2007-0071 and WO-2007-0072. The applications included a copy of a proposed "Tri-Party Purchase and Sale Agreement" involving the transfer of the assets to the Sewer District, and the Sewer District entering into a long-term operation, maintenance and capital improvements agreement with Environmental Management Corporation ("EMC"). To facilitate the proceedings, the Commission consolidated these cases, designating Case No. SO-2007-0071 as the lead case.

On August 17, the Commission issued notice and joined the Sewer District and the Missouri Department of Natural Resources ("DNR") as parties to the action. The Commission also set an intervention deadline for September 6. On September 19, after filing a timely motion to intervene, Raintree Plantation Property Owners Association ("POA") was granted intervention. EMC was joined as a party on December 4, in response to the Office of the Public Counsel's unopposed motion to add EMC as a party. John Kolisch filed a late request to intervene on December 14, which was denied.

The parties identified two primary issues in this case: 1) Would the proposed transfer of Central Jefferson's water and sewer assets to the Sewer District be detrimental to the public interest; and 2) If the transfer of assets, as proposed, would be detrimental to the public interest, could the Commission impose conditions such that the transfer, as approved, would not be detrimental to the public interest? The proceedings culminated with an evidentiary hearing to address these issues on December 19-20.

Findings of Fact

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

1. Central Jefferson is a Missouri corporation engaged in providing water and sewer service in the areas of Missouri certificated to it by the Commission, specifically the provision of these services to the Raintree Plantation Subdivision ("Subdivision").
2. Central Jefferson's principal office and place of business is located at 1519 McNutt Road, Herculaneum, Missouri 63048.
3. Central Jefferson is owned equally in one-third shares by Jeremiah Nixon, Kenneth McClain and the trust of Norville McClain, Kenneth McClain's father.
4. Raintree Plantation, Inc. ("Raintree") is a Missouri corporation and is the developer of the Subdivision.
5. Raintree was incorporated at approximately the same time as Central Jefferson and is owned by the same three individuals.
6. The Subdivision is a planned development consisting of approximately 3,400 lots located in Jefferson County, Missouri.
7. Raintree installed water mains to serve all of the 3,400 lots in the Subdivision, and has installed sewer mains to serve about 3,000 of the lots; however, 400 lots do not yet have access to sewer mains.
8. Pursuant to the Lot Reservation Agreement executed by Raintree with each lot purchaser, all water and sewer lines were to have been completed by 1983.
9. Raintree donated the water and sewer mains to Central Jefferson.
10. To recover its costs from installing the water and sewer mains, Raintree requires the buyers of each lot to pay a connection fee for connecting to the water and sewer mains.
11. Raintree's connection fee is collected pursuant to an "Intrastate Exemption Statement" executed by Raintree and the purchaser of the lot.
12. Raintree's connection fee totals \$1,100.00 and is composed of a \$700.00 fee for sewer service, \$300.00 fee for water service and a \$100.00 fee for fire hydrant connection.
13. Raintree invested approximately four million dollars in the water and sewer facilities in the Subdivision.
14. Raintree has sold all but approximately 30 lots in the Subdivision.
15. The Subdivision currently has approximately 681 fully constructed homes that receive water and wastewater services from Central Jefferson.
16. Central Jefferson utilizes two wells for the Subdivision's water supply.
17. The water from Well No. 1 contains lead in excess of the 15 parts per billion that is permitted in drinking water by the Missouri

Department of Natural Resources ("DNR") and; consequently, when water is used from this well it must be mixed with water from Well No. 2 to have an acceptable lead content.

18. Water from Well No. 2 is used exclusively, except on days of high demand; however, this well has only one pump, and should this pump fail then only water from Well No. 1 would be available for drinking.

19. The water system currently has a storage tank with the capacity of 50,000 gallons, but the DNR states that the Subdivision should have a storage tank with a capacity to hold at minimum one day's water supply, which is 200,000 gallons. Average daily demand for the Subdivision in 2005 was 202,560 gallons, with peaks of 300,000 gallons in the summer months.

20. Central Jefferson's sewage treatment plant was originally constructed with an inflow capacity of 32,000 gallons per day, which was subsequently increased to 64,000 gallons per day. The 64,000 gallon per day design flow was for a design population equivalent to 636 people.

21. As a result of continued construction of homes in the Subdivision, the sewage inflow to the treatment plant exceeds its design capacity by averaging an inflow of 100,019 gallons per day or 56% over its daily design flow. Based on this inflow, the Subdivision currently has a population equivalent of 2320 people, which is 265% over its design population equivalent.

22. The wastewater treatment facility has exceeded its average design flow every month since July 2000, and this is dry weather flow.

23. Central Jefferson failed to submit its Discharge Monitoring Reports in a timely manner 85% of the time between 2000 and 2004.

24. Central Jefferson did not make reasonable efforts to eliminate or prevent the entry of surface or ground water into its sanitary sewer system, and has been unable to eliminate or prevent the entry of surface or ground water into its sanitary sewer system. In fact, Central Jefferson abandoned efforts to resolve this defect in its system.

25. The Norville McClain Trust, a one-third owner of Central Jefferson's common stock, refuses to invest additional money in the water and sewer systems for the Subdivision, and consequently, it is impossible for the remaining owners to provide the necessary improvements and expansion of the water and sewer facilities.

26. On September 27, 2004, the DNR issued a Notice of Violation to Central Jefferson finding it had violated the Missouri Clean Water Law, Sections 644.051(1) and (2) and 644.076.1, RSMo, and 10 CSR 20-7.031(3)(A),(B), and (C) for having caused pollution of Galligher Creek.

27. On August 4, 2005, the DNR issued a Notice of Violation to Central Jefferson finding it had violated the Missouri Clean Water Law, Section 644.076.1, and 10 CSR 20-7.015(9)(A)(1) and 9.020(2) for failing to retain a certified operator to supervise the operation and maintenance of

the wastewater treatment facility and for failing to submit complete or timely Discharge Monitoring Reports for May and June 2005.

28. On October 26, 2005, the DNR issued a Notice of Violation to Central Jefferson finding it had violated the Missouri Clean Water Law, Sections 644.051(1) and (2) and 644.076.1, and 10 CSR 20-6.010(1)(A) and 5(A) for having discharged wastewater into an unnamed tributary of Galligher Creek without a Missouri State Operating Permit, and for having caused pollution to the same tributary.

29. In total, the DNR has issued Central Jefferson a dozen Notices of Violation in connection with its operations in the Subdivision.

30. While Central Jefferson would not concede the violations charged by DNR, it did concede that it has been operating its sewer system above its design capacity and that it has failed to control ground and surface water entry into its system.

31. Central Jefferson does not presently satisfy the DNR's safe drinking water standards or sewage discharge standards.

32. On November 30, 2005, the United States Environmental Protection Agency ("EPA") issued a Finding of Violation and Order of Compliance, Docket No. CWA-07-2006-0060, finding that Central Jefferson discharged pollutants into the waters of the United States in violation of Section 301 of the Clean Water Act, 33 U.S.C. Section 1311 and Section 402 of the Clean Water Act, 33 U.S.C. Section 1342.

33. As part of the November 30, 2005 Order of Compliance, the EPA imposed a moratorium on connections to the sewage treatment facilities until the facilities were expanded and improved.

34. The EPA's ordered moratorium prohibits all new sewer connections to the wastewater treatment plant "unless and until a professional engineer registered and in good standing in the State of Missouri certifies in advance that the new connection to the sewage collection system will not result in the wastewater treatment plant exceeding its existing design average daily hydraulic capacity limit of 64,000 gallons per day."

35. On March 2, 2006, the EPA issued a second Finding of Violation and Order of Compliance, Docket No. CWA-07-2006-0060, finding that Central Jefferson discharged pollutants into the waters of the United States in violation of Section 301 of the Clean Water Act, 33 U.S.C. Section 1311 and Section 402 of the Clean Water Act, 33 U.S.C. Section 1342.

36. At the local public hearing held in conjunction with this matter on November 6, 2006, the home and property owners in the Subdivision provided sworn testimony expressing numerous complaints involving the quality and safety of the water and sewer service provided by Central Jefferson. Those complaints/problems include, but were not limited to:

- a. infrastructure deterioration and lack of maintenance of that infrastructure;
- b. inadequate trunk lines;

- c. ineffective straining system for nonorganic waste;
- d. micro-bacterial and inorganic contamination of the drinking water;
- e. unsafe lead level in Well 1;
- f. inadequate water storage capacity;
- g. inadequate sewer capacity resulting in the need to haul sludge out of the subdivision;
- h. homeowners having to clean manhole covers and collection boxes by hand to prevent the backup of sewage into their homes, three or four times a year since 1998;
- i. pump grinders that burn up;
- j. backflow of sewage into basements;
- k. raw sewage contaminating lawns, creeks and lakes;
- l. Central Jefferson's failure to flush out fire hydrants; and,
- m. Central Jefferson's failure to provide safe and adequate water and sewer service.

37. Central Jefferson responded to the complaints raised at the local public hearing, generally denying all allegations; however, it did not deny that its sewer treatment facility was operating beyond its daily inflow capacity, that it had less than one day's storage capacity for drinking water, or that it was unable to control ground and surface water entry into its sewer system. Central Jefferson also did not deny that the homeowners in the Subdivision were having to maintain the collection boxes to prevent sewage from backing up into their homes.

38. Central Jefferson does not provide safe and adequate water and sewer service.

39. Unable or unwilling to invest in improvements to the water and sewer facilities, Central Jefferson's owners have attempted to sell the companies' assets.

40. Central Jefferson and Aquasource Utility, Inc. ("Aquasource") executed a Stock Purchase Agreement whereby Aquasource was to acquire Central Jefferson's assets.

41. Aquasource is a Delaware corporation, and its affiliate Aqua Missouri, Inc., is a Missouri corporation, engaged in providing water and sewer service in the areas of Missouri.

42. On June 17, 1999, Raintree, Central Jefferson, and Aquasource executed a second agreement ("Connection Fee Agreement") in addition to, or as a part of, the Stock Purchase Agreement whereby Aquasource agreed to construct the remaining sewer mains that were needed in the Subdivision and Raintree would assign to Aquasource its rights to the connection fees paid to Raintree by the purchasers of those lots.

43. On February 14, 2000, Aquasource terminated its Stock Purchase Agreement with Central Jefferson by letter; however, the Connection Fee Agreement concerning constructing the remaining lines remained in dispute.

44. On May 15, 2001, Raintree, Central Jefferson, and Aquasource executed a Settlement Agreement and Amendment ("Settlement Agreement") in an attempt to settle a lawsuit arising from a claim of breach of the Connection Fee Agreement.

45. The Settlement Agreement reaffirms the obligations imposed by the Connection Fee Agreement pertaining to the installation of new sewer lines and collection of connection fees, provides for the dismissal of Count II of the lawsuit, and provides that all disputes arising under the terms of the Connection Fee Agreement be submitted to arbitration.

46. By virtue of the Connection Fee Agreement and the Settlement Agreement, Aquasource is responsible for installing the remaining 400 sewer lines.

47. Aquasource and Raintree still have an ongoing dispute regarding who will pay for the engineering costs associated with the installation of the remaining sewer lines.

48. On July 13, 2006, Central Jefferson, the Sewer District and EMC executed a "Tri-Party Purchase and Sale Agreement, whereby Central Jefferson would transfer certain assets of its sewer and water operations to the Sewer District in return for the Sewer District paying Central Jefferson's debt or approximately \$102,000.00 owed on the water tower serving the water system.

49. The Sewer District is a countywide sewer district formed by the Jefferson County Commission in June of 2000, pursuant to Sections 249.430 to 249.668.

50. The Sewer District Trustees are appointed by the County Commission, and the County Commission exercises control over the Sewer District, which has powers to "pass all necessary rules and regulations for the proper management and conduct of the business of the sewer district."

51. EMC is a Missouri corporation that partners with municipalities to manage water and wastewater systems.

52. EMC's principal office and place of business in Missouri is located at 1001 Boardwalk Springs Place, O'Fallon, Missouri 63368.

53. EMC has the necessary experience and capabilities with designing, constructing, operating and maintaining water and wastewater facilities to take over Central Jefferson's assets, bring the current water and wastewater systems into compliance with environmental regulations and expand these systems to accommodate current and expected future growth in the Subdivision.

54. As part of the Tri-Party Purchase and Sale Agreement, EMC will construct improvements to the water and sewer systems at a cost up to \$1.8 million, and will operate, improve, and maintain the water and sewer facilities for a period of 20 years.

55. As part of the Tri-Party Purchase and Sale Agreement, the Sewer District and EMC entered into a long-term operation, maintenance

and capital improvement agreement whereby the Sewer District will compensate EMC and provide sufficient revenue to compensate EMC for capital improvements to the water and sewer systems.

56. Paragraph 5.4 of Article V, Contingencies, of the Tri-Party Purchase Agreement, referred to as the PSC Approval Contingency, provides that: "Central Jefferson shall have one-hundred eighty (180) days following the Effective Date to obtain the consent of the Public Service Commission to Sewer District's acquisition of the Facility and the other property, if such approval is required."

57. Paragraph 5.4 of Article V, Contingencies, of the Tri-Party Purchase Agreement provides: "In the event the PSC Approval Contingency is not satisfied, there shall be no obligation on the part of Sewer District or EMC to close the transaction contemplated by this Agreement."

58. On August 31, 2006, Central Jefferson and EMC entered into an interim Agreement for Operation and Maintenance of Water and Water Treatment Facilities, whereby Central Jefferson engaged EMC to provide for the maintenance and operation of its water and wastewater systems beginning on September 1, 2006, to such date as the Tri-Party Purchase and Sale Agreement closed or was dissolved.

59. At the time of hearing, the Sewer District and EMC intended to execute a permanent operation and maintenance agreement that would become effective at the time Central Jefferson's assets were transferred to the Sewer District. A copy of the proposed agreement was admitted into evidence as Exhibit 5.

60. The Sewer District and EMC executed the permanent Utility Operation, Maintenance and Capital Improvement Agreement ("Permanent O & M Agreement") on January 16, 2007. The contract has a term of 20 years.

61. The Permanent O & M Agreement provides, inter alia, that EMC will operate and maintain the Sewer District's water and sewer facilities in the Subdivision and that the Sewer District would compensate EMC in the amounts of \$37.00 per home per month for sewer service, fixed rate for 20 years; \$6.30 per 1000 gallons of water, comprised of a charge of \$5.80 per 1000 gallons and a 50 cent per 1000 gallons administration charge for the Sewer District; and a tap-on fee of \$1,500.00 per new home construction.

62. EMC's compensation arrangement in the Permanent O & M Agreement is identical to EMC's draft pricing proposal for water and sewer rates presented at hearing that were to take effect upon implementation of the Tri-Party Agreement.

63. EMC's draft pricing proposal also includes an additional \$1,000.00 tap-on fee paid to the Sewer District to create a capital reserve fund. The capital reserve fund would be used for new construction for plant expansion or replacement of existing facilities.

64. To the extent that the Sewer District's 50 cent per 1000 gallons administration charge is not required for administrative expenses, the remaining amount would also go into the Sewer District's capital reserve fund.

65. EMC's draft pricing proposal also allows the Company to recover 6% return on capital investment and a 12% operating profit.

66. The Permanent O & M Agreement does not fix the rates that the Sewer District will charge its customers in the Subdivision.

67. On July 13, 2006, the Sewer District and Raintree executed a Sewer and Water Service Fee Agreement.

68. The Sewer and Water Service Fee Agreement delineates the specific connection fees that the Sewer District will collect that will then be paid through to Raintree.

69. The Sewer and Water Service Fee Agreement provides, *Inter alia*:

a. For each of the 400 lots that lack access to sewer mains, which Aquasource is required to construct, the Sewer District will pay Raintree \$1,100.00.

b. For each lot that is currently served by the existing water and sewer system, the Sewer District will pay Raintree \$800.00 until such time that Raintree's expenses, identified in paragraph 4 of the agreement, are paid. These expenses include: (1) engineering expenses already incurred; (2) engineering expenses for the new water and sewer systems to be completed by Aquasource; (3) cost of satisfaction of contingencies required for the Sewer District to take control of Central Jefferson's assets; (4) costs related to the closing and transfer of Central Jefferson's assets; (5) costs of responding to any investigative inquiries from any governmental entity within 5 years of the effective date of the agreement; and, (6) current and future attorney's fee related to the above mentioned expenses. Engineering expenses to date are \$61,705.36 and attorney's fees to date are \$65,031.73. This payment will absolve the lot owner's obligation to pay \$1,100.00 to Raintree pursuant to the Intrastate Exemption Statement.

c. For each lot that is currently served by the existing water and sewer system, after the expenses listed in (b) are paid, the Sewer District will pay Raintree \$550.00. This payment will absolve the lot owner's obligation to pay \$1,100.00 to Raintree pursuant to the Intrastate Exemption Statement.

d. Payments to Raintree, or its designee, from the Sewer District shall cease on the 15th year anniversary of the effective date of the agreement.

70. A breakdown of the various known connection fees a new customer in the Subdivision would pay is as follows:

a. A new customer would pay \$1,500.00 to the Sewer District, which it would pass through to EMC pursuant to the Permanent O & M Agreement.

b. A new customer would pay \$1,000.00 to the Sewer District, which would be deposited into the Sewer District's capital reserve fund.

c. A new customer would pay \$1,100.00, \$800.00 or \$550 to the Sewer District, which it would pass through to Raintree. Raintree would pass through \$1,100.00 to Aquasource for each of the 400 lots for which Aquasource is required to construct sewer mains, and would keep all of the payments of \$800.00 or \$550.00 as determined by Sewer and Water Service Fee Agreement.

71. A new customer in the Subdivision would pay minimum connection fees of \$3,050.00, or \$3,300.00, or \$3,600.00.

72. None of the various agreements before the Commission establishes the exact connection fee that the Sewer District will charge each new customer; they only establish what connection fees will be collected by EMC, paid by the Sewer District to Raintree, or which pass through to Aquasource.

73. The payment of connection fees to Raintree by the Sewer District, as described in the Sewer and Water Service Fee Agreement will absolve the lot owner's current obligation to pay \$1,100.00 to Raintree pursuant to the Intrastate Exemption Statement.

74. While the Sewer District has determined what connection fees will be collected and paid to EMC and Raintree, and what connection fees will go into its capital reserve fund, the actual total amount for connection fees the Sewer District will charge each new customer has not yet been determined.

75. Currently, the Sewer District plans to charge each customer \$6.30 per 1000 gallons of water, comprised of a charge of \$5.80 per 1000 gallons and a 50 cent per 1000 gallons administration charge for the Sewer District.

76. The Sewer District based its pricing on a predicted average use of 5000 gallons per month per household, which would result in a minimum bill of \$31.50 per month at the rate of \$6.30 per thousand gallons.

77. The Staff of the Missouri Public Service Commission testified that an average household would use 6250 gallons per month, resulting in a minimum monthly bill of \$39.38 at the rate of \$6.30 per thousand gallons.

78. The Office of the Public Counsel's witness, Ted Robertson, testified that average customer usage would be approximately 7000 gallons per month.

79. Utilizing Staff's average water usage calculation of 6250 gallons per month, EMC's commodity rate that it charges the Sewer District

could be reduced to \$5.04 per 1000 gallons of water without jeopardizing EMC's profitability.

80. The Sewer District will charge each customer in the Subdivision \$37.00 per home per month for sewer service, fixed rate for 20 years.

81. The Sewer District's proposed rates would take effect immediately upon the transfer of Central Jefferson's assets.

82. John Kolisch does not live in the Subdivision, but he is a customer of Central Jefferson. Mr. Kolisch paid the full cost of extending Central Jefferson's water and sewer lines to connect his neighboring business to Central Jefferson's water and sewer services.

83. Central Jefferson's Water Service Tariff, P.S.C. Mo. No. 1, Sheet 15, Rule 15(A)(3), Extension of Water Mains provides: Refunds of cost of extension shall be made to applicant(s) as follows:

a. Should the actual cost of extension be less than the estimated cost, the Company shall refund the difference as soon as the actual cost has been ascertained.

b. Company shall divide the actual cost of the extension by the number of lots abutting said extension to obtain the per lot extension cost. When counting lots, corner lots which abut an existing main shall be excluded. As additional customers are directly attached to the extension, these additional customers shall pay to the applicant the per lot construction cost for the lot being connected.

c. Each refund shall be paid directly to initial applicant(s) or their assigns, based upon the percentage of the actual extension cost contributed by each applicant.

84. Central Jefferson's Sewer Service Tariff, P.S.C. Mo. No. 1, Sheet 10.1, Rule 10(A)(3), Extension of Collecting Sewers provides: Refunds of cost of extension shall be made to applicant(s) as follows:

a. Should the actual cost of extension be less than the estimated cost, the Company shall refund the difference as soon as the actual cost has been ascertained.

b. Company shall divide the actual cost of the extension by the number of lots abutting said extension to obtain the per lot extension cost. When counting lots, corner lots which abut an existing main shall be excluded. As additional customers are directly attached to the extension, these additional customers shall pay to the applicant the per lot construction cost for the lot being connected.

c. Each refund shall be paid directly to initial applicant(s) or their assigns, based upon the percentage of the actual extension cost contributed by each applicant.

85. The extensions paid for by John Kolisch abut 9 lots that can connect to Central Jefferson's sewer system and 12 lots that can connect to Central Jefferson's water system.

86. The lots which would be required to make pro rata payments to Mr. Kolisch for connection to the water system are Lot Nos. 126 through

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137 of Section 5 (a total of twelve (12) lots). The lots which would be required to make pro rata payments to Mr. Kolisch for connection to the sewer system are Lot Nos. 129 through 134 of Section 5 and Lot Nos. 46, 47 and 49 of Section 1 (a total of nine (9) lots).

87. Pursuant to Central Jefferson's Tariffs, the refund that Mr. Kolisch should receive for each sewer connection to the extension is \$2,783.11 per lot and the refund Mr. Kolisch should receive for each water connection is \$799.83.

88. If the Commission approves the transfer of assets, Central Jefferson's Certificate of Convenience and Necessity and its Tariffs shall be canceled.

89. Once Central Jefferson's Tariffs are canceled, Central Jefferson's obligation to reimburse Mr. Kolisch will be extinguished.

90. Central Jefferson agrees with conditioning the transfer upon an amendment to the Sewer and Water Service Fee Agreement between Raintree and the Sewer District to ensure that Mr. Kolisch remains in the same position contractually as he does now for receiving his refunds from Central Jefferson's Tariffs.

91. The Sewer District agrees to condition the transfer on six of the thirteen conditions suggested by the POA, which are:

a. The POA and its members shall have the ability to participate in the process by which the Sewer District adjusts rates, fees and charges related to water and sewer service.

b. EMC and the Sewer District shall establish a schedule and funding device under which wastewater treatment capacity and water distribution and storage capacity are increased to accommodate projected growth in the Subdivision.

c. The transfer of assets shall not close until the "Compliance Agreement" between the District, EMC and the DNR is executed.

d. The transfer of assets shall not close until the Permanent O & M Agreement between the District and EMC is executed. Moreover, the Permanent O & M Agreement must cover timely response and repair of blocked collection lines and leaking or otherwise faulty transfer stations.

e. The potable water supply of Raintree is increased to the capacity suggested in the "Compliance Agreement" and the lead content is reduced to the minimal levels set by federal and state regulation.

f. The expanded potable water and wastewater treatment facilities are designated for the exclusive use of Raintree Subdivision's present and future homeowners.

92. DNR, EMC and the Sewer District have complied with condition (c) in Finding of Fact number 91, having executed a Compliance Agreement on January 17, 2007.

93. The Compliance Agreement provides, inter alia:

a. EMC and the Sewer District have agreed to add storage capacity and achieve compliance with Well 1, or modify Well 1, or contract a new well to achieve compliance with Chapter 640 with regard to the drinking water facility as soon as it can reasonably be achieved after the transfer of assets, and per an agreed-upon a compliance schedule included in the agreement.

b. EMC and the Sewer District have agreed to upgrade and/or replace the current wastewater treatment facility in order to achieve compliance with the Missouri Clean Water Law as soon as it can reasonably be achieved after the transfer of assets, and per an agreed upon a compliance schedule included in the agreement.

c. EMC and the Sewer District have agreed to submit a Sanitary Sewer Study and Improvement Plan (SSSIP) containing a priority-based schedule for implementation of improvements and upgrades to the DNR's Regional Office within 365 days of the transfer.

d. EMC and the Sewer District have stipulated to a schedule of penalties should EMC and/or the Sewer District fail to meet any deadline set forth in the compliance schedules included in the agreement.

94. EMC and the Sewer District have complied with condition (d) in Finding of Fact number 91, having executed a Permanent O & M Agreement on January 16, 2007.

95. Should the Commission approve the transfer, that approval will have no effect on any civil penalties for which Central Jefferson may be liable to the DNR or the EPA.

96. Should the Commission approve the transfer, that approval will have no effect on any civil penalties the Commission may seek against Central Jefferson in relation to its provision of water and sewer services while under the jurisdiction of the Commission.

Conclusions of Law

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

Jurisdiction and Authority

Central Jefferson is a "water corporation," a "sewer corporation" and a "public utility" as defined in Section 386.010(58), (48) and (42), and is subject to the jurisdiction, control and regulation of the Commission. The Jefferson County Public Sewer District is a countywide sewer district formed by the Jefferson County Commission in June of 2000, pursuant to Sections 249.430 to 249.668, as such is not subject to the jurisdiction, control and regulation of the Commission.

Standard for Approval for the Transfer of Assets

Section 393.190 provides, in pertinent part:

No gas corporation, electrical corporation, water corporation or sewer corporation shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public utility, without having first secured from the commission an order authorizing it so to do.

Section 393.190 does not set forth a standard or test for the Commission's approval of the proposed transfer of assets. However, the Missouri Supreme Court in *State ex rel. City of St. Louis v. Public Service Commission of Missouri* determined that Section 393.190's predecessor, Section 5195, RSMo 1929, recognized the standard for Commission's approval to be if the transaction so described is not detrimental to the public interest. This standard is further cemented by the Commission's own rules, which require an applicant for such authority to state in its application "[t]he reason the proposed sale of the assets is not detrimental to the public interest." "The Commission may not withhold its approval of the disposition of assets unless it can be shown that such disposition is detrimental to the public interest."

The Missouri Court of Appeals has stated of Section 393.190: "The obvious purpose of this provision is to ensure the continuation of adequate service to the public served by the utility." "To that end, the Commission has previously considered such factors as the applicant's experience in the utility industry; the applicant's history of service difficulties; the applicant's general financial health and ability to absorb the proposed transaction; and the applicant's ability to operate the assets safely and efficiently."

Provision of Safe and Adequate Service

Section 393.130.1 provides, in pertinent part: "Every gas corporation, every electrical corporation, every water corporation, and every sewer corporation shall furnish and provide such service instrumentalities and facilities as shall be safe and adequate and in all respects just and reasonable." While the safe and adequate service standard has not been articulated with particularity, and while the following list is not intended to be exhaustive, the Commission routinely examines regulated water and sewer companies with the following criteria in mind when assessing whether this standard has been met. Any water or sewer corporation must demonstrate, on an on-going basis, that:

- a. it has the technical, financial and managerial resources and ability to develop, operate and maintain a water and sewer system;
- b. its drinking water facility has been appropriately engineered, designed and constructed, and is properly licensed to provide sufficient capacity to meet the demands of the service area;
- c. its water supply and storage facilities do in fact have sufficient capacity to meet the demands of the service area;

d. its drinking water quality is in compliance with DNR, EPA and all state and local Department of Health regulations with regard to inorganic, organic and bacterial contaminants, and with all public health standards;

e. its sewer treatment facilities has been appropriately engineered, designed and constructed, and is properly licensed to provide sufficient capacity to meet the demands of the service area;

f. its sewer treatment facilities do in fact have sufficient capacity to meet the demands of the service area, thus adequate capacity to accommodate and appropriately treat the daily influent and effluent of the service area;

g. its sewer treatment facility is in compliance with DNR, EPA and all state and local Department of Health regulations with regard to contaminants, inflow and discharge capacity, safe discharge of effluent, and with all public health standards;

h. its infrastructure is of sufficient quality, is compliant with all relevant statutes and regulations, and is sufficiently maintained as to ensure the continuous delivery of water and/or sewer service to its service area.

Moreover, with regard to sewer utilities, Commission Rule 4 CSR 240-60.020 provides, in pertinent part:

(1) Each sewer utility shall maintain and operate a sewage treatment facility of adequate capacity and properly equipped to treat the sewage and discharge effluent of the quality required by the laws of the state of Missouri and in other respects shall comply with the laws and regulations of the state and local health authority.

(2) The design and construction of a utility's system of sewers, treatment facility and all additions and modifications shall conform to the requirements prescribed by law except that any rule contained in this chapter shall apply which is more stringent than those prescribed by the Clean Water Commission.

(3) The sewer utility shall make reasonable efforts to eliminate or prevent the entry of surface or ground water into its sanitary sewer system. It may request assistance from the appropriate state, county or municipal authorities, but such a request does not relieve the sewer utility of its responsibility to prevent the entry of such surface or ground water.

Penalties

Section 386.570 provides:

1. Any corporation, person or public utility which violates or fails to comply with any provision of the constitution of this state or of this or any other law, or which fails, omits or neglects to obey, observe or comply with any order, decision, decree, rule, direction, demand or requirement, or any part or provision thereof, of the commission in a case in which a penalty has not herein been provided for such corporation, person or public utility,

is subject to a penalty of not less than one hundred dollars nor more than two thousand dollars for each offense.

2. Every violation of the provisions of this or any other law or of any order, decision, decree, rule, direction, demand or requirement of the commission, or any part or portion thereof, by any corporation or person or public utility is a separate and distinct offense, and in case of a continuing violation each day's continuance thereof shall be and be deemed to be a separate and distinct offense.

3. In construing and enforcing the provisions of this chapter relating to penalties, the act, omission or failure of any officer, agent or employee of any corporation, person or public utility, acting within the scope of his official duties of employment, shall in every case be and be deemed to be the act, omission or failure of such corporation, person or public utility.

Section 386.600 authorizes the Commission to seek such penalties in the circuit court. It provides, in pertinent part:

An action to recover a penalty or a forfeiture under this chapter or to enforce the powers of the commission under this or any other law may be brought in any circuit court in this state in the name of the state of Missouri and shall be commenced and prosecuted to final judgment by the general counsel to the commission.

These statutes together authorize the Commission to seek penalties for failing to provide safe and adequate service. However, the Commission may only initiate such a lawsuit seeking penalties after holding a contested hearing.

Moreover, as another possible action by the Commission, Section 393.145.1 provides:

If, after hearing, the commission determines that any sewer or water corporation that regularly provides service to eight thousand or fewer customer connections is unable or unwilling to provide safe and adequate service, has been actually or effectively abandoned by its owners, or has defaulted on a bond, note or loan issued or guaranteed by any department, office, commission, board, authority or other unit of state government, the commission may petition the circuit court for an order attaching the assets of the utility and placing the utility under the control and responsibility of a receiver. The venue of such cases shall, at the option of the commission, be in the circuit court of Cole County or in the circuit court of the county in which the utility company has its principal place of business.

Consequently, the Commission could, after hearing and after making a determination that Central Jefferson has not provided, or is unable or unwilling to provide, safe and adequate service, or has actually or effectively abandoned its operations, seek penalties or order its general counsel to petition the circuit court for the appointment of a receiver.

Decision

The Commission in making this decision has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision. After applying the facts, as it has found them, to its conclusions of law, the Commission has reached the following decision.

The Commission concludes that there is substantial and competent evidence on the record as a whole that Central Jefferson does not provide safe and adequate water service. The sworn testimony of Todd Thomas, civil engineer and vice president and general manager of EMC; Kenneth McClain, President and one of the owners of Central Jefferson; the witnesses at the local public hearing held in this matter, and the DNR Report of Compliance, all support this conclusion. Even though Lance Dorsey, environmental specialist for the DNR, testified that there were no outstanding compliance or enforcement actions against Central Jefferson with regard to its provision of drinking water, this is not the sole criteria for determining if safe and adequate service is being provided.

Given the lead contamination of Well 1, the lack of adequate water storage capacity for uncontaminated water or even for a blend of water from Wells 1 and 2, and the fact that no back up equipment or plans are in place should the pump on Well 2 fail, the residents of the Subdivision are situated in a precarious position. When asked what Central Jefferson would do if the pump failed on Well 2 failed, Mr. McClain's stated:

If No. 2 does go offline, then they have – there's supposed to be notice sent out, signed in front of Raintree and however they notify the people. If it goes out, not to drink the water. It's usable, just not to drink it."

Providing a warning to residents that they only have contaminated drinking water in the event of equipment failure is not adequately providing for the continuous delivery of safe and adequate water service. Lacking sufficient storage capacity to provide even one day's worth of water usage for the service area is not consistent with the provision of safe and adequate water service. One only need look to the recent storm related electrical outages in Union Electric's service areas to appreciate the threat of not having adequate storage or contingency plans, and, having to rely on Central Jefferson's established track record for the operation and maintenance of the water system is simply not comforting to this Commission. Central Jefferson has proved that it no longer has the technical and managerial ability to develop, operate and maintain a water system.

Additionally, the Commission concludes that there is substantial and competent evidence on the record as a whole that Central Jefferson fails to provide safe and adequate sewer service. The sewer system is continually operating beyond its design capacity and sewage from this system is reported to be contaminating surrounding lakes, creeks, yards and basements. The EPA's findings of violation and moratorium on new connections to the sewer system, as well as the numerous DNR violations, speak for themselves. Additionally, it would appear that Central Jefferson is in violation of Commission Rule 4 CSR 240-60.020, not only for exceeding the system's design capacity and for failure to comply with environmental

and health regulations, but also for its failure to control the surface and ground water that drains into its system.

Clearly, Central Jefferson has allowed its water and sewer system to decay, and its owners have expressed a lack of willingness or lack of capacity to bring these systems into compliance with environmental regulations or to expand and improve the system to provide safe and adequate service to its current and future customers. Bearing this in mind, the Commission concludes that it is not detrimental to the public interest to approve the transfer of Central Jefferson's assets and operations to the Sewer District, which has contracted with a competent company, EMC, to operate, maintain and expand the current facilities.

The current proposal for transfer of Central Jefferson's assets, however, shall be conditioned. The conditions imposed will include those the Sewer District has consented to at hearing and the condition Central Jefferson has consented to with regard to placing Mr. Kolisch in the same legal position as he now stands in relation to his ability to collect reimbursement for the extensions to the system that he has provided. The Commission might prefer to add additional conditions to this transfer; however, the Commission recognizes its need to show measured restraint to ensure that the property and home owners in the Subdivision receive safe and adequate service as expeditiously as possible and that the current facilities are expanded to accommodate future growth in the Subdivision.

While the Commission lacks jurisdiction and authority over the Sewer District and Raintree, and has no standing to challenge the "side dealings" surrounding this transaction, the Commission expresses its extreme displeasure with the Sewer and Water Service Fee Agreement executed between these parties. This agreement funnels connection fees from the property owners back to Raintree for the questionable consideration of enforcing a contract with Aquasource, a duty Raintree already has, and for ill defined contributions that Raintree has made to Central Jefferson for various engineering and legal expenses. Simply put, this transaction does not pass the "smell test." Perhaps another party with standing will have the opportunity to challenge this transaction considering the proximity of the corporate entities and owners of Raintree and Central Jefferson.

Nevertheless, the Commission has the authority to seek penalties against Central Jefferson for any violations of state statutes, Commission Rules, and the Company's tariff provisions. The hearing held in this matter was a contested hearing, and the issues identified by the parties and adopted by the Commission clearly contemplated that Central Jefferson's compliance with the statutes and regulations surrounding the operation and maintenance of its water and sewer facilities were at issue when determining if the transfer of assets was in the public interest. In addition, the Commission specifically ordered DNR's compliance report and the DNR presented live testimony concerning environmental and capacity issues. Central Jefferson was provided adequate time to prepare its responses and to present evidence and cross-examine the witnesses in this case. Central Jefferson also was represented at the local public hearing, and had adequate opportunity to cross-examine the witnesses testifying at that hearing.

While Central Jefferson would not concede to the violations charged by DNR, or to numerous complaints raised at public hearing, it did concede that it has been

operating its water system without adequate storage capacity, that it has been operating its sewer system above its design capacity and that it has failed to control ground and surface water entry into its system. Central Jefferson failed to controvert the overwhelming evidence supporting its substandard operation of its water and wastewater treatment facilities.

Consequently, the Commission shall order its General Counsel to seek the maximum amount in penalties from Central Jefferson for the following violations:

a. Every violation of the Missouri Clean Water Act, Sections 644.051(1) and (2), and Section 644.076.1, as found by the DNR, is a violation of Commission Rule 4 CSR 240-60.020.1, in that Central Jefferson failed to maintain and operate a sewage treatment facility of adequate capacity and properly equipped to treat the sewage and discharge effluent of the quality required by the laws of the state of Missouri and in other respects failed to comply with the laws and regulations of the state and local health authority. Each violation is a separate and distinct offense, and each day forward from the date that DNR found the violation, and Central Jefferson failed to bring its system into compliance, is a separate and distinct offense.

b. Every violation of 10 CSR 20-6.010(1)(A) & 5(A), 10 CSR 20-7.015(9)(A)(1), 10 CSR 20-7.031(3)(A), (B), & (C), and 10 CSR 20-9.020(2), as found by the DNR, is a violation of Commission Rule 4 CSR 240-60.020.1, in that Central Jefferson failed to maintain and operate a sewage treatment facility of adequate capacity and properly equipped to treat the sewage and discharge effluent of the quality required by the laws of the state of Missouri and in other respects failed to comply with the laws and regulations of the state and local health authority. Each violation is a separate and distinct offense, and each day forward from the date that DNR found the violation, and Central Jefferson failed to bring its system into compliance, is a separate and distinct offense.

c. Each day that the capacity of Central Jefferson wastewater treatment facility was exceeded was a failure of Central Jefferson to maintain and operate its sewage treatment facility with adequate capacity and is a violation of Commission Rule 4 CSR 240-60.020.1 and Section 393.130.1. Central Jefferson's sewer treatment facility capacity has been exceeded every day since on or about July 1, 2000, each day thereafter being a separate and distinct offense.

d. Each day that Central Jefferson failed to make reasonable efforts to eliminate or prevent the entry of surface or ground water, and each day that Central Jefferson did in fact fail to eliminate or prevent the entry of surface or ground water, into its sanitary sewer system is a violation of Commission Rule 4 CSR 240-60.020.3 and Section 393.130.1. This problem was identified as arising on or about December 1, 2003, each day forward being a separate and distinct offense.

e. Each day that Central Jefferson has been unable to provide adequate storage of uncontaminated drinking water, to ensure the safe and adequate provision of water services is a violation of Section

393.130.1. DNR documented annual water consumption figures exceeding the demand of Central Jefferson's storage capacity in 2005. Consequently, each day forward from on or about January 1, 2005 when adequate reserves were unavailable is a separate and distinct offense.

Should the General Counsel wish to develop additional factual support for the violations found in this contested hearing, or to support additional violations for which a penalty is authorized, then it shall file a complaint with the Commission against Central Jefferson asserting any allegations the General Counsel wishes to pursue.

IT IS ORDERED THAT:

1. The application of Central Jefferson County Utilities, Inc., for an order authorizing the transfer and assignment of certain water and sewer assets to Jefferson County Public Sewer District, filed on August 15, 2006, is approved, subject to the conditions outlined in the body of this order, specifically delineated in Findings of Fact numbers 90 and 91.

2. Central Jefferson County Utilities, Inc., is authorized to take any and all lawful actions necessary to carry out the proposed sale of assets.

3. Central Jefferson County Utilities, Inc., shall file a report in this case stating the status of the transactions no later than March 9, 2007, and continuing every 30 days until it has notified the Commission that all the transactions have been completed.

4. After the transactions have been completed, in an additional order, the Commission will relieve Central Jefferson County Utilities, Inc., of its obligation to provide water and sewer service to the public in its assigned service area and will cancel its certificate and tariff.

5. The General Counsel of the Missouri Public Service Commission is hereby authorized to seek penalties against Central Jefferson County Utilities, Inc., pursuant to Section 386.570, RSMo 2000, in the Circuit Court of appropriate venue, for any and all violations of state statutes, Commission Rules, or the Company's tariff provisions as identified in the body of this order.

6. The General Counsel of the Missouri Public Service Commission shall file its action seeking penalties before the effective date of this order.

7. The General Counsel of the Missouri Public Service Commission is further authorized to file a complaint action against Central Jefferson County Utilities, Inc., as described in the body of this order. Should the General Counsel elect to pursue a complaint, it shall file that action before the effective date of this order.

8. The Commission does not waive its right to seek penalties under Sections 392.210 and 386.570, RSMo, for failure to timely file annual reports or pay assessments.

9. All objections not ruled on are overruled and all motions not granted are denied.

10. This order shall become effective on February 28, 2007.

ATMOS ENERGY CORPORATION

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15 Mo. P.S.C. 3d

Davis, Chm., Murray, Gaw,
Clayton and Appling, CC., concur
and certify compliance with the
provisions of Section 536.080, RSMo 2000.

Stearley, Regulatory Law Judge

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of Atmos.*

Case No. GR-2006-0387
Tariff No. YG-2006-0762

Gas §18. The Commission rejected the general rate increase originally requested by Atmos Energy Corporation and also authorized Atmos to file new tariff sheets in compliance with this order. The Commission reported that the status quo rate design was just and reasonable and that the volumetric rates encourage conservation. The Commission also clarified that if Atmos filed new tariff sheets with the new fixed monthly charge rate design, it shall also implement an efficiency and conservation program as set out within this report. Otherwise, the Commission found that Atmos shall maintain its current rate structure with no additional revenue required.

APPEARANCES

James M. Fischer and **Larry W. Dority**, Fischer & Dority, P.C., 101 Madison Street, Suite 400, Jefferson City, Missouri 65101, for Atmos Energy Corporation.

Douglas C. Walther, Associate General Counsel, Atmos Energy Corporation, Post Office Box 650205, Dallas, Texas 75265-0205, for Atmos Energy Corporation.

David Woodsmall, Finnegan, Conrad & Peterson, 428 East Capitol Avenue, Suite 300, Jefferson City, Missouri 65101, for Hannibal Regional Hospital.

Robin E. Fulton, Schnapp, Fulton, Fall, Silvey & Reid, L.L.C., 135 East Main Street, Fredericktown, Missouri 63645, for Noranda Aluminum, Inc.

Marc D. Poston, Senior Public Counsel, Office of the Public Counsel, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Kevin A. Thompson, General Counsel, **Lera L. Shemwell**, Senior Counsel, and **Robert S. Berlin**, Associate General Counsel, Missouri Public Service Commission,

*This case was appealed to the Missouri Court of Appeals (WD 70219) and affirmed. See 289 S.W.3d 240 (Mo. App. WD 2009).

ATMOS ENERGY CORPORATION

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15 Mo. P.S.C. 3d

Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Nancy Dippell, Deputy Chief Regulatory Law Judge.

REPORT AND ORDER

Issue Date: February 22, 2007

Effective Date: March 4, 2007

Syllabus: This order rejects the general rate increase originally requested by Atmos Energy Corporation. The order also authorizes Atmos to file new tariff sheets in compliance with this order. If Atmos files new tariff sheets with the new fixed monthly charge rate design, it shall also implement an efficiency and conservation program as set out herein. Otherwise, the Commission finds that Atmos shall maintain its current rate structure with no additional revenue required.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Procedural History

On April 7, 2006, Atmos filed revised tariff sheets which set forth revised rate schedules and certain revised charges for all of Atmos' service territories in the state of Missouri, designed to produce an increase of approximately \$3.4 million in new revenues for Atmos. The new rate schedules would increase revenues to provide an overall rate of return on rate base of 8.59 percent on the test year rate base of \$56.0 million.¹

Atmos is the largest pure natural gas distribution company in the United States, with corporate offices located in Dallas, Texas. Atmos is comprised of six gas utility operating divisions, and its Mid-States Division (located in Franklin, Tennessee) provides natural gas distribution service in Missouri, Tennessee, Virginia, Georgia, Kentucky, Illinois and Iowa. Regional and state offices for the Missouri operations are located in Hannibal, Jackson and Sikeston. Atmos serves approximately 60,000

¹ Ex. 1, pp. 5-6, 10-11.

customers in Missouri, and the customer base includes residential, commercial and industrial customers. Employing a Missouri-based work force of approximately 75 employees, Atmos' utility plant in Missouri includes over 2,150 miles of transmission and distribution lines.²

Atmos' Missouri operations are comprised of six base rate areas located in the northeast, southeast and west-central areas of Missouri, and are the result of the following acquisitions: Greeley Gas Company purchased in 1993; United Cities Gas Company purchased in 1997; and Associated Natural Gas Company purchased in 2000.³

Atmos had not filed for a rate case since acquiring these Missouri service areas, so the rates for each district were set when the preceding LDC had its last rate case. United Cities filed its last rate request in Missouri in 1994, and rates were approved and implemented in 1995. The last rate increase affecting the utility properties Atmos acquired from ANG was filed, approved and implemented in 1997.⁴

A "Joint Issues List, List of Witnesses and Order of Cross-Examination" was filed by the Staff of the Commission on behalf of the parties, on November 14, 2006. As set forth in the "Joint List of Issues," the parties identified the following issues as being resolved:

1. Billing Determinants
2. Research and Development Rider
3. Noranda (all issues)
4. Class share of revenue by district
5. Uncollectibles in the PGA
6. Customer Service Issues
7. Class Cost of Service

In addition, local public hearings, a rate design technical conference, a settlement conference and evidentiary hearings were held in this matter. The parties each submitted prehearing and post hearing briefs, or a statement declining to do so. The post hearing briefs were submitted on January 19, 2007.

On December 12, 2006, the second part of Exhibit 144 was filed by Staff. No objection to the exhibit was received, and it is hereby admitted into evidence.

The Partial Stipulation and Agreement

In addition to the issues identified as being resolved in the Joint Issues List of November 14, 2006, Atmos, Staff and the Office of the Public Counsel submitted their Partial Non Unanimous Stipulation and Agreement to the Commission for approval on November 29, 2006. The Agreement sets forth additional issues settled among those parties. Staff filed its memorandum in support of the Agreement on

² Ex. 1, pp. 4-5, 10.

³ Ex. 1, p. 3; Ex. 110, pp. 1-2.

⁴ Ex. 1, p. 5; Ex. 110, p. 3.

December 12, 2006. No party opposed the Agreement. Therefore, as permitted by Commission Rule 4 CSR 240 2.115, the Commission shall treat the Agreement, attached to this Report and Order as Attachment A, as if it were unanimous. The Commission finds the Agreement just and reasonable and, therefore, approves it. In its discussion of the issues as set forth by the parties, the Commission will identify and address those specific components that have been resolved pursuant to the Agreement.

The Issues

1. What is the appropriate revenue requirement?

- a. What is the appropriate level of expense?**
- b. What is the appropriate rate of return / return on equity?**
- c. What is the appropriate level of revenue excess / deficiency?**

Ratemaking involves two successive processes. First is the determination of the revenue requirement; the amount of revenue the utility must receive to pay the costs of producing utility service while yielding a reasonable rate of return to the investors. The second process is rate design, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers.

Atmos' gross annualized revenue of \$16,507,737 was stipulated to in the Partial Non Unanimous Stipulation and Agreement. Atmos' revised tariff sheets as originally proposed would have increased revenues to provide an overall rate of return on rate base of 8.59 percent on the test year rate base of \$56.0 million. The original proposal also contained a weather mitigation adjustment in the rates. Atmos' requested return on common equity (ROE) in this case was 12 percent.

Staff initially calculated a \$1.2 million revenue excess. Staff is not seeking a revenue reduction or filing an excess earnings complaint. After evaluating the positions of the parties (a difference of \$4.4 million), Staff believed there was a significant chance that it would not prevail in its entire revenue reduction. Furthermore, if Staff failed to prevail on all its issues, Staff believed that Atmos might end up with a revenue increase. And, given that ROE was an issue worth \$1 million, Staff believed the Commission might easily determine that a zero revenue requirement or even a positive change was necessary. Thus, it is Staff's opinion that a zero change in cost of service on a total company basis will still result in just and reasonable rates. Instead of a revenue reduction, Staff is now advocating a change from Atmos' current rate design, to a fixed monthly delivery charge for non gas costs.

Staff originally proposed a ROE of 8.59 percent to 9.39 percent. Because Staff has advocated a zero change in revenue requirement with a new rate design, Staff no longer advocates a particular ROE. Instead, Staff recommends the revenues stay the same.

After reviewing Staff's proposed new rate design, Atmos abandoned its rate increase proposal and is advocating adopting Staff's fixed monthly delivery charge rate design with the slight modification of "sculpting" rates so that the summer charge is less than the winter charge while overall annual revenues stay the same.

Public Counsel recommends that the Commission find that rates should be reduced based upon the initial revenue requirement position of the Staff. Public Counsel did not file any direct testimony in this case regarding the overall revenue requirement. Public Counsel also has not filed a complaint against the reasonableness of Atmos' existing rates.

The Commission finds, based on the evidence regarding rate of return and the positions of the parties, that regardless of the rate design, no change in cost of service, on a total company basis, is necessary to produce just and reasonable rates. As a result, the Commission finds that the answer to subpart c of this issue – What is the appropriate level of revenue excess/deficiency? – is zero. Having made this determination, the first two subparts of this issue (a. What is the appropriate level of expense? and b. What is the appropriate rate of return/return on equity?) are rendered moot. Nevertheless, the Commission will address Public Counsel's position on these issues.

Public Counsel's witness, Mr. Trippensee, sponsored cost of common equity rebuttal testimony suggesting that the Commission use a seven percent ROE in this proceeding if Staff's rate design proposal is adopted. Public Counsel believes this reduction in ROE is necessary to offset the corresponding elimination of weather variability and other business risk for Atmos. Mr. Trippensee attempted to quantify the risk reduction that he believed was associated with the fixed delivery charge rate design. However, as explained further below, the seven percent ROE was calculated using a methodology which is very problematic and is not a method typically relied on by experts in the field.

Both Atmos and Staff's witnesses on this issue, Dr. Donald A. Murry and Mr. Matthew Barnes, thoroughly rebutted Mr. Trippensee's proposal and established that such recommendation was not supported by any commonly accepted rate of return analysis. Mr. Trippensee was also unable to offer any authority in support of his methodology, which Dr. Murry described as "just unorthodox opinion." Furthermore, Mr. Trippensee "did not analyze the cost of common equity of companies that may have similar risk characteristics as those that may be in effect for Atmos' Missouri operations" and "did not even recognize that many of [Staff's] . . . comparable companies have weather mitigation rate designs that minimize risks related to changes in the weather."

As Dr. Murry explained in detail in his Surrebuttal Testimony and on the witness stand, contrary to the criticism that Staff's analysis does not consider the decreased business risk associated with its proposed rate design, seven of the eight companies that Mr. Barnes identified as comparable to Atmos operate under some type of revenue stabilization mechanisms for their residential and small commercial customers. In addition, Mr. Barnes confirmed that there was no need for further reduction in his recommended ROE because risk is already reflected in his comparable group analysis. The evidence also revealed that Atlanta Gas and Light, one of the comparable companies, has a rate design similar to what Staff is proposing in this case. That company has been authorized a 10.9 percent return on equity. Mr. Barnes further testified that Staff proposed a "range" of ROEs in this case, as it typically does, which covers a variety of risks affecting the companies.

The Commission finds that Mr. Barnes' analysis of comparable companies includes some degree of risk reduction based on the fact that most of the companies have weather mitigation elements. While Mr. Trippensee had some valid arguments about the need for risk to be considered, his proposed ROE was not reasonable and the Commission finds his methodology to be unreliable.

Based on all the foregoing evidence, the Commission finds that there is zero net additional revenue requirement necessary in order for Atmos to achieve its stipulated gross annualized revenue of \$16,507,737. The Commission finds that rates designed to produce a zero net revenue increase are just and reasonable in that they meet Atmos' prudent operating expenses and, based on the analysis of Staff of comparable companies, allow an opportunity to earn a reasonable return on the value of the private property dedicated to public service.

This finding that no change in revenue requirement is necessary does not mean, however, that the Commission accepts Staff and Atmos' fixed delivery charge rate design proposal *carte blanche*. Rather, as will be explained below, the Commission has determined that a fixed delivery charge is not acceptable without a substantial energy efficiency and conservation program.

2. What is the appropriate treatment of depreciation and should depreciation expense be reduced by a depreciation reserve amortization?

Record Keeping and Reporting

Depreciation Record Keeping and Reporting has been settled in accordance with the Partial Non Unanimous Stipulation and Agreement.

Depreciation Reserve Amortization

Staff and Atmos have proposed a negative amortization of the depreciation reserve in the amount of \$591,000. This approach would be implemented by entering a negative amortization of \$591,000 into the depreciation reserve account 108. This would provide an immediate benefit to Atmos' customers by lowering Atmos' depreciation expense to a level that Staff believes is appropriate.

Public Counsel objects to this negative amortization based on Atmos providing insufficient data for the Staff to perform an accurate depreciation analysis. Public Counsel also objects because it argues that the negative amortization will require Atmos to reinvest moneys already paid by ratepayers in order to reduce current rates, and will require the customers to pay a return "on and of" these amounts in future rates.

Staff's witness, Mr. Gilbert, testified that he was unable to verify the accuracy of Atmos' data and records and "accepted [Atmos] management's recognition and acknowledgment of an over-accrual of depreciation." Mr. Gilbert admitted that future ratepayers would be required to repay the \$591,000, but testified that ratepayers would pay less with the negative amortization than they would pay in rates with different depreciation rates. Mr. Gilbert gave the following example:

[I]f we were to use an example of 10 percent for the return on equity for that additional \$591,000 of rate base, it would cost ...[the ratepayers] \$59,100 a year as

opposed to savings of \$591,000 a year in depreciation expense. So, the difference of those two would be the net savings to the current ratepayers.

Although there might be different methods of achieving the same goal, with the negative amortization, future rates to customers will be less than if the \$591,000 was reflected in lower depreciation rates. This method of amortization has often been used by both Staff and other utility companies to offset depreciation over- and under-accruals in reserve account 108. In this instance, the amortization would offset an over-accrual to the depreciation reserve.

The Commission finds that, as a whole, the annual depreciation accrual should be reduced by approximately \$591,000. The Commission further finds that entering a negative amortization of \$591,000 to the depreciation reserve account provides an immediate benefit to Atmos' customers by lowering Atmos' depreciation expense. The Commission finds that the benefits of the negative amortization outweigh any potential harm and that the negative amortization is therefore just and reasonable.

3. What is the appropriate rate design?

- a. **What is the appropriate rate structure for residential, small, and medium general service?**
- b. **What is the appropriate structure for the small general service rate (including the medium general service rate if the small general service class is split)?**

Rate Design

Atmos currently has a "traditional" residential base rate design consisting of a customer charge and a volumetric rate. Under the traditional rate design, residential non-gas margin costs are collected using both a monthly customer charge, which does not vary with usage, and a volumetric charge levied on each Ccf consumed. Non-gas margin costs make up only a portion of a residential customer's total monthly bill. The actual gas cost portion of the bill, called the purchased gas adjustment or PGA, makes up the rest. For the average customer, this is about 80 percent of the total.

In the current case, Staff has proposed a shift from the traditional two-part base rate design to a design in which all non-gas costs are recovered in one fixed monthly charge. This type of fixed delivery charge is often termed a "straight fixed variable" rate design.

For residential and small general service classes Staff recommends recovering the entire amount of the non-gas, or margin, costs in a fixed monthly delivery charge. Staff believes this proposed rate structure will address two significant current issues affecting the natural gas distribution market: 1) remove disincentives for utilities to encourage and assist customers in making conservation and efficiency investments; and 2) reduce the effects of weather on utility revenues and customer bills.

Under Staff's proposal, each of Atmos' three service areas, Western Missouri (WEMO), Northeast (NEMO), and Southeast (SEMO), would have a unique fixed delivery charge that is based, per the Agreement, on the revenues generated by the

current residential customers within that geographic service area. Staff's proposed fixed monthly delivery charges are as follows:

SEMO (includes Neelyville) \$13.92 / month
 WEMO (Butler and Greeley) \$19.43 / month
 NEMO (Kirksville; Palmyra; Hannibal; Canton;
 Bowling Green) \$20.61 / month

Staff argues that maintaining the "status quo" rate structure:

1. forces Residential customers whose usage is greater than the average to pay more than the cost required to serve them, while allowing smaller customers to underpay their cost-of-service;
2. discriminates between identical Residential customers in contiguous districts by charging different non-gas margin rates;
3. creates unnecessary volatility in customer bills by collecting a larger portion of customers' cost-of-service in the winter;
4. provides no incentive for utilities' to aggressively promote customer efficiency and conservation to their customers; and a utility doing so would be acting contrary to its shareholder interests;
5. sends incorrect price signals to Residential customers; and
6. does nothing to address Senate Bill 179.

Atmos' original rate design proposal embodied a weather normalization adjustment. However, Atmos' witnesses testified that after careful consideration of the Staff's rate design proposal, Atmos supports the adoption of the Staff's rate design recommendations in lieu of the weather normalization adjustment.

As Staff's witness, Ms. Ross, testified, there is a "rapidly-changing environment" with regard to natural gas distribution. Ms. Ross explained that "[a]pproximately five years ago, natural gas prices increased dramatically, and did not return to their previous levels." This increase in prices caused residential customer bills to double. In addition, the non-gas portion of a customer's bill went from being approximately 60 percent of the total monthly bill to being approximately 20 to 25 percent of the total monthly bill.

In addressing the fixed delivery charge rate design proposal, Ms. Ross explained that the Staff rationale has changed over the years. And, that on a national basis, there has been much discussion about conservation and "decoupling," or separating the delivery costs from the volumetric costs. Ms. Ross specifically references a November 2005, National Association of Regulatory Utility Commissioners (NARUC) Resolution on Energy Efficiency and Innovative Rate Design. That resolution calls for state commissions and other policy makers to consider new rate designs that will encourage energy conservation and energy efficiency.

Public Counsel opposes Staff's rate design proposal and advocates maintaining the status quo. Public Counsel argues that the fixed delivery charge rate design is harmful to consumers because: (1) the effect of the proposal is truly not known without sufficient studies; (2) customer efforts to conserve energy will be negated; (3) no conservation or efficiency programs have been introduced; and (4) it will be

contrary to good public policy in that it will shift a substantial portion of the cost to the lowest use customers.

The Commission has set natural gas rates as a two-part base rate for many years and found those rates to be just and reasonable. There is no way of knowing 100 percent of the effects a fixed rate design will have on the ratepayers without having actually experienced such a design. However, the Commission finds the decision by Atmos to abandon its request for a \$3.4 million revenue increase in its entirety is sufficient reason to overcome any doubts about the proposed rate design. Especially when considering that even a portion of that revenue increase, if found just and reasonable, could have a traumatic effect when spread out over the approximately 60,000 customers served by Atmos. The Commission further finds that such a rate design is worthwhile so long as it is accompanied by an energy conservation program.

The current rates are designed with a conservation incentive "built in" in that the less gas a customer uses the less that customer will pay. The current rate design encourages conservation by increasing the minimum monthly bill paid by the customer. The rationale is that customers will notice a change in their fixed monthly bill charge and adjust their behavior appropriately. Requiring the company to initiate a conservation program is further insurance that the fixed delivery charge rate design will promote conservation. Thus, in order to change the rate structure, the Commission finds that a conservation program of significant size would be necessary to offset any loss of traditional rate design conservation incentive.

The evidentiary record rebuts Public Counsel's second argument. Under Staff's rate design, customer efforts to conserve energy will not be negated. Eighty percent of a customer's total bill is purchased gas cost. Even under Staff's proposed rate design where the volumetric portion of non gas cost is removed in favor of a fixed delivery charge, the customer is still going to have a great incentive to reduce consumption in order to reduce 80 percent of that customer's bill. Thus, consumption is going to be largely driven by the wholesale cost of gas. In addition, by removing the disincentive that Atmos has for encouraging consumption, there is the potential for even greater conservation and efficiency to occur through a comprehensive program funded by the company.

Public Counsel next argues that no conservation or efficiency programs have been introduced. Public Counsel's argument is not accurate. It would be more accurate to say that Atmos has not introduced a sufficient program. With the change in rate design, Atmos has committed to spend \$78,000 for low income weatherization (\$2,600 per household for 30 customers) and has agreed to institute a residential efficiency audit program for all residential customers (approximately 50,000) – not just low-income customers. The audit program will cost the customer \$25, and Atmos will pay the additional cost of the estimated \$60 to \$100 total cost per audit. Atmos witness, Patricia Childers, also testified that Atmos will participate in collaborative meetings with Staff and Public Counsel to provide any further "details" that may be necessary.

Public Counsel did not come forward in this proceeding with any weatherization or efficiency proposals that could assist in encouraging energy conservation or

efficiency. Further, Ms. Meisenheimer makes it clear that no conservation proposals would be presented by Public Counsel in connection with the Staff's rate design proposal. Ms. Meisenheimer also testified that she could not support any fixed delivery charge that recovered 100 percent of the non gas cost. Ms. Meisenheimer did state, however, that she agreed that this type of rate design could be just the "carrot" to involve companies in energy conservation programs.

Finally, Public Counsel asserted that the delivery charge proposal will be contrary to good public policy in that it will shift a substantial portion of the cost to the lowest use customers. The customer demographics for Atmos regarding average residential annual Ccf usage, along with the annual Ccf consumption for various typical residential end uses, is depicted on Staff Exhibit 142. Exhibit 142 shows that space heating is the major area of consumption at 640 Ccf annually. The next largest area of consumption is water heating at 288 Ccf, gas fireplace inserts at 84 Ccf, and then gas cooking stoves at 24 Ccf. However, the evidence shows that currently the low use customer is being subsidized. For example, Ms. Ross testified that a customer who uses gas only for cooking will have the same equipment (meters and pipes) as a customer using natural gas for space heating, heating water, and cooking. The Commission finds that the cost of serving a residential customer is the same regardless of the customer's usage. So, under the status quo, customers using less than the average will underpay their cost-of-service, while customers using more than the average will overpay their cost-of-service. Staff's fixed delivery charge rate design provides a "carrot" (revenue stabilization) to get Atmos involved in energy conservation programs. However, in this case the Commission does not find sufficient resources of the company being dedicated to replacing the lost incentives for conservation provided by the traditional rate design. Atmos must give consideration for the decreased risk that it will have under a rate design which completely eliminates weather volatility. Atmos has done that by forgoing its request for an additional \$3.4 million. And, Staff's comparable companies include some elements of risk within the analysis. However, that is not enough.

The proposed fixed monthly rate design will eliminate the inherent conflict between the shareholders (whose returns increase if more gas is sold) and the ratepayers (who will only pay less by using less). Thus, the potential for a significant program is there. The Commission also acknowledges the pledge of a \$78,000 low income weatherization and the unlimited \$25 energy audits that the shareholders are willing to provide as a step in the right direction. However, there was no evidence to suggest that these measures will be sufficient and no details were presented as to how the programs would be implemented. The Commission cannot find that Atmos and Staff have shown that the fixed delivery charge rate design as presented will encourage efficiency and conservation.

As Public Counsel points out, based on the specific facts of other cases, the Commission has previously determined that "[h]igh fixed monthly customer charges tend to defeat customer efforts to reduce their bill by conserving natural gas. As a result, . . . the public interest is best served by setting customer charges as low as reasonably possible." However, the natural gas distribution business has changed

drastically in less than a decade. It continues to evolve and as such, the Commission must be able to recognize an opportunity to evolve as well. And, as the NARUC resolution states, there is a need for state commissions to do more to promote reduced energy demand and consumption. The Commission is also aware of other programs implemented by other Missouri companies referred to in this proceeding and in other states as evidenced by the information provided in Exhibit 144. The Commission finds that a comprehensive energy efficiency and conservation program can work to provide benefits to the ratepayers and to the general public interest by reducing the demand and consumption of natural gas.

The Commission finds that under the circumstances of this case, Atmos' rates are ripe for being redesigned. However, the Commission cannot find such a design to be in the public interest without some assurance of a significant energy conservation and efficiency program that will educate and assist Atmos' customers in conservation and reduced demand. In this instance the Commission has determined that with the right conservation and efficiency program, a fixed delivery charge would be in the public interest while allowing Atmos a fair return on its investment.

Atmos has proposed \$78,000 and unlimited energy audits creating a minimum of \$1.75 million worth of potential liability. Obviously, not every one of the 50,000 residential customers served by Atmos will request an audit. However, that commitment shows that Atmos is capable and willing to provide enough funding to implement a meaningful conservation program. Thus, the Commission finds that it would be just and reasonable and in the public interest to implement a fixed delivery charge rate design as proposed by Staff on the condition that Atmos contribute annually, one percent (1%) of its annual gross revenues (currently, approximately \$165,000) to be used for an energy efficiency and conservation program.

If Atmos does not provide for such a program, the Commission cannot find that the proposed rate design is just and reasonable and in the public interest and therefore, the Commission must reject it. In that event, the Commission determines that it is just and reasonable and in the public interest to maintain the status quo rate design and that no party has justified a change in the revenue requirement.

The Commission finds that an energy and conservation program must be approved by the Commission and must be the result of a collaborative process involving the Staff, Public Counsel, Atmos, the other parties to this case (that wish to participate), the Energy Center of the Missouri Department of Natural Resources, and other parties that the Commission shall designate. As the Commission has found with regard to other companies, a successful program may include Energy Star education and communication, appliance rebate and replacement, green construction for old and new homes, Pay As You Save programs, weatherization, energy audits (with follow up), and others. Such a program may contain a low income component as well as residential, commercial, and industrial components. The comprehensive program should be designed with methods for gathering and reporting data to analyze its effectiveness.

Therefore, the Commission directs that if Atmos files tariff pages in compliance with this order designed to implement a fixed delivery charge, it shall also set up a

new program by meeting with the other parties set out above, and any other social service agency or party that the Commission designates to participate, and design a program to be approved by the Commission and implemented no later than August 31, 2007. The Commission will direct that Atmos file a report regarding the status of any collaborative effort every thirty days. In addition, Atmos must present a program for Commission consideration no later than June 30, 2007. Finally, if the fixed delivery charge rate design is implemented, Atmos shall file on an annual basis a report with the Commission for the purpose of evaluating the effect of a fixed delivery charge rate design on energy efficiency and conservation.

If Atmos does not file tariff pages designed to implement a fixed delivery charge rate design, it shall file new tariff pages designed to implement the status quo rate design with the other changes as set out in this Report and Order.

The Commission will issue further orders following this Report and Order to set up the collaborative process to design the conservation program if necessary.

Seasonal Rates

Atmos recommends one modification to the Staff proposal by seasonally “sculpting” the fixed monthly delivery charge. Atmos proposes that the delivery charge be higher in the winter and lower in the summer. The sculpting of the rates would allow for the same annual revenue collections as Staff’s rate design. Atmos argues that the benefits of its sculpting proposal are that it will reduce the risk of customer loss during the summer months and it will aid in customer acceptance of the changed rate design.

Staff’s fixed monthly delivery charge rate design proposal, as modified by Atmos’ sculpting proposal set forth in Schedule GLS 1 as follows:

	Summer	Winter
Butler/Greeley	\$15.00	\$25.46
Kirksville/Palmyra/old UCG	\$15.00	\$28.24
Old SEMO/Neelyville	\$10.00	\$19.23

As set out below, the Commission finds that the problem of customers disconnecting on a seasonal basis should be solved through the seasonal disconnection charges. While the “sculpted” rates may offer less of an incentive for customers to disconnect in the warmer months, it also would have a significant affect on rates in the winter months. The Commission finds that this disparity is not justified.

Small General Service Rate Class

Staff proposes to create new classes of General Service customers. The basis for this part of Staff’s proposal was the large variation in usage between members of the class. Some of the General Service class use zero Ccfs, and some of them use close to a million Ccfs in one year. Staff proposes to split the Small General Services rate class so that customers using more than 2,000 Ccf per year will retain the traditional rate structure while those at or below 2,000 Ccf will be under the

same rates as residential ratepayers. For the others, there would be a new Medium General Service class, a Large General Service class, and a Large Volume Service class. Staff recommended the traditional rate design for those customers.

Small General Service Customers using less than 2,000 Ccf per year are served with the same meter/regulator and service lines as residential customers. Approximately 80 percent of Atmos' current Small General Service customers use less than 2,000 Ccf per year.

The proposed Medium General Service class would include non residential customers using from 2,000 to 75,000 Ccf per year. The Large General Service class would include non residential customers using from 75,000 to 200,000 Ccf per year.

Atmos agrees to accept Staff's proposal to split the general service class and to have uniform classes throughout the state.

Public Counsel believes the Commission should maintain the existing structure for the entire Small General Service rate class. Public Counsel's foremost concern with Staff's proposal is that it will create discontinuity within the Small General Service class. Under Staff's proposal, General Service customers using 2,001 Ccf will pay two to three times as much in non gas rates as a customer using 2,000 Ccf.

The Commission is not persuaded by Public Counsel's argument. The evidence supports Staff's proposal. Whenever classes are distinguished, there must be a dividing line between those classes. The proposal by Staff is logical in that those customers using less than 2,000 Ccf per year are served by the same size and type of equipment as residential customers. Thus, the Commission finds that a residential delivery charge for Small General Services customers using less than 2,000 Ccf per year within the same territory is just and reasonable. The Commission shall adopt the proposal of Staff with regard to this issue.

4. What are the appropriate miscellaneous charges (activation charges for connection, reconnection, and transfer; late payment, NSF, and seasonal reconnection)?

Atmos Witness Michael H. Ellis sponsors Atmos' proposal to make various miscellaneous charges (connection, reconnection, and transfer; late payment; insufficient funds; and seasonal reconnection) uniform and consistent across its Missouri service area. Mr. Ellis supports the rates proposed with a cost analysis discussed in, and attached to, his testimony. Staff proposes that these miscellaneous charges be based on the actual costs rounded to the nearest whole dollar.

While Atmos and Staff have reached agreement on all of the issues addressed in the Miscellaneous Charges area, Public Counsel objects to the changes. The exception is for interest paid on customer deposits, a change that would bring parity to all deposits. An agreement was also reached to revise Atmos' proposed tariff language and use the generic terminology, instead of the term "activation charge."

Connection, Reconnection, and Transfer Charges

Some areas of Atmos' service territory currently do not have connection, reconnection, or transfer charges. The Commission finds that it is appropriate to make these types of charges uniform within all of Atmos' service territory. In addition, the Commission finds that it is reasonable to align the charges with the actual costs to provide the service.

The actual costs of providing the specific services and applicable rates to be applied on a statewide basis, as agreed to by Atmos and Staff, are:

Type of Charge	Actual Cost	Proposed Charge
Connection – Normal Hours	\$23.56	\$24.00
Connection – After Normal Hours	\$50.09	\$50.00
Reconnection – Normal Hours	\$23.56	\$24.00
Reconnection – After Normal Hours	\$50.09	\$50.00
Transfer – Normal Hours	\$20.02	\$20.00
Transfer – After Normal Hours	\$46.55	\$47.00

The Commission finds the proposed charges to be just and reasonable based on the actual costs to provide such services and shall adopt them.

NSF Charges

As with the other charges, Staff supports a statewide charge in an amount closely related to the actual costs. Currently, Atmos charges \$15.00 for an insufficient funds (NSF) charge for approximately 75 percent of its customers. The rates for the remaining customers have been under cost at \$10.00 and Staff was able to discern that charge had been applied only twice in the last three years. Thus, for all practical purposes Atmos has had an NSF charge of \$15.00. Therefore, the Commission finds it reasonable to set these charges on a statewide basis in an amount that is closer to the actual costs. The Commission adopts a statewide NSF charge for Atmos of \$15.00.

Late Payment Fee

Atmos also requests authority to apply the authorized late payment fee found in specific existing tariff sheets (equal to 1.5 percent of the outstanding balance) across all rate schedules. The late payment fees existing in Atmos' Missouri tariffs vary in amounts and this change will make the charge consistent across all of Atmos' Missouri service areas. Staff supports and recommends that the late payment fee be consistent throughout the tariff. Public Counsel only addresses this issue in its Prehearing Brief, where this component is listed with those "miscellaneous charges that remain unresolved between the parties."

The Commission finds that the late payment fee equal to 1.5 percent of the outstanding balance is reasonable and shall be applied on a statewide basis by Atmos.

Seasonal Reconnection

ATMOS ENERGY CORPORATION

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The proposed seasonal reconnection charge is the most contentious of the Miscellaneous Charges. One tenth of Atmos' customers disconnect for a month or more each year. Thus causing Atmos to forgo revenues from its investments to those properties (e.g. meters, pipes, mains, etc.). Staff proposes a two component reconnection charge to dissuade seasonal customers that disconnect during the non winter months and do not pay for the costs associated with providing utility service. Such a customer would pay the traditional reconnection charge (\$24.00 proposed); in addition, the customer would make up all missed delivery charges that occurred while the customer was disconnected. Staff proposes a 12 month limitation to the second component, regardless of the reason for disconnection. The purpose of this change is for the company to make up the revenues lost during the months of disconnection. Otherwise, the company has a certain amount of embedded costs that it cannot recoup unless gas service is being provided to that customer.

Although Atmos proposed seasonally sculpting the rates as a possible way to alleviate some of the seasonal loss concerns, it supports Staff's proposal. Atmos believes that it can recoup sufficient revenue under its sculpted rate proposal without collecting all the missed customer charges. In addition, Atmos' original proposal included a reconnection charge of up to twelve months of a \$9.00 statewide customer charge. Atmos requests that regardless of the methodology chosen, the Commission address this concern.

Public Counsel does not offer any type of adjustment to Atmos' revenue requirement to adjust for seasonal customers, but argues that it is appropriate to allow customers to disconnect during the non winter months.

Atmos has a provision similar to Staff's proposal in its tariffs for its current SEMO, Butler, and Kirksville Districts. Those provisions, however, require the payment of the customer charge, and not the volumetric portion, of the missed months where the customer has requested the disconnection.

As the undisputed evidence shows, Atmos has a significant problem with lost revenues due to ten percent of its customer base disconnecting for a month or more and then reconnecting at the same address. Customers seek to avoid paying the fixed cost of providing gas service when not using gas for heat, and thus shift costs for their meters and equipment during that time to the other customers. The Commission finds that a seasonal reconnection charge is a just and reasonable way to discourage seasonal disconnection while allowing Atmos to recover its fixed costs of offering service to the premises.

The Commission further finds, however, that there is not sufficient justification for recovery of Staff's proposed seasonal reconnection charges up to twelve months. The twelve-month recovery of the fixed delivery charge would be a total of up to: \$167.04 (SEMO); \$233.16 (WEMO); and \$247.32 (NEMO). Customers would pay the \$24.00 reconnection fee in addition to the seasonal reconnection charges. The Commission finds that Staff's proposed collection of customer charges for up to twelve months would cause a significant barrier to low-income households trying to get service reconnected for the winter heating season. After carefully examining all the various proposals set forth to solve the seasonal disconnect problem, the Commission is able to find a solution.

The proposal presented to the Commission is for a “seasonal” disconnection charge and all of the evidence suggests that it is customers who disconnect for the warmer months and then reconnect for winter at the same location that cause the issue which needs to be addressed. Thus, Atmos and Staff are seeking to discourage those customers who disconnect during the summer season. The “summer season” is clearly meant to be the time period from March 1 to October 31 as defined in the Commission’s Cold Weather Rule. Therefore, it is unreasonable to make the applicable period for the “seasonal” disconnection charge longer than seven months.

Even with a seven-month cap on the seasonal disconnection charge these fees might be a rate shock for some customers. Because the customers have not previously had the higher fixed delivery charge during the summer months, customers who disconnect on a seasonal basis will be shocked to discover that they must pay as much as \$97.44 (SEMO), \$136.01 (WEMO), and \$144.27 (NEMO), plus the \$24.00 reconnection fee, in order to reconnect service. This is especially significant because in all likelihood those customers disconnected because they could not afford to pay the monthly charge in the summer months.

Given that the Commission has found the recovery of the fixed delivery charges to be a reasonable cost recovery mechanism, the Commission has determined that the rate shock to the customers justifies a further reduction of the amount of recovery in order to mitigate the rate shock to the customers. The Commission determines that customers would not be so shocked by a charge that was one half of the seven-month summer season. Therefore, the Commission finds that it is just and reasonable to reduce the seven-month cap further by half.

The Commission finds that the seasonal disconnection charge is just and reasonable and in the public interest so long as it is limited to a three-and-one-half-month cap on recovery of the fixed monthly delivery charge. In addition, the Commission finds that this provision should be prospective only. That is, Atmos should not be allowed to recover any reconnection charges that were not in effect at the time of the customer’s disconnection. For example, if Atmos files new tariffs with the fixed monthly charge, it must only charge the customer what it could have charged under the tariff that was in effect for that customer at the time of the disconnection.

5. Should Atmos’ districts be consolidated for purposes of setting margin non gas rates in this case?

Atmos currently has six sets of base tariffs and six purchased gas adjustments (PGAs) for its Missouri service areas (although there are seven separate PGA rate filings). The areas are referred to as District B (Butler); District K (Kirksville); District S (Southeast Missouri, all of which are properties formerly operated by Associated Natural Gas Company); District G (Greeley) formerly operated by Greeley Gas Company; District U (Hannibal/Canton/Palmyra/Neelyville) and District P (Palmyra), both formerly operated by United Cities Gas Company. Staff proposes to consolidate base rates into three geographic areas. A map depicting this proposal

was entered into evidence as Exhibit 100. Staff's proposal is very similar to that of Atmos and is supported by Atmos. OPC opposes this consolidation.

The consolidated rates are supported by the Staff's cost studies and based on seven different districts' rates. The consolidation will combine the current rate districts into three service territories based on location, and will set a single rate for all customers in a particular class in a particular geographic area. By consolidating the districts, customers in neighboring communities will pay similar non gas rates.

The new areas would be as follows:

- i. NEMO: Kirksville, Palmyra, Hannibal/Canton/Bowling Green
- ii. SEMO: Neelyville and SEMO
- iii. WEMO: Greeley and Butler/Rich Hill

Public Counsel opposes consolidating the districts without comprehensive data and cost studies. Public Counsel argues that the embedded costs for each district may not be the same. In addition, Public Counsel argues that customer confusion will result from the widely varying changes in rates as the result of consolidation.

The Commission is persuaded by Staff's evidence that the districts should be consolidated. Staff identified what appear to be inequities between users in various districts of Atmos. A customer using 720 Ccf per year would pay annual non gas costs as follows:

Kirksville –	\$138
Palmyra –	\$163
Hannibal/Canton/Bowling Green –	\$269
Greeley –	\$290
Butler –	\$213
Neelyville –	\$269

Thus, Staff has shown that customers in neighboring districts pay much different costs for the same gas usage.

The cost for Atmos to serve similarly situated customers in neighboring districts, such as the combining of three adjoining northeast Missouri districts into one service territory, is about the same. Atmos does not buy equipment, such as meters or mains, in quantities intended to serve just one "legacy" district. Atmos service employees serve all customers in each of its geographical service areas. Corporate overhead expenses associated with serving a residential customer are also indifferent as to the "legacy" district that customer lives in.

While there may be some difference in costs due to the vintage of the distribution equipment in various "legacy" districts at any given point in time, Atmos' cost to provide service today do not change from area to area. Moreover, the cost of meters, regulators, and service lines is the same for all districts. In addition, when a customer calls Atmos customer service, the call is first answered by a Company representative located in one of three out-of-state call centers. If that call cannot be addressed, then it is routed to one of seven Missouri call centers which serve the surrounding area. These calls are routed without regard for the predecessor company that served the area ten years ago. Related billing and customer service costs do not vary among Atmos' current seven districts.

For Atmos to make the attempt to collect and break out its costs to serve each of seven "legacy" districts is unnecessary – particularly in light of the reasonableness of combining these districts into their natural geographic service areas. The Commission finds that it is just and reasonable to consolidate the base rate districts of Atmos as proposed by Staff.

6. Should Atmos' PGA tariffs be consolidated for purposes of setting gas rates in this case?

Staff recommends consolidating Atmos' PGA rate districts, by pipelines served, into the following four districts: (1) Butler and Greeley; (2) Hannibal/Canton, Bowling Green and Palmyra; (3) Kirksville and (4) SEMO and Neelyville.

Butler and Greeley are combined into one district because their primary source of gas comes from the Mid Continent Basin. As a result, the commodity costs are basically the same, even though the gas is being transported over two different pipelines.

For the SEMO/Neelyville consolidated PGA district, Staff's witness, Mr. Imhoff, noted that NGP&L pipeline currently feeds both Neelyville and a part of SEMO as well, even though SEMO has four different pipelines feeding into it.

At hearing, Mr. Imhoff also testified that Staff will have each individual "legacy" district take care of its respective Actual Cost Adjustment (ACA) balances to "zero them out." The current balances are very close with the exception of the ACA factor, which will run for 12 months to recover or refund any over or under-recovery. Although Atmos proposed a statewide consolidation for the PGA, its witness testified that consolidation of the four areas identified by Staff's direct testimony is acceptable.

Public Counsel opposes PGA consolidation. Public Counsel argues that the rates vary significantly among districts, and the parties have offered no compelling reason other than administrative burden to alter the PGA structure. Gas costs represent 73 percent to 82 percent of a customer's bill, and consolidating could have a substantial negative effect on customers in areas with lower rates.

The Commission finds that PGA consolidation as proposed by Staff will simplify and improve the PGA/ACA rate process by making it more efficient as a result of reducing the current number of filings made by Atmos. This is accomplished by logically identifying the PGA computation by pipeline or supply source. New, consolidated PGA districts have similar transportation rates and gas supply sources. Such consolidation is consistent with how other regulated LDCs (e.g., AmerenUE) currently file PGA rate filings. In addition, one company is currently doing all gas purchasing for each of the districts, and employing the same hedging program and strategy for Missouri. Finally, as Staff's testimony showed, under the current PGA rates, "the maximum rate differential between the various proposed PGA rate district consolidations . . . [is] \$.0309 per Ccf." Thus, the effect on customer rates will be insignificant.

In addition, although the four PGA areas do not align exactly (Kirksville is the exception) with the geographic non-gas rates, they are substantially the same in

most areas and, therefore, the benefits of bill comparability will be achieved if the Commission adopts the four areas as recommended by Staff. The Commission finds the PGA consolidation to be reasonable and shall adopt Staff's proposal.

7. Other Tariff Issues:

- a. **Should a cash-out policy be implemented?**
- b. **Should the Commission allow third-party administered pools for cash-outs?**
- c. **What is the appropriate level of lost and unaccounted gas?**
- d. **Should the Commission approve an Economic Development Rider?**
- e. **Should the mains extension policy and the determination of amounts to be charged be changed in this case?**

Cash-Out Policy

The cash out provision allows transportation customers to resolve imbalances by cash payments instead of making up imbalances with gas volumes in kind. This provision replaces Atmos' existing policy of charging \$15.00 per Mcf when the balance is negative, or absorbing the gas when the imbalance is positive. Whether the imbalance is positive or negative, a transportation customer will pay a price determined by a formula that uses a published industry price. If the imbalance is greater than 5 percent of the monthly contract volume, the price will be inflated or deflated by an index referenced in the tariff. This standardized policy will replace Atmos' current practice of applying varying policies. Atmos also agrees to make minor changes to the transportation tariffs.

Public Counsel's only opposition noted in testimony is that large transportation customers would be allowed to create pools that would allow pool members to offset imbalances, thus allowing large volume customers flexibility at smaller ratepayer expense. According to Staff, the only customers on Atmos' system that could pool are the school districts, which are allowed to pool by statute.

The Commission finds that it is just and reasonable to have a standardized policy regarding cash outs. Furthermore, there was no evidence that this policy will affect any customer or revenues of Atmos in any manner, other than school districts which all allowed to pool under current Missouri statutes. Thus, the Commission finds in favor of Atmos on this issue.

Third-Party Administered Pools for Cash-Out

Atmos proposes to allow third parties to create pools that would allow pool members to offset imbalances caused by transport customers taking more or less gas from the system than the amount under contract. According to Staff, the only customers on Atmos' system that could pool are the school districts which are already allowed to pool by Section 393.310, RSMo. Public Counsel has the same concerns as with the Cash Out issue above.

For the reasons stated above, the Commission finds in favor of Atmos' proposal.

Level of Lost and Unaccounted Gas

The issue of the level of lost and unaccounted gas has been settled among the parties and is addressed in the Partial Non Unanimous Stipulation and Agreement.

Economic Development Rider

An Economic Development Rider (EDR) encourages industrial customers to use Atmos' natural gas service by providing limited discounts. Staff carefully analyzed the proposal and recommended that it be adopted.

Public Counsel's testimony that the EDR would force residential and small customers to subsidize industry discounts is unsupported and contrary to Staff's analysis indicating that generally, a new industrial customer will generate revenues and defray costs beyond the initial discounted amounts.

The Commission is persuaded by Mr. Ensrud's Surrebuttal testimony regarding this matter. He testifies that a new customer will generate revenues and defray fixed costs to the point that both Atmos stockholders and ratepayers will benefit. In addition, Mr. Ensrud testifies that secondary benefits of the potential economic development, such as new jobs, new tax revenue, and increased property values are also to be taken into consideration. The Commission finds that it is just and reasonable and in the public interest to allow an EDR as proposed by Atmos. The Commission finds for Atmos with regard to this issue.

Mains Extension Policy and the Determination of Amounts to be Charged

Atmos proposes to eliminate its current minimum line extension policy. Currently, customers may receive up to 150 feet of gas main extension free. Instead, Atmos would use a computer model to estimate the cost of the main and the revenue that will be produced. The initial customer would be compensated by the utility if additional customers come on to the extended portion of the main. Staff proposes one exception with regard to refunds, but otherwise agrees with Atmos' proposal.

Public Counsel opposes Atmos' proposal to eliminate the minimum line extension, and subject every new residential and small business customer to a feasibility review resulting in an up front fee for main extensions. "A reasonable fee free line extension is both a reasonable obligation to impose on a public utility and an investment in future earnings for the utility."

The Commission agrees with Public Counsel and finds that the main extension policy should not be eliminated at this time. Proposing such a drastic change from 150 feet free to zero feet free is not a reasonable proposal. The Commission finds in favor of Public Counsel on this issue. Atmos shall not implement a new main extension policy.

Conclusions of Law

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

Jurisdiction

Atmos is a public utility, and a gas corporation, as those terms are defined in Section 386.020(42) and (18), RSMo 2000. As such, Atmos is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

Burden of Proof

Section 393.150.2, RSMo 2000, provides in part, "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . gas corporation . . . and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

Commission's Authority

Pursuant to Section 393.130.1, RSMo 2000, the Commission has authority to prohibit the implementation of gas rates that are unjust or unreasonable.

Section 393.140 authorizes the Commission to determine just and reasonable rates. Section 393.150, in pertinent part, authorizes the Commission to suspend for a period of time any schedule stating new rates, charges, rules, regulations, or practices, and to hold "a hearing concerning the propriety of such rate, charge, . . . rule, regulation or practice." Section 393.270 provides in paragraph 4 that in determining the price to be charged, "the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question" The courts have held that this statute means that the Commission's determination of the proper rate must be based on consideration of all relevant factors.

In determining whether rates are just and reasonable, the Commission must balance the interests of the investor and the consumer. The Commission's failure to establish just and reasonable rates would, in fact, violate the United States Constitution. In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly

profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.

The dominant purpose in creation of the Commission is public welfare. Section 386.610 reads, in relevant part, that "[t]he provisions of this chapter shall be liberally construed with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities." The Commission must weigh the benefits and detriments to all the groups affected by its decision.

Under Section 386.270, RSMo 2000, all rates of a public utility that have been approved by the Commission are prima facie lawful and reasonable until found otherwise in a suit brought for that purpose pursuant to the provisions of Chapter 386.

DECISION

Stipulation And Agreement

Atmos, the Staff, and Public Counsel filed on November 29, 2006, their Partial Non Unanimous Stipulation and Agreement, which sets forth issues settled among the parties.

Pursuant to 4 CSR 240 2.115(2)(C), because no parties objected within seven days to the Partial Non Unanimous Stipulation and Agreement, the Commission may, by operation of law, treat this Agreement as a unanimous stipulation and agreement.

The Stipulation addressed the following issues as resolved among the parties: Billing Determinants; Other Post Retirement Benefits (OPEB) Contribution; Class Share of Revenue by District / Class Cost of Service; Customer Service Requirements and Reporting; PGA Minimum Filing Requirements; Depreciation Record Keeping and Reporting; and Gas Loss Reporting.

Based on the agreement of the parties, the Commission concludes that the Agreement constitutes a just and reasonable settlement of all of the issues included therein.

Contested Issues

1. Revenue Requirement

- a. Level of Expense

- b. Rate of Return / Return on Equity
- c. Level of Revenue Excess / Deficiency

The Commission concludes that rates designed to produce a zero net revenue requirement allowing for a stipulated gross annualized revenue of \$16,507,737 are just and reasonable in that they meet Atmos' prudent operating expense and allow an opportunity to earn a reasonable return on the value of the private property dedicated to public service.

2. Depreciation and Reserve Amortization

The Depreciation issues are resolved among the parties in accordance with the Stipulation, which constitutes a just and reasonable settlement of the issues.

The Commission concludes that, as a whole, the annual depreciation accrual should be reduced by approximately \$591,000 and that, by Atmos entering a negative amortization of \$591,000 to the depreciation reserve account, this provides an immediate benefit to Atmos' customers by lowering Atmos' depreciation expense. The Commission concludes that based on these facts, this is a just and reasonable result.

3. Rate Design

Based on the specific facts in this case, the Commission finds that placing all non gas costs into a fixed delivery charge, within the context of a zero revenue increase and the consolidation of the operating districts into three service areas (NEMO, WEMO, and SEMO) will provide for just and reasonable rates if it is accompanied by a meaningful energy efficiency and conservation program as described above. Thus, the Commission concludes that no party justified a change in revenue requirement, and absent the conservation program, the Commission must reject the proposed fixed delivery charge rate design. If Atmos chooses to enter into a significant energy efficiency and conservation program as set out in this order to be approved by the Commission, it may file tariffs including a fixed delivery charge rate design.

The Commission determines that the problem of seasonal disconnects is most appropriately handled in the context of a seasonal disconnection charge. Thus, the Commission concludes the proposed seasonally "sculpted" rates are not just and reasonable.

The Commission further concludes that creating a Small General Service class that is based on the same operating parameters and cost of service of the Residential class provides just and reasonable rates for non residential customers.

The Commission also concludes that maintaining the traditional rate design for Medium General Service and Large General Service customers provides just and reasonable rates to the members of these service classes.

1. Miscellaneous Charges

The Commission concludes that uniform, statewide cost-based charges for Activation, Reconnection, Transfer, Late Payment, and NSF are just and reasonable.

The Commission concludes that the "seasonal" reconnection charge is a just and reasonable method of discouraging customers from disconnecting from the system on a seasonal basis. In addition, the seasonal reconnection charge will

allow Atmos to recover its fixed costs of serving the customer and prohibit the shifting of costs from the customer who disconnects to all other customers. The Commission further determines, however, that for the charge to truly be a "seasonal" disconnection charge, it cannot reasonably recover more than seven months of the fixed monthly charge. The Commission further determines that the recovery of up to seven months of a fixed monthly delivery charge would be so shocking to customers attempting to reconnect as to be unreasonable. Therefore the Commission determines that the recovery of the fixed monthly delivery charge for the purpose of a seasonal reconnection fee should be limited to three-and-one-half months. In addition, Atmos shall only collect the seasonal disconnection charge on a prospective basis.

2. Company PGA Tariffs Consolidation

The Commission concludes that the consolidation to four PGA districts provides for just and reasonable rates because the consolidation is based on the cost similarity of interstate pipelines that serve the districts and/or the cost similarity of the sources of gas supply to the districts.

3. Company District Consolidation

Because the costs to provide service to each service area do not change among those areas, the Commission concludes that the consolidation of operating districts into three geographic service areas (NEMO, WEMO, SEMO) for the purpose of setting non gas margin rates (the fixed delivery charge) provides for just and reasonable rates.

4. Other Tariff Issues

The Commission concludes that the Cash Out Policy and the Economic Development Gas Service Rider provide for just and reasonable rates and that no credible evidence opposing these tariff issues has been provided by Public Counsel.

The Commission concludes that Third-Party Administered Pools for cash outs provide for just and reasonable rates and notices that school districts are permitted to pool under Section 393.310.

The Lost and Unaccounted Gas issue is resolved among the parties in accordance with the Stipulation, which constitutes a just and reasonable settlement of this issue.

With regard to the main extension policy proposed by Atmos and Staff, the Commission concludes that it is not a just and reasonable policy, and therefore it must be rejected.

CONCLUSION

The Commission has thoroughly considered the facts of this case and the arguments of all the parties. The Commission has found that the status quo rate design is just and reasonable and that the volumetric rates encourage conservation. The Commission agrees with its Staff that the facts of this case present an opportunity to implement just and reasonable rates under a rate design that is quite novel in the state of Missouri. However, the Commission has determined that it is not just and reasonable to relinquish the conservation measures currently in place in

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the form of volumetric rates without also implementing a significant efficiency and conservation program to offset the loss of conservation encouraged by the volumetric portion of the rate. Therefore, the Commission has determined that Atmos shall maintain the status quo rate design unless it proceeds with a significant energy efficiency and conservation program as set out in the body of this order. If Atmos chooses to go forward with such a program, it may file new tariffs designed to implement not only that program, but also a fixed delivery charge rate design.

IT IS ORDERED THAT:

1. Exhibit 144 is admitted into evidence.
2. All pending motions and requests for relief not otherwise granted are denied.
3. The Partial Non Unanimous Stipulation and Agreement filed on November 29, 2006, is hereby approved as a resolution of all issues contained therein (See Attachment A).
4. The parties are ordered to comply with the terms of the Stipulation and Agreement.
5. The proposed gas service tariff sheets (Tariff No. YG 2006 0762) submitted on April 7, 2006, by Atmos Energy Corporation for the purpose of increasing rates for gas service to retail customers are rejected. The tariff sheets rejected are:
 - P.S.C. MO. No. 2
 - Original Sheet No. 1 through Original Sheet No. 113
6. Atmos Energy Corporation may file tariffs that comply with this Report and Order.
7. If Atmos Energy Corporation files tariffs that include a fixed delivery charge rate design, it shall also set up an energy efficiency and conservation program as outlined in the body of this order to be implemented no later than August 31, 2007, and shall present a program to the Commission for consideration no later than June 30, 2007.
8. If Atmos Energy Corporation files tariffs that include a fixed delivery charge rate design, beginning on April 1, 2007, Atmos shall report to the Commission no later than the first day of every month as to the status of the collaborative process set out herein.
9. If Atmos Energy Corporation files tariffs that include a fixed delivery charge rate design, it shall file on an annual basis a report with the Commission for the purpose of evaluating the effectiveness of a fixed delivery charge rate design on energy efficiency and conservation.
10. This Report and Order shall become effective on March 4, 2007.

Davis, Chm., and Appling, C., concur;
Murray, C., concurs, with separate concurring
opinion attached;
Gaw and Clayton, CC., dissent, with separate
dissenting opinion(s) to follow;

and certify compliance with Section 536.080, RSMo 2000.

CONCURRING OPINION OF COMMISSIONER CONNIE MURRAY

I write separately to express my disagreement with conditioning the fixed variable rate design on an annual contribution of one percent (1%) of Atmos' annual gross revenues to an energy efficiency and conservation program. Under the circumstances of this case, Atmos' rates are ripe for being redesigned, as the record supports. It is inappropriate and likely extrajudicial for the Commission to order an expenditure not proposed by any party on the record for a program neither proposed nor yet designed.

Atmos has committed to spend \$78,000 for low income weatherization and has agreed to institute a residential efficiency audit program for all residential customers. In addition, Atmos committed to educating customers about the delivery charge prior to and during the implementation. Atmos has further committed to participate in collaborative meetings with the Staff and Public Counsel.

The new fixed variable rate design will eliminate the inherent conflict in the traditional rate design between the shareholders whose fixed cost recovery decreases when less gas is sold and ratepayers who only save money by using less gas. The new rate design provides revenue stabilization that removes the disincentive from the Company to encourage energy efficiency and conservation.

Rather than create a new expenditure program from evidence aliunde and Commission speculation, the Commission could have addressed its concern for tangible results in energy efficiency and conservation in a simpler way. It should have merely directed Atmos to file and Staff to review annually reports tracing the effect of the new rate design upon energy efficiency and conservation. The rate design's effectiveness could be evaluated prior to Atmos' next rate case and collaborative discussions in the meantime could explore potential improvements to Atmos' energy efficiency and conservation programs.

Otherwise, I agree with the Report and Order.

**DISSENTING OPINION OF COMMISSIONERS
ROBERT M. CLAYTON III AND STEVE GAW**

These Commissioners dissent from the majority's Report and Order which fundamentally modifies the utility's rate design in a significant shift ofPSC policy. While the Report and Order trumpets a supposed denial of any rate increase on behalf of the utility's customers, it also rejects a rate reduction suggested by staff in

the amount of \$1.2 million. The majority has adopted a number of new provisions to protect the company from fluctuating revenues due to changing weather patterns and changing consumer behavior including customer conservation efforts. Under the new plan, consumers will bear more risk and responsibility than previous customers of gas utilities in Missouri. Despite assertions to the contrary, the majority failed to take advantage of an opportunity to require a number of pro-consumer provisions to offset the change in rate design, especially in the areas of energy efficiency and conservation to help consumers reduce their consumption of gas and, therefore, reduce their bills. The company will now have stabilized revenues while low use consumers will pay greater, and in some cases significantly greater, amounts toward their utility bills. Those low use consumers who are also low income will be particularly hard hit. Furthermore, the fixed charges that consumers will be charged are not cost-based; they are revenue-based. This means that customers in the northeast and west are penalized for being in colder climates with a rate design that favors a lower revenue producing region in the southeast.

Lastly, consumers should be aware that the majority Report and Order contains a number of unpleasant surprises for those who do not retain traditional natural gas service. Customers who disconnect from the system on a seasonal basis will now have a new charge awaiting their return to the system. Those customers will actually be obligated to pay for gas service even when they are disconnected from the system.

I. Rate Design

Atmos filed this rate case seeking a rate increase of \$3.4 million, while in response, the staff countered with an assertion that the utility was over-earning by \$1.2 million. Instead of pursuing a revenue reduction or filing an over-earnings complaint within this rate case, Staff conceded ground by proposing a departure from the traditional rate design to a fixed variable rate design. Atmos' current rate design is based on a customer charge and a volumetric rate. This traditional rate design determines non-gas margin costs by using a monthly charge, which does not change, and a volumetric charge. The volumetric charge varies according to the amount of gas a customer uses, causing the larger users of gas to pay more for the distribution system as a whole. The Commission has long history of finding the traditional rate design to be just and reasonable. These Commissioners do not have confidence in this paradigm shift occurring without thorough study and research to determine that this new rate design is just and reasonable and without company concessions for increased efficiency and conservations programs.

A. Energy Efficiency and Conservation

Natural gas is a resource that until recently has been taken for granted in this country. Until the winter of 2000-2001, natural gas prices had never exceeded \$5.00 MMBtu and had fluctuated within a very narrow range. Upon deregulation of the wholesale market for natural gas, prices began to fluctuate based on supply, demand and other pressures. The communities of Palmyra, Hannibal, Canton and

Bowling Green experienced significant volatility in the market as prices spiked to an all time high of \$10.00 MMBtu during the winter of 2000-2001. Such wild swings in the price of gas disrupt budget planning of businesses and families alike as well as raise questions about the role of the PSC and the nature of a deregulated natural gas market.

The public outcry diminished as prices eventually receded to a level of approximately \$3.00 MMBtu until 2003 when the prices began to gradually increase. Due to increased demand by industrial, commercial, utility and residential customers and constraints in supply, the price more than doubled within two years and eventually peaked in October 2005 at \$14.00 MMBtu. Hurricane damage in the Gulf of Mexico disrupted or halted much of the gas production in Louisiana and the Gulf while production elsewhere failed to keep up with the demand. Additionally, allegations have been raised to question the transparency and legitimacy of the natural gas market including a number of criminal proceedings. But not for the significantly warmer winters of 2005 and 2006 was a public health and safety crisis averted that would have seen average monthly gas bills skyrocketing. While some public assistance was available, the assistance fell far short of need, having barely eclipsed the funding level set at the federal LIHEAP's inception in the early 1980's. Additionally, much of the middle class, small business and industry would have been faced with an economically devastating price increase with no relief in sight. While the prices for natural gas have since subsided from the all time high records, the prices are still high and volatile. Overall demand, supply, and speculation make it imperative that conservation potential be maximized.

For these reasons and others, it is imperative that Missouri take steps to reduce demand for natural resources by giving consumers the tools and information they need to embrace the concepts of energy efficiency and conservation. As in the debate over U.S. oil consumption and the desire to reduce dependence on foreign sources, steps must be taken now to reduce natural gas consumption rather than relying on developing facilities and infrastructure to import gas in the form of Liquefied Natural Gas (LNG) to meet demand. In fact, gas and oil prices fluctuate relative to each other suggesting a need for a reduction in consumption for both natural resources.

A fixed variable rate design must be accompanied by a substantial commitment by the company to a conservation and energy efficiency program. This is important for at least two reasons. First, the elimination of a volumetric component to the price paid for LDC service reduces the price signal sent to consumers to conserve. The Commission should therefore increase the incentives for conservation and efficiency to, at a minimum, counteract this loss. Second, nationally the policy of giving gas utilities a straight fixed variable design, which significantly reduces the utilities' financial risks due to weather fluctuation, has been linked with a corresponding agreement to implement significant conservation and efficiency programs. These Commissioners view this case as an opportunity to establish a comprehensive conservation and energy efficiency program to help educate customers on how to reduce their consumption and, in turn, save on their bills. Customers are keenly aware of the high costs of natural gas and should be prepared for taking steps to

save, conserve and modernize their businesses and homes. Missouri lags behind most other states when it comes to saving energy and this Report and Order fails to demonstrate a new commitment by the Commission to help customers save in all future cases.

These Commissioners would have preferred to see a Commission mandate and commitment of the utility to begin comprehensive planning on how to help consumers reduce their gas consumption. Under the fixed variable rate design, the company's economic prospects will not be affected by warmer winters. The only variable charge on the customer's bill will be the actual price of the natural gas commodity delivered by the pipeline. By "decoupling" the company's recovery of its costs and investment from the volumes of gas sold, the company no longer has competing interests that incent it to discourage reduced gas usage. Specifically, the utility is not hurt if consumers choose to reduce their consumption. However, customers have lost some of their incentive to cut their consumption because the price signal sent to consumers to conserve has been reduced by abolishing volumetric rates. Conservation is important and that importance should be reflected by significant actions from the Commission and utilities to cause conservation by the consumer. Reduction of energy demand should be encouraged through efficiency programs, communication, and education.

The utility will reap substantial benefits from the new rate design. While this winter has proven to be decidedly frigid and bitterly cold, the trends have been for very mild winters where temperatures remain at a level sufficient to relieve customers of high winter heating bills. In fact, in the prior two winters, customers have experienced temperatures well above the norm. Even this winter heating season, Missouri temperatures remained well above normal until the beginning of 2007. During mild winters, when sales decrease, the utility's ability to earn its authorized rate of return may be more difficult and it may find it has no other alternative but file another rate case requesting increases in base rates. This rate design will permit the company to recoup its investment, regardless of the type of winter, with more stability in revenues and less volatility in its pricing. In fact, the majority has awarded the company a stable revenue stream based on revenues that allow the company to earn greater than its traditionally authorized rate of return. The Commission has the responsibility to balance the interests and risks of both the rate paying public as well as the company. The result of the new rate design shifts an inappropriate amount of risk from the company and places it on the shoulders of ratepayers. However, in exchange for giving the Company this significant benefit, the Majority has extracted insufficient effort toward the goal of energy conservation in return. The Commission has reduced the incentive to conserve by deleting the volumetric component of the rate. It should not only replace the incentive but make a significant effort to achieve substantial energy conservation and efficiency. The effort made in this case is only minimal.

These Commissioners believe that certain additional steps could have been taken to lessen the impact on the rate payer while also displaying leadership on future Missouri energy policy. The majority Report and Order adopted a figure that was half of what these Commissioners recommended be included to jump start the

energy efficiency and conservation program. The utility will have the responsibility to set aside funds amounting to 1% of gross revenues (approximately \$165,000), which represents \$2.75 per customer per year in the Atmos service territory. With an account balance of \$165,000, the parties will have the task of taking steps to design and implement a new program of energy efficiency and conservation and submit the proposal for the Commission's approval by June 30, 2007. The development of such a proposal is a positive statement by the Commission and was suggested by these Commissioners. Considering that Atmos has no energy efficiency or conservation programs in place in any of its service territories, the amount set aside for the program should be doubled to ensure that the resources are available throughout its service territories to effectively change customer actions and attitudes about efficiency and conservation. Unfortunately, the sum adopted by the majority leaves much in doubt for a successful implementation of the program.

It is important that a comprehensive plan address all customers served by Atmos. A successful plan would benefit the customers of Atmos through less commodity use. Residential consumers, especially low income families, could see immediate benefits from lower volumetric usage. Overall, lowering of demand reduces capacity issues on transmission and distribution systems and as a part of a larger strategy would potentially ease price pressures. Business and commercial interests who have the highest per capita usage have the most to gain from reducing their costs in the form of energy usage. Many of the energy efficiency leaders are large businesses who have invested in new technologies and reconsidered past practices. These Commissioners urge their colleagues to embrace energy efficiency and conservation by requiring the company to respond to the deadline of June 30, 2007, with a comprehensive program complete with an efficiency audit program, education and training, options for appliance tradeout or rebates, communication of accredited businesses that specialize in efficiency, appropriate methods of establishing targets or goals of reducing demand and any other programs adopted by other states that would reduce demand.

B. Determining the Amount of the Fixed Monthly Charge

Through a series of acquisitions, Atmos' Missouri operations consist of Greeley Gas Company purchased in 1993; United Cities Gas Company purchased in 1997; and Associated Natural Gas Company purchased in 2000. Until filing this rate case, Atmos had been operating according to the effective tariffs in each district as they were set when the preceding LDC had its last rate case. Atmos is a unique combination of infrastructures of varying age, construction and geographic location. Staff did not perform a class cost of service study on this company. There are no reliable numbers on which to depend when determining what it actually costs to serve the company's customers. A class cost of service study is incredibly important in this company's case due to its unique structure because it is an amalgamation of three, separate and distinct LDCs.

While staff testified that the cost to serve the different geographic areas where these former LDCs operate is about the same, this assertion is purely speculative

without a class cost of service study to support it. Yet the rates authorized in the majority's Order are substantially higher in Northeast Missouri. Additionally, staff calculated the fixed monthly rate for each service area based on historic, volumetric rates. This is especially troubling when the NEMO district is the area with the coldest winters and the most gas consumption. If the Commission wants to shift its rate design policy to a fixed rate based on what it costs to serve a class of customers, it makes no sense to set the fixed charges on historic volumetric rates. This is especially true when a class cost of service study would have provided accurate numbers on which to rely. It is difficult to convince a customer in the NEMO service area that its fixed monthly charge should be considerably more each month than the fixed monthly charge paid by a customer in the SEMO service area without reliable cost of service figures. These Commissioners have no confidence in staff's speculative determination of an appropriate fixed monthly charge in each of the service areas that varies from the southeast of \$13.92 per month to \$19.43 per month in the west to the highest charge of \$20.61 per month in the northeast.

These Commissioners share the Office of Public Counsel's (OPC) serious concerns for consumers with the adoption of a fixed variable rate design because the effect of this rate design is unknown and without adequate studies, customers' efforts to conserve will be diminished, there is a lack of conservation and efficiency programs and a shift of a large portion of the cost to low-use customers. The Staff argued tirelessly that customers should pay the same for their service through the fixed monthly charge because that was the only fair way to share the costs. The Staff then abandoned that position when it calculated the costs among the various territories without a valid basis.

II. Seasonal Disconnects

Some customers will also find a surprise from a number of tariff provisions approved by the majority. Customers who disconnect for any reason at any time throughout the year will now be required to pay the actual cost of reconnecting to the system (x24.00) as well as an additional charge for all missed delivery charges (up to three and half months). This effectively means that these customers will be paying for natural gas service during months when their usage is zero and they are fully disconnected from the system.

These Commissioners believe that customers should be able to leave and re-join the system as they choose, subject to the actual cost of reconnection to the system. Customers who do not need or cannot afford to stay on the system may now be forced to stay on the system. It is troubling to charge customers for a time period when they were not receiving service.

What makes this even worse is that this reconnection fee is not targeted at those who leave the system in the summer months and reconnect during the winter heating season. All customers who disconnect for any reason and then reconnect at the same address in a twelve month period are now required to pay this fee. This includes military personnel, college students and those attending to family or personal issues. These Commissioners would have preferred that the Report and

Order, at a minimum, have included specific exceptions for military, education and health reasons to limit unfair costs, if not eliminating the reconnection fee above the actual cost of reconnection.

Seasonal reconnection fees will be an additional barrier to low-income customers who search for any way to lawfully reduce their monthly costs which includes turning off the gas when it is not necessary. Low-income customers will now have to gather even more money to pay for the system when they were not receiving any gas service. This unfair fee places even more stress on the low income customer as well as the public assistance coffers that are already over-extended. The ultimate result may be to drive away customers to propane service to the detriment of other utility customers or fail to attract new customers.

III. Customer Service

Prior to and during the prosecution of this rate case, a number of concerns have been raised regarding Atmos' customer service performance. The staff found that Atmos' customer service performance standards were not meeting the requirements of PSC rules and policy. In addition, Commissioner Clayton has received contacts from customers unhappy with customer service whether relating to the questionable accuracy of information received from utility representatives, discourteous treatment by Atmos representatives and difficulties in understanding various company payment programs. Furthermore, the record reflects that industry surveys have suggested that Atmos has performed below average in customer service satisfaction.

Staff has insisted on improvements in customer service. Calls should be answered in a more timely fashion, information is to be more accurately disseminated and the Atmos customer call center will be reviewed for improvements in responding to Missouri inquiries. In the partial Non-Unanimous Stipulation and Agreement filed on November 29, 2006, Atmos agreed to report monthly all data it currently reports to staff and the OPC on a quarterly basis, including all call center performance metrics. By reporting this information more frequently, staff will be able to more quickly identify any failure to meet PSC policy and rules. In addition, Atmos agreed to notify staff and the OPC of all plans to improve the performance of the call center services to Missouri customers and any changes that involve the answer of Atmos' Missouri customer calls by the Waco Call Center or previous TXU customer calls being answered by the Amarillo or Metairie Call Centers.

Atmos also committed to increasing its efforts to educate its customers about the budget billing process. This commitment includes informational material that will be mailed to Missouri customers who express interest in this program; training for Atmos' call center employees specifically about the Missouri budget bill program and how bills are calculated; and an annual mailing to all Missouri budget bill customers as a reminder of the billing program's requirements.

While Atmos' commitments to specific ways to improve customer service are steps in the right direction, these Commissioners encourage Atmos to open customer service centers in Missouri. Access to Atmos' customer service

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representatives would be much improved if Missouri customers had the opportunity to call a local number or go to an Atmos location for information and assistance.

These Commissioners urge Atmos to improve its service and find ways to satisfy the concerns raised by staff and the rate paying public. The commitments made by the company must be reevaluated in the years to come to ensure that they meet the standards set by this Commission. The public services offered by the company must be of a high quality with customers confident in the information it distributes.

IV. Conclusion

In conclusion, these Commissioners do not support the Report and Order because it implements a new rate design without thorough study and without a meaningful commitment by Atmos to a comprehensive conservation and energy efficiency program. This decoupling results in Atmos' investment risk being substantially decreased while its potential profit margin is stabilized without additional benefit to ratepayers. Additionally, these Commissioners do not have confidence in the rates assigned to the various service territories and believe that only a comprehensive class cost of service study can suggest equitable rates around the state. Finally, these Commissioners cannot support "seasonal disconnection" charges that require payment for services not received.

For the foregoing reasons, these Commissioners respectfully dissent.

**In the Matter of the Application of the L.W. Sewer Corporation (Missouri), LLC
for Authority to Reorganize and Convert to a Nonprofit Sewer Company.**

Case No. SA-2007-0105

Sewer §10. The Commission ordered that L.W. Sewer Corporation, LLC, is granted authority to reorganize and convert to a nonprofit sewer company to be known as L.W. Sewer Company.

**ORDER GRANTING AUTHORITY TO REORGANIZE AND CONVERT
TO A NONPROFIT SEWER COMPANY**

Issue Date: February 27, 2007

Effective Date: March 9, 2007

Syllabus: This order grants L.W. Sewer Corporation, LLC, the authority to convert into a nonprofit sewer company, and cancels L.W. Sewer Corporation's certificate of convenience and necessity and tariff.

Procedural History

On September 18, 2006, L.W. Sewer Corporation, LLC (LWS) asked the Commission for authority to reorganize and convert to a nonprofit sewer company. In addition, LWS asked that the Commission cancel its certificate of convenience and necessity. On September 20, the Commission issued an Order and Notice and directed interested parties to file an application to intervene no later than October 10. No applications to intervene were filed.

Staff filed its initial Recommendation on November 9, claiming that LWS needed to file executed copies of its Articles of Conversion, Amendment and Acceptance and the related shareholder consent. Further, Staff mentioned that LWS needed to file its proposed bylaws under which the proposed nonprofit sewer company would operate. Upon receiving those, Staff stated that it would file its final recommendation, including information from the Missouri Department of Natural Resources regarding whether LWS complies with DNR requirements.

As directed by the Commission, on December 12, LWS filed its Articles of Conversion, Amendment and Acceptance, its Amended and Restated Bylaws, and its Statement of Unanimous Consent to Action Taken in Lieu of a Special Meeting of the Sole Shareholder. Staff responded on January 18, stating that it recommended that the Commission grant LWS the requested relief but stated, among other things, that LWS had not yet made its third quarterly payment of its FY2007 assessment, which was due on January 15, 2007. Also, Staff stated that one additional filing must be made with the Secretary of State for LWS to accomplish its conversion.

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Finally, Staff stated that Section 4, Article II of LWS's bylaws conflict with Section 393.839.5, RSMo, inasmuch as the bylaws mandate a shorter notice time of member meetings than provided in the statute.

After LWS made a compliance filing on February 8, Staff responded on February 13, stating that LWS had satisfied the above Staff concerns. Staff recommends that the Commission grant LWS the authority to reorganize and convert into a nonprofit sewer company, cancel LWS's tariff and certificate of convenience and necessity, and close the case.

Decision

Section 393.827, RSMo 2000, allows for a sewer corporation to convert into nonprofit sewer company. Upon that conversion, Section 393.847, RSMo Supp. 2002, states that the Commission has no jurisdiction over the nonprofit sewer company. Based upon the verified pleadings of LWS and Staff, the Commission finds that LWS has complied with Section 393.827 and, therefore, the Commission shall grant LWS its requested relief.

IT IS ORDERED THAT:

1. L.W. Sewer Corporation, LLC, is granted authority to reorganize and convert to a nonprofit sewer company to be known as L.W. Sewer Company.
2. The certificate of convenience and necessity the Commission issued to L.W. Sewer Corporation, LLC, in Case No. 17,314, effective November 8, 1972, is canceled.
3. The tariff of L.W. Sewer Corporation, P.S.C. Mo. No. 1, assigned tracking number JS-2002-0036, is canceled.
4. This order shall become effective on March 9, 2007.
5. This case shall be closed on March 10, 2007.

Davis, Chm., Murray, Gaw, Clayton, and Appling, CC., concur.

Pridgin, Senior Regulatory Law Judge

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Manager of the Manufactured Housing and Modular Units Program of the Public Service Commission, Complainant, v. Blakely Manufactured Homes, Respondent.

Case No. MC-2006-0389

Manufactured Housing §1. The Commission directs the department of the General Counsel to seek civil penalties from Blakely Manufactured Homes for clearly violating the Commission rules and therefore violated statute §700.100.3(6) which told how to properly set up and install a modular unit.

APPEARANCES

Sue Crane, Attorney at Law, Brady & Crane, L.L.C., 411 Court Street, Fulton, Missouri 65251, for Blakely Manufactured Homes.

Eric Krauss, Attorney at Law, Wuestling & James, L.L.C., 720 Olive Street, Suite 2020, St. Louis, Missouri 63101, for Blakely Manufactured Homes.

Robert S. Berlin, Senior Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Manager of the Housing and Modular Units Program of the Missouri Public Service Commission.

Blaine Baker, Associate Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Manager of the Housing and Modular Units Program of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Cherlyn D. Voss, Regulatory Law Judge

REPORT AND ORDER

Issue Date: February 27, 2007

Effective Date: March 9, 2007

Summary

The Missouri Public Service Commission finds that Blakely Manufactured Homes violated the Commission rules alleged in counts 1 through 9 of the Complaint filed by the Manager of the Manufactured Housing and Modular Units Program of the Commission ("Manager") on April 7, 2006, and thereby failed to meet its statutory duty pursuant to § 700.100.3(6) RSMo 2000¹ to properly set up and install a modular unit. This order further authorizes the Commission's General Counsel to seek civil penalties from Blakely Manufactured Homes pursuant to § 700.115.2 RSMo.

¹ All references to the Revised Statutes of Missouri are to the 2000 edition unless otherwise stated.

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Background

This complaint is based upon a Modular Unit Site Inspection Report of a new modular unit home bearing modular unit identification number M3264-01 ("the Modular Home") that was purchased from and set up by Blakely Manufactured Homes ("Blakely"). The Manager alleges Blakely failed to properly set up the Modular Home in violation of § 700.100.3(6) RSMo and various Commission Rules. The Manager further alleges that Blakely's failure to properly set up the Modular Home resulted in significant damage to the Modular Home and injury to its owners during a storm. Blakely claims it fully complied with all statutory and regulatory obligations related to setting up the Modular Home, because it set up the Modular Home in compliance with instructions received from the manufacturer of the Modular Home.

FINDINGS OF FACT

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Procedural History

On April 7, 2006, the Manager filed a complaint against Blakely. The Manager's complaint alleges that Blakely sold to Lawrence and Joyce King ("the Kings") a modular home bearing unit identification number M3264-01, the Modular Home. The Manager's Complaint further alleges that Blakely failed to properly set up and install the Modular Home in violation of § 700.100.3(6) RSMo and Commission Rules 4 CSR 240-123.065 and .080. Blakely filed a verified Answer on May 10, 2006, denying it had committed any of the violations alleged by the Manager.

On July 17, 2007, the Commission issued an order adopting a procedural schedule. At the request of the parties, that procedural schedule did not call for prefiled testimony, but instead anticipated all testimony would be presented live at an evidentiary hearing. The Manager and Blakely each timely filed their witness lists on October 18, 2007. After 3:00 p.m. on October 31, 2006, the day before the evidentiary hearing was scheduled to begin; Blakely filed a First Amended List of Witnesses from which the name Mr. Clarence Blakely, the owner of Blakely, had been removed.

The evidentiary hearing was conducted on November 1, 2006. At the hearing, the Manager called Lawrence and Joyce King, the owners of the Home, Ronald Pleus, the manager of the Commission's manufactured housing and modular units program, field inspector supervisor Silas Eugene Winn, and field inspector Tim Haden. Blakely participated in the hearing through counsel, but

Mr. Blakely did not appear and Blakely did not call any witnesses. The parties filed a single round of posthearing briefs.

Blakely's Certificate

On December 12, 2005, Blakely completed an Application for a Manufactured Home or Modular Unit Certificate of Dealer Registration with the Missouri Public Service Commission, which the Manager received on December 28, 2005.² On December 29, 2005, the Missouri Public Service Commission issued a Certificate of Dealer Registration to Blakely Manufactured Homes.³ From that date through the events at issue, Blakely was a licensed manufactured and modular unit home dealer in the state of Missouri.⁴ Blakely's Certificate of Dealer Registration expired on December 31, 2006, and Blakely has not submitted a request to renew that certificate for 2007.⁵

Blakely's Contractual Obligations to the Kings

On October 18, 2005, a modular home sales agreement was executed between Larry and Joyce King and Blakely.⁶ This was the first modular home ever sold by Blakely.⁷ On the "Remarks" section of the Sales Agreement, Exhibit 3, the following is clearly stated, "All option on attached order sheet includes delivery, complete set-up including air conditioning." The Kings further testified, and Blakely did not dispute, that the sale of the Modular Home included set-up and installation and that the set-up and installation were not waived in any manner.⁸

Set-up Status of the Modular Home on March 10, 2006

The Kings testified that they had several telephone conversations with Mr. Blakely regarding when the Modular Home would be ready for them to move in, because they did not want to leave their home in the State of California until the Modular Home was ready.⁹ Mr. Blakely informed the Kings that the Modular Home would be ready for them to move into when they arrived in Fulton.¹⁰

The Kings arrived at the site of their new Modular Home around noon on Friday, March 10, 2006, and started to move furniture into the home.¹¹ Mr. Blakely

² Exhibit 2 HC.

³ Exhibit 1.

⁴ Tr. 37, lines 12-16.

⁵ The Manufactured and Modular Units Program of the Missouri Public Service Commission Licensed Dealers List at www.psc.mo.gov/manhouse/Attachments/Licensed.Dealers.pfd.

⁶ Exhibit 3 HC.

⁷ Tr. 128, lines 3-6.

⁸ Tr. 43, line 25, and Tr. 44, lines 1-5; Tr. 71, lines 14-20.

⁹ Tr. 44, lines 16-25, and Tr. 45, lines 1-12.

¹⁰ Tr. 44, lines 16-25, and Tr. 45, lines 1-12; Tr. 74, lines 9-17; Tr. 78, lines 7-12.

¹¹ Tr. 44, lines 6-11.

was at the home site when the Kings arrived.¹² Mr. Blakely gave no indication that the Modular Home was not ready for the Kings to move into and made no effort to stop them from moving in.¹³ Mr. Blakely not only helped the Kings begin the moving-in process by helping them line up their moving van with a door of the Modular Home, but also had his son place the ramp of the moving van into the doorway to further facilitate the unloading of the van's contents into the Modular Home.¹⁴

The Kings testified that, based upon their earlier phone conversations with Mr. Blakely and his actions when they arrived at the Modular Home site, they believed the Modular Home was ready for them to move into and that the only thing remaining to be completed was some duct work in the basement.¹⁵ The Commission finds that Blakely had completed its set-up of the Modular Home prior to Mr. Blakely and his son assisting the Kings to move into that home on March 10th.

The March 13th Storm

Sometime after midnight, in the early morning hours of March 13, 2006, a storm struck the Fulton area. During the storm, as the Kings were making their way toward the basement of the Modular Home to take shelter, the Modular Home was partially dislodged from its foundation, thereby destroying the Modular Home and causing serious injuries to the Kings.¹⁶ The storm moved the Modular Home roughly 14 feet from its original location.¹⁷ The King's motor home that was sitting approximately 15 feet from the Modular Home during the storm was not overturned or seriously damaged.¹⁸

Set-up and Construction Deficiencies

Based upon the uncontroverted testimony of the Manager's witnesses, the Commission finds the following facts to be true.

Count 1: Blakely failed to properly attach the Modular Home onto the basement foundation in accordance with either the manufacturer's instructions or

¹² Tr. 45, lines 13-18.

¹³ Tr. 45, lines 19-24.

¹⁴ Tr. 45, line 25, and Tr. 46, lines 4-15.

¹⁵ Tr. 45, lines 19-24; Tr. 56, lines 11-25; Tr. 57, lines 1-2; Tr. 60, lines 8-12; Tr. 66, lines 10-21; Tr. 73, lines 4-6.

¹⁶ Tr. 54, lines 1-12; Tr. 55, lines 18-25; Tr. 56, lines 1-10; Tr. 58, lines 11-25; Tr. 59, lines 1-20; Tr. 87, lines 11-22.

¹⁷ Tr. 176, lines 6-8.

¹⁸ Tr. 64, lines 5 -16.

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the Generic HUD manual that Blakely contends Mr. Blakely received from the manufacturer.¹⁹ Specifically:

1. The Modular Home was resting on concrete walls on the ends and backside and improperly fastened to the walls using "Minute Man" frame straps that were embedded in the top of the concrete walls and fastened to the inside of the home's perimeter rim joist using (1) ¼" x 1 1/2" lag bolt per strap;
2. The "Minute Man" straps were improperly spaced approximately 2-feet to 4-feet from the corners, and up to approximately 6-feet to 7-feet apart along the walls;
3. Neither the manufacturer nor the Minute Man company approve Blakely's method of using "Minute Man" straps to fasten a modular home to a foundation;
4. The front side of the home was resting on a wood framed walkout wall;
5. There was no visible fastening of the home to the wood framed walkout wall;
6. The wood framed walkout wall was improperly fastened to the basement floor with anchor bolts, 1-inch washer and nut, spaced up to 17" apart;
7. The manufacturer's set up instructions require a 2" x 6" treated sill plate fastened to the top of the basement wall using 5/8" x 7" minimum embedment anchor bolts with nut and 2/9 inch washer, spaced at 6-feet a part maximum and within 1-foot from the ends of each plate, but Blakely failed to install any sill plate on top of the basement walls;
8. Blakely did not use an approved "Simpson Tie" installed according to the manufacturers installation instructions to attach the sill plate to the foundation; and
9. The home's perimeter rim joist was not fastened to the basement sill plate using the required 16d nails spaced a maximum of 6-inches apart.²⁰

Blakely's failure to properly attach the Modular Home onto the Basement foundation resulted in the home being shifted 14 feet during the March 13th storm.²¹

Count 2: Blakely failed to properly support the centerline of the Modular Home with the necessary number of jack posts as per the manufacturer's instructions, which left the center of the Modular Home, where the two sections meet, insufficiently supported.²² The Manufacturer's set-up instructions called for 12

¹⁹ Tr. 99, lines 9-20; Tr. 101, line 18 through Tr. 103, line 7; Tr. 159, lines 19-22; Tr. 175, lines 3-7; Tr. 176, lines 6-8; Exhibit 4, p. 2; and Exhibit 6, page 6.

²⁰ Exhibit 4, pp. 2 and 3; See also: Tr. 101, line 10 through 103, line 18.

²¹ *Id.*

²² Tr. 104, lines 7-20; Tr. 105, lines 10-15. Exhibit 4, p. 2; and Exhibit 6, page 7.

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jack posts along the Modular Home's center line and the Generic HUD Manual required 9, but Blakely only installed 6 or 7 spaced approximately nine feet apart along the homes center line.²³

Count 3: Blakely failed to follow the manufacturer's instructions by neglecting to properly attach the supporting jack posts to the center beam of the Modular Home, as well as to the concrete footing.²⁴ The manufacturer requires the top of each jack post to be fastened on two sides at the center beam using two number 10 x 2" screws minimum, but Blakely only fastened one side of each jack post to the center beam with a lag bolt.²⁵ Additionally, the manufacturer requires the base of each jack post to be fastened using a (4) 5/8" x 8" anchor bolt, but Blakely did not fasten the Modular Home's jack posts at their base.²⁶

Count 4: Blakely failed to fasten the hinged roof of the Modular Home to the king post stubs as required by the directions contained in the manufacturer's instructions, which caused the king posts to shift off the stubbed king posts during the March 13th storm.²⁷ The manufacturer requires the Modular Home's 2" and 3" bottom rail to be fastened to the stubbed kingpost using 2 number 8 x 3" wood screws, tow –screwed at each truss, but:

1. There was no visible fastening between the Modular Home's hinged king posts and the stubbed kingposts; and
2. The Modular Home's 2" and 3" bottom rail was not fastened to the stubbed kingposts.²⁸

Count 5: Blakely failed to properly fasten in place the drop-in roof ridge sections of the Modular Home in accordance with the manufacturer installation instructions, which caused the peak section of the Modular Home to come loose when the Modular Home was moved from its foundation during the March 13th storm.²⁹ The manufacturer's installation instructions require that the bottom rails of the ridge sections to be fastened to the top rails of the roof sections using two number 8 x 3-inch screws per bay, but:

1. The Modular Home's ridge sections were improperly shimmed between the ridge rails and roof rails with lumber up to approximately 5-inches; and

²³ Exhibit 4, pp. 2 and 4; See also: Tr. 104, line 7 through Tr. 106, line 13 and Tr. 127, line 16 through Tr. 128 line 2.

²⁴ Tr. 106, lines 14-25; Tr. 107, lines 1-25; Tr. 108, lines 1-3; Exhibit 4, p. 2; and Exhibit 6, page 8.

²⁵ Exhibit 4, pp. 2 and 5; See also: Tr. 106, line 14 through Tr. 108, line 3.

²⁶ Id.

²⁷ Tr. 108, lines 9-22; Tr. 109, lines 1-15; Exhibit 4, p. 2; and Exhibit 6, page 9.

²⁸ Exhibit 4, pp. 2, 6 and 7. See also: Tr. 108, line 4 through 109, line 15.

²⁹ Tr. 109, line 22 through Tr. 111, line 5; Exhibit 4, p. 2; and Exhibit 6, page 10.

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2. The Modular Home's ridge sections were only held in place with nails.³⁰

Count 6: Blakely failed to properly fasten together the two end walls of the home sections as per the directions in the manufacturer's instructions.³¹ The manufacturer requires that the end walls of the two sections be fastened together using number 8 x 3" screws spaced a maximum of 12-inches apart,³² but:

1. The Modular Home's end walls were fastened with just two metal straps held on by small screws,³³ and
2. The metal straps Blakely used were not approved for securing home sections together.³⁴

Count 7: Blakely failed to properly construct the stairway to the basement of the Modular Home in accordance with the International Residential Code-2000.³⁵ Blakely installed stairs in the Modular Home that were enclosed from the back which require a minimum ten-inch tread and ¾-inch nosing, but the Modular Home stairs only had a nine-inch tread and lacked the requisite ¾-inch nosing.³⁶

Count 8: Blakely did not install guard rails on the sides of the stairway to the basement of the Modular Home in accordance with the International Residential Code-2000.³⁷ Although Blakely built a stairway to the basement of the Modular Home that was over 30" above the floor or grade and thus required guard rails, Blakely did not install any guard rails on that stairway.³⁸

Count 9: Blakely did not install a handrail on either side of the stairway to the basement of the Modular Home in accordance with the International Residential Code-2000.³⁹ Stairs installed in modular homes must have at least one handrail on one side of the stairway, but Blakely failed to install a handrail on either side of the stairway to the basement of the Modular Home.⁴⁰

Set-up Instructions Received by Blakely

Blakely did not offer any evidence or argument suggesting that the specific violations and specific problems listed in the "Summary of Problems" section of the

³⁰ Exhibit 4, pp. 2 and 8. See also: Tr. 109, line 16 through 111, line 5.

³¹ Tr. 111, line 13 through 112 line 11, Exhibit 4, p. 2; and Exhibit 6, page 11.

³² Exhibit 4, pp. 2 and 9. See also: Tr. 111, lines 6 – 25.

³³ Tr. 112, lines 1 – 7.

³⁴ Tr. 112, lines 8 – 11.

³⁵ Tr. 112, line 12 through 113, line 11; Exhibit 4, p. 2; and Exhibit 6, page 12.

³⁶ Id.

³⁷ Tr. 114, line 7 through Tr. 115, line 2; Exhibit 4, p. 2; and Exhibit 6, pages 13-14.

³⁸ Id.

³⁹ Tr. 115, lines 3-16; Exhibit 4, p. 2; and Exhibit 6, pages 13-14.

⁴⁰ Id.

Site Inspection Report, items numbered 5 through 13, were inaccurate.⁴¹ Instead, Blakely argues that Mr. Blakely received the wrong set-up manual from Four Season's Manufacturing, Inc., d/b/a Four Seasons Housing ("Four Seasons"), the manufacturer of the Modular Home, and that Blakely set up the Modular Home in accordance with that manual. The only evidence in the record supporting Blakely's contention that it did not receive the appropriate set-up manual is a single statement Mr. Blakely made to field inspector, Tim Haden. Mr. Haden testified that during a visit to Blakely, Mr. Blakely "held up an installation instruction manual for a Four Seasons HUD house⁴² and he said, this is what I got with the home."⁴³ Since Mr. Blakely declined to testify at the evidentiary hearing, the Commission could not ask him what, if any, other information he received from Four Seasons or whether Four Seasons made any assertions to him regarding what instructions to use in setting up the Modular Home. There is insufficient evidence in the record to support a finding that Mr. Blakely did not receive the appropriate set-up manual from Four Seasons.

Set-up Violations Irrespective of Manual Used

Inspection Supervisor Winn testified that he had compared the Generic HUD Manual Blakely's counsel contends Four Seasons sent to Mr. Blakely with the instructions that Four Seasons provided to the Manager.⁴⁴ Winn testified that the two manuals are "basically the same, following the same guidelines as to the fastening, the bolts, things like that."⁴⁵ Mr. Pleus and Mr. Winn each testified, and Blakely offered no evidence to dispute, that the Modular Home was also not set up in compliance with the Generic HUD Manual.⁴⁶

Blakely did identify one difference between the set-up and installation requirements in the Generic HUD Manual and the manufacturer's instructions, the number of jack posts required. The manufacturer's instructions called for 12 jack posts along the center line of the home,⁴⁷ while the Generic HUD Manual only required 9.⁴⁸ However, since Mr. Blakely only used 6 or 7 jack posts along the center line, this too would be the set-up violation irrespective of which instruction manual was used.⁴⁹

⁴¹ The Site Inspection Report was marked Exhibit 4 and admitted into evidence during the November 1, 2007 evidentiary hearing without objection.

⁴² The installation instruction manual for a Four Seasons HUD house will hereinafter be referred to as the "Generic HUD manual".

⁴³ Tr. 125, lines 12-20.

⁴⁴ Tr. 169, line 18 through 170, line 3;

⁴⁵ *Id.*

⁴⁶ Tr. 170, line 24 through 171 line 11; Tr. 175, lines 3-7; and Tr. 186, line 8 through 188 line 9.

⁴⁷ Tr. 105, lines 10-15.

⁴⁸ Tr. 127, line 16 through 128 line 2.

⁴⁹ Tr. 106, lines 2-6.

Furthermore, Mr. Pleus and Mr. Winn both testified that even if Blakely's set-up of the Modular Home was reviewed based upon the Generic HUD Manual, while the specific details might have been different, Blakely would still have committed each of the violations alleged in the Manager's complaint.⁵⁰

CONCLUSIONS OF LAW

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

1. Blakely is a registered dealer of modular units as defined by § 700.090 RSMo Cum. Supp. 2005. As such, Blakely is subject to the Commission's jurisdiction pursuant to Chapter 700 RSMo.

2. The Commission has jurisdiction to consider the Manager's complaint against Blakely.⁵¹

3. A registered dealer who sells a modular unit is responsible for completing the proper initial set-up and installation of that unit unless the purchaser expressly releases the dealer from that obligation.⁵²

4. If the Commission finds Blakely failed to meet its statutory duty pursuant to § 700.100.3(6) RSMo to properly set up and install the Modular Home, the Commission may direct its General Counsel to seek penalties in civil court as authorized by § 700.115.2 RSMo. That section provides in pertinent part as follows:

2. Notwithstanding any provisions of subsection 1 of this section to the contrary, whoever violates any provision of this chapter shall be liable to the state of Missouri for a civil penalty in an amount which shall not exceed one thousand dollars for each such violation. Each violation of this chapter shall constitute a separate violation with respect to . . . or with respect to each failure or refusal to allow or perform an act required by this chapter; . . .

5. The Commission has adopted minimum standards for the manufacture and installation of tiedowns and anchors for modular units pursuant to its authority under § 700.076(2) RSMo. Those standards are contained in 4 CSR 240-123.065 and 4 CSR 240-123.080. Section 4 CSR 240-123.065(1) provides as follows:

(1) A dealer who sells a modular unit shall arrange for the proper initial set up of the modular unit unless the dealer obtains from the purchaser or the purchaser's authorized agent a written waiver of that service as described in section 700.100.3(6), RSMo.

⁵⁰ Id.

⁵¹ § 700.100.2, RSMo Cum. Supp. 2005.

⁵² 4 CSR 240-123.065(1)

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Section 4 CSR 240-123.065(2) defines "proper initial set up" as follows:

- (2) As used in this rule, "proper initial set up" means installation and set up of the modular unit in accordance with the installation manual provided by the manufacturer of the modular unit and in complete compliance with the code and with all of the provisions regarding set up in sections 700.010 to 700.115, RSMo.

Section 4 CSR 240-123.080(7) reads as follows:

- (7) All modular units manufactured on or after July 1, 1976, shall be set up or installed according to the manufacturer's installation manual.

6. Commission rules 4 CSR 240-123.065(1) and (2) and 4 CSR 240-123.080(7) taken together require a dealer to set up and install each modular unit it orders and sells in accord with the installation instructions for that specific modular unit provided by that modular unit's manufacturer. As used above, "provided by" means the instructions generated or published by the manufacturer for a specific unit. It does not mean physically handed or mailed to any individual dealer.

Further, before a person or company can sell modular units in the State of Missouri, they must obtain a dealers' registration certificate from the Commission.⁵³ A dealer holding such a registration certificate is expected to know the model type of each modular unit it orders and to verify that it receives the correct set-up and installation manual for each unit.

7. Blakely was required to construct the stairway to the basement of the Modular Home, including installation of hand rails and guardrails, in accordance with the International Residential Code-2000 ("2000 IRC"). Section 4 CSR 240-123.080(3) provides that modular units "shall be manufactured in accordance with and meet the requirements of the following building codes: . . . ; *International Residential Code-2000* . . ." Further more, 4 CSR 240-123.080(4) incorporates into the rule the full text of the material listed in section 4 CSR 240-123.080(3), including the International Residential Code-2000.⁵⁴

8. R314.2 2000 IRC requires a minimum tread depth of ten inches and a 3/4-inch nosing if the back of the stairs are enclosed.⁵⁵

9. R315.1 2000 IRC requires at least one handrail to be placed upon a staircase constructed in a modular unit, such as the Modular Home.⁵⁶

10. R316.2 2000 IRC requires guards "not less than 34 inches in height" on the "open sides of stairs with a total rise of more than 30 inches (762 mm) above the floor . . ."⁵⁷

⁵³ § 700.090 RSMo.

⁵⁴ 4 CSR 240-123.080(4).

⁵⁵ R314.2 2000 International Residential Code.

⁵⁶ R315.1 2000 International Residential Code.

DECISION

After applying the facts as it has found them to its conclusions of law, the Commission has reached the following decisions on the issues framed or raised by the parties:

Issue 1: If a manufacturer fails to send a dealer the appropriate set-up and installation instructions for a modular unit, does it release the dealer from its obligation to properly set up and install that modular unit under § 700.1003(6) RSMo, 4 CSR 240-123.065(1) and (2), and/or 4 CSR 240-123.080(7)?

A dealer is not released from its obligation to properly set up that home under § 700.100.3(6) RSMo, 4 CSR 240-123.065(1) and (2), and/or 4 CSR 240-123.080(7), when it does not receive the appropriate set-up and installation instructions for that modular unit from the manufacturer. As set out above, Blakely's interpretation of 4 CSR 240-123.080(7), which is that a licensed modular unit dealer has no duty to verify that it receives the appropriate set-up and installation manuals for the modular units it orders and sells, is incorrect. The Commission finds that a licensed dealer, such as Blakely, has a duty to obtain from the manufacturer the appropriate installation and set-up instructions for the specific modular units ordered and to install and set up the units in accordance with those instructions.

While a manufacturer clearly has a duty to provide to the dealer the appropriate set-up and installation instructions for each unit it sends to that dealer, its failure to carry out that duty does not release a dealer from its independent responsibility to verify it received the appropriate instructions. Blakely's interpretation of 4 CSR 240-123.065 and .080 could discourage dealers from taking any steps to ensure they have the correct set-up and installation instructions for the units they sell, and thereby place their customers at unreasonable risk. Further, because it would be difficult, if not impossible, to prove what manual a dealer did or did not receive, Blakely's interpretation could allow a dealer that received the appropriate set-up and installation manual to claim otherwise.

Issue 2: Was the set-up and installation of the Modular Home in compliance with the instructions Blakely claims it received from the Modular Home's manufacturer?

It is not necessary for the Commission to reach a decision on this issue, because the Commission found Blakely had a duty to obtain from the manufacturer the appropriate installation and set-up instructions for the specific model ordered and to install and set up the Modular Home in accordance with those instructions. However, all of the evidence presented in this case indicates that if Blakely's installation and set-up of the Modular Home had been reviewed under the Generic HUD Manual, the specific details of the violations might have been slightly different,

⁵⁷ R315.2 2000 International Residential Code.

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but Blakely would still have committed each of the violations alleged in the Manager's complaint.⁵⁸

Issue 3: Was the set-up and installation of the Modular Home completed on March 10, 2006, when the owners began moving into the Modular Home?

The set-up and installation of the Modular Home was completed on March 10, 2006, at or before the time the Kings, assisted by Mr. Blakely and his son, began moving into the Modular Home.

Issue 4: Did Blakely meet its statutory duty pursuant to § 700.100.3(6) RSMo to properly set up and install the Modular Home according to the manufacturer's instructions and in accordance with Commission rules?

Blakely did not meet its statutory duty pursuant to § 700.100.3(6) RSMo to properly set up and install the Modular Home according to the manufacturer's instructions and in accordance with Commission rules as alleged in the Manager's Complaint, Counts 1 through 9.

(a) **Count 1: Did Blakely fail to properly attach the Modular Unit onto the basement foundation in accordance with manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7)?**

Blakely failed to properly attach the Modular Unit onto the basement foundation in accordance with manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7).

(b) **Count 2: Did Blakely fail to properly support the centerline of the Modular Home with necessary jack posts according to manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7)?**

Blakely failed to properly support the centerline of the Modular Home with necessary jack posts according to manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7).

(c) **Count 3: Did Blakely fail to properly attach the supporting jack posts to the Modular Home's center beam and to the concrete footing according to the manufacturer's foundation drawing in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7)?**

Blakely failed to properly attach the supporting jack posts to the Modular Home's center beam and to the concrete footing according to the manufacturer's

⁵⁸ Tr. 170, line 24 through 171 line 11; Tr. 175, lines 3-7; and Tr. 186, line 8 through 188 line 9.

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foundation drawing in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7).

- (d) **Count 4: Did Blakely fail to properly fasten the Modular Home's hinged roof according to manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7)?**

Blakely failed to properly fasten the Modular Home's hinged roof according to manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7).

- (e) **Count 5: Did Blakely fail to properly fasten in place the drop-in roof ridge sections of the Modular Home in accordance with manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7)?**

Blakely failed to properly fasten in place the drop-in roof ridge sections of the Modular Home in accordance with manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7).

- (f) **Count 6: Did Blakely fail to properly fasten together the end walls of both Modular Home sections in accordance with manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7)?**

Blakely failed to properly fasten together the end walls of both Modular Home sections in accordance with manufacturer instructions in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(7).

- (g) **Count 7: Did Blakely fail to properly construct the Modular Home stairway to the basement in accordance with the International Residential Code-2000 in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(3), (4) and (7)?**

Blakely failed to properly construct the Modular Home's stairway to the basement in accordance with the International Residential Code-2000 in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(3), (4) and (7).

- (h) **Count 8: Did Blakely fail to install guards on the sides of the Modular Home's stairway in accordance with International Residential Code-2000 in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(3), (4) and (7)?**

Blakely failed to install guards on the sides of the Modular Home's stairway in accordance with International Residential Code-2000 in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(3), (4) and (7).

- (i) **Count 9: Did Blakely fail to install a handrail on the Modular Home's basement stairway in accordance with International**

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Residential Code-2000 in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(3), (4) and (7)?

Blakely failed to install a handrail on the Modular Home's basement stairway in accordance with International Residential Code-2000 in violation of 4 CSR 240-123.065(1) and (2), and 4 CSR 240-123.080(3), (4) and (7).

Issue 5: Should the Commission authorize its General Counsel to seek civil penalties from Blakely pursuant to § 700.115.2?

Blakely failed to meet its statutory duty pursuant to § 700.100.3(6) RSMo to properly set up and install the Modular Home, the Commission will direct its General Counsel to seek penalties in civil court as authorized by § 700.115.2 RSMo.

CONCLUSION

Blakely Manufactured Homes clearly violated the Commission rules alleged in counts 1 through 9 of the Complaint filed by the Manager on April 7, 2006, and thereby failed to meet its statutory duty pursuant to § 700.100.3(6) RSMo to properly set up and install a modular unit. The Commission will authorize its General Counsel to seek civil penalties from Blakely Manufactured Homes pursuant to § 700.115.2 RSMo. If Blakely, or any entity controlled by Mr. Blakely,⁵⁹ seeks a Certificate of Dealer Registration from the Commission or renewal of an existing certificate the Manager shall advise the Commission of that request. The Commission will determine whether to grant or renew any such certification request.

IT IS ORDERED THAT:

1. The General Counsel of the Missouri Public Service Commission is directed to seek civil penalties from Blakely Manufactured Homes pursuant to § 700.115.2 RSMo.
2. The Manager of the Manufactured Housing and Modular Units Department of the Missouri Public Service Commission shall advise the Commission of any request for a Certificate of Dealer Registration or to renew a Certificate of Dealer Registration submitted by Blakely Manufactured Homes, or any entity controlled by Mr. Clarence Blakely.⁶⁰ The Commission will determine whether to grant or renew any such certification request.
3. This Report and Order shall become effective on March 9, 2007.

Davis, Chm., Murray, Gaw,
Clayton, and Appling, CC., concur,
and certify compliance with the
provisions of Section 536.080, RSMo.

⁵⁹ Mr. Blakely will be deemed to "control" a company if he serves as director, officer or partner or owns more than 10% of the company.

⁶⁰ Id.

NORTHWEST MISSOURI CELLULAR LIMITED PARTNERSHIP

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In the Matter of the Application of Northwest Missouri Cellular Limited Partnership for Designation as a Telecommunications Company Carrier Eligible for Federal Universal Service Support Pursuant to § 254 of the Telecommunications Act of 1996.

Case No. TO-2005-0466

Telecommunications §14.1. The Commission designated Northwest Missouri Cellular Limited Partnership as a Telecommunications Company Carrier Eligible for Federal Universal Service Fund purposes pursuant to § 254 of the Telecommunications Act of 1996.

ORDER GRANTING MOTION TO AMEND REPORT AND ORDER

Issue Date: March 1, 2007

Effective Date: March 11, 2007

On January 25, 2007, Northwest Missouri Cellular Limited Partnership filed a motion requesting that the Commission amend its Report and Order issued on September 21, 2006, to include language that will clarify the service area for which it designated NWMC as an eligible telecommunications carrier for federal Universal Service Fund purposes. No response to the motion was received.

Because NWMC sought eligible telecommunications carrier status in an area served by a rural telephone company, and seeks that status for an area other than the rural carrier's entire study area, 47 CFR 54.207 requires that the service area of Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, and Sprint Missouri, Inc.,¹ be redefined in order for NWMC to be eligible to receive federal universal service support. The Commission intended for its order to specify the service areas in which NWMC was designated as an ETC and make the redefinitions as necessary. The order, however, was not clear on these points. Therefore, the Commission hereby clarifies and amends its Report and Order to include the following findings and conclusions.

Cream Skimming

Although not specifically included within any of the disputed issues in this case, the issue of "cream skimming" must be addressed because of NWMC's request to redefine the Alltel² and Grand River Mutual³ and Sprint⁴ service areas for the

¹ Sprint Missouri, Inc., has changed its name to Embarq Missouri, Inc., but was referred to in the Report and Order, and will continued to be referred to, as "Sprint."

² NWMC proposes to redefine the Alltel service area to allow NWMC to be designated as an ETC in only the Albany and Grant City wire centers as well as substantially all of the Allendale wire center. (Application ¶11.)

³ NWMC proposes to redefine the Grand River Mutual service area to allow NWMC to be designated as an ETC in the Barnard, Conception Junction, Denver, Darlington, Gentry, Graham, New Hampton, Parnell, Ravenwood and Sheridan wire centers. (Application ¶12.)

purpose of the competitive ETC designation.⁵ Cream skimming occurs when a competitive ETC serves only the lower cost portions of an incumbent local exchange carrier's study area but receives support calculated in relation to unserved, higher-cost portions of the study area. In its Virginia Cellular⁶ and Highland Cellular⁷ orders, the FCC held that where the population densities of the entire ILEC study area are significantly lower than the population density within the ETC service area, cream skimming has occurred. In the present case, no cream skimming has occurred.

Specifically, witness Jonathan Reeves established that:

In the case of the proposed redefinition of the Alltel service area in Zone 1, the population density in the proposed NWMC service area is 21.54 people per mile as compared to Alltel's Zone 1 study-wide average population density of 32.61 people per square mile;

The single Allendale wire center proposed for inclusion in NWMC's ETC service area from Alltel's Zone 3 study area is the most rural wire center in that entire study area, having a population density of 4.64 persons per square mile as compared to the population density of 12.90 persons per square mile for the entire Zone 3 study area;

The average population density for the Grand River wire centers proposed for inclusion within the NWMC service area is 8.35 persons per square mile, slightly below the overall population density of Grand River's Zone 2 which is 8.48 persons per square mile;

The Sprint wire centers included within the proposed NWMC ETC service area have an average population density of 27.39 persons per square mile as compared to an overall study area population density of 54.00 persons per square mile; and

In each and every instance where NWMC seeks redefinition of the ILEC service area, the population densities within the portions of those study areas sought to be included in the NWMC ETC service area fall below the overall population densities upon which the LEC level of support has been based.⁸

⁴ NWMC proposes to include the following Sprint wire centers within its proposed ETC service area: Craig, Fairfax, Hopkins, King City, Maryville, Mound City, Pickering and Tarkio wire centers. (Application ¶12.)

⁵ As explained in detail in the Application, NWMC is not seeking to redefine the study area for any rural LEC; NWMC is merely seeking to redefine several LEC service areas for the limited purpose of designating a competitive ETC. (Application ¶13.)

⁶ In the Matter of Federal-State Joint Board on Universal Service, Virginia Cellular, LLC Application for Designation as an Eligible Telecommunications Carrier In the Commonwealth of Virginia, Memorandum Opinion and Order, CC Docket No. 96-45, FCC 03-338 (rel. January 22, 2004).

⁷ In the Matter of Federal-State Joint Board on Universal Service, Highland Cellular, Inc., Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia, CC Docket No. 96-45, FCC 04-37 (rel. April 12, 2004).

⁸ Direct Testimony of Jonathan D. Reeves ("Reeves Direct") 4:17 – 6:15.

Thus, the Commission determines that under the population density analysis, there is no cream skimming.

Even if this were not the case, the FCC has formulated a procedure to virtually eliminate the concern of cream skimming, even where the population density might not be as it is in the present case:

[A]s the Commission concluded in Universal Service Order, the primary objective in retaining the rural telephone company's study area as the designated service area of a competitive ETC is to ensure that competitors will not be able to target only the customers that are the least expensive to serve and thus undercut the incumbent carrier's ability to provide service to the high-cost customers. Rural telephone companies now have the option of disaggregating and targeting high-cost support below the study area level so that support will be distributed in a manner that ensures that the per-line level of support is more closely associated with the cost of providing service. Therefore, any concern regarding "creamskimming" of customers that may arise in designating a service area that does not encompass the entire study area of the rural telephone company has been substantially eliminated.⁹

Consequently, even if NWMC were not able to demonstrate that cream skimming is not an issue based on population density, there would be no basis to find that cream skimming exists.

Redefinition of Service Areas

The Commission has designated NWMC as an eligible telecommunications carrier in the non-rural study areas of Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri, and CenturyTel of Missouri, and the complete rural study area of Northwest Missouri Cellular Limited Partnership. Further, the Commission designated NWMC an ETC in the partial study areas of Alltel, Grand River Mutual, and Sprint. For these partial rural study areas, pursuant to Section 214(e)(5) of the Communications Act of 1934, as amended, and Federal Communications Commission (FCC) Rule 54.207, the Commission designated NWMC as an ETC in the complete wire centers as follows:

Alltel Missouri

Albany
Grant City
Allendale

Grand River Mutual

Barnard
Conception Junction

⁹ Petitions for Reconsideration of Western Wireless Corporation's Petition for Designation as an Eligible Telecommunications Carrier in the State of Wyoming, 16 FCC Rcd 19144, 19149 (2001) (emphasis added, footnotes omitted). See also Pine Ridge, supra, 16 FCC Rcd at 18141, where the FCC used identical language in designating Western Wireless as an ETC for an area that is less than the ILEC's entire study area.

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Denver
Darlington
Gentry
Graham
New Hampton
Parnell
Ravenwood
Sheridan

Sprint Missouri

Craig
Fairfax
Hopkins
King City
Maryville
Mound City
Pickering
Tarkio

The Commission finds that: (1) NWMC's redefinition will not result in cream skimming; (2) the rural carriers whose service areas NWMC seeks to redefine will not be harmed by the redefinition of their study areas to conform to NWMC's licensed service area; (3) the rural carriers whose service areas NWMC seeks to redefine will not be required to recalculate costs as a result of a service area redefinition; and (4) no other administrative burdens have been placed on the rural carriers whose service areas NWMC seeks to redefine as a result of a service area redefinition. Accordingly, the Commission approves NWMC's request to redefine the service areas of Alltel, Grand River Mutual, and Sprint.

IT IS ORDERED THAT:

1. The Motion to Amend Report and Order filed by Northwest Missouri Cellular Limited Partnership on January 25, 2007, is granted.
2. The Report and Order issued on September 21, 2006, is hereby amended as set out above to redefine the service areas of Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, and Sprint Missouri, Inc.¹⁰
3. This order shall become effective on March 11, 2007.
4. This case may be closed on March 12, 2007.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur.

Dippell, Deputy Chief Regulatory Law Judge

¹⁰ Now known as Embarq Missouri, Inc.

In the Matter of the Application of Missouri RSA No. 5 Partnership for Designation as a Telecommunications Company Carrier Eligible for Federal Universal Service Support Pursuant to § 254 of the Telecommunications Act of 1996

Case No. TO-2006-0172

Telecommunications §8. The Commission ordered that the Report and Order issued on September 21, 2006 be amended as set out in this order to redefine the service areas of Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, Mark Twain Rural Telephone Corporation, and Spectra Communications Group, LLC, d/b/a CenturyTel.

ORDER GRANTING MOTION TO AMEND REPORT AND ORDER

Issue Date: March 1, 2007

Effective Date: March 11, 2007

On January 25, 2007, Missouri RSA No. 5 Partnership (MO 5) filed a motion requesting that the Commission amend its Report and Order issued on September 21, 2006, to include language that will clarify the service area for which it designated MO 5 as an eligible telecommunications carrier for federal Universal Service Fund purposes. No response to the motion was received.

Because MO 5 sought eligible telecommunications carrier status in an area served by a rural telephone company, and seeks that status for an area other than the rural carrier's entire study area, 47 CFR 54.207 requires that the service area of Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, Mark Twain Rural Telephone Company, and Spectra Communications Group, LLC, d/b/a CenturyTel, be redefined in order for MO 5 to be eligible to receive federal universal service support. The Commission intended for its order to specify the service areas in which MO 5 was designated as an ETC and make the redefinitions as necessary. The order, however, was not clear on these points. Therefore, the Commission hereby clarifies and amends its Report and Order to include the following findings and conclusions.

Cream Skimming

Although not specifically included within any of the disputed issues in this case, the issue of "cream skimming" must be addressed because of MO 5's request to redefine the Alltel,¹ Grand River Mutual,² Mark Twain,³ and Spectra⁴ service areas for

¹ MO 5 proposes to redefine the Alltel service area to allow MO 5 to be designated as an ETC in only the Laclede, Mendon, Rothville, and Sumner wire centers. (Application ¶¶11.)

the purpose of the competitive ETC designation.⁵ Cream skimming occurs when a competitive ETC serves only the lower cost portions of an incumbent local exchange carrier's study area but receives support calculated in relation to unserved, higher-cost portions of the study area. In its *Virginia Cellular*⁶ and *Highland Cellular*⁷ orders, the FCC held that where the population densities of the entire ILEC study area are significantly lower than the population density within the ETC service area, cream skimming has occurred. In the present case, no cream skimming has occurred.

Specifically, witness Jonathan Reeves established that:

In the case of the proposed redefinition of the Alltel service area in Zone 1, the population density in the proposed MO 5 service area is 9.56 people per mile as compared to Alltel's Zone 1 study-wide average population density of 28.89 people per square mile;

The two wirecenters proposed for inclusion in MO 5's service area from Alltel's Zone 2 study area are the two most rural wire centers in that entire study area, having population densities of 6.98 and 7.14 persons per square mile as compared to the population density of 20.2 persons per square mile for the entire Zone 2 study area;

The average population density for the wirecenters proposed for inclusion in MO 5's service area from Grand River's zone 2 is 8.83 persons per square mile, nearly identical to the overall population density of Grand River's Zone 2 which is 8.48 persons per square mile;

The Mark Twain wire centers included within the proposed MO 5 ETC service area have an average population density of 7.64 persons per square mile as compared to an overall study area population density of 9.57 persons per square mile;

² MO 5 proposes to redefine the Grand River Mutual service area to allow MO 5 to be designated as an ETC in the Linneus, Meadville, Purdin, and Browning wire centers. (Application ¶12.)

³ MO 5 proposes to include the Mark Twain Bethel and Leonard wire centers within its proposed ETC service area. (Application ¶13.)

⁴ MO 5 proposes to include the following Spectra wire centers within its proposed ETC service area: Brunswick, Clarence, Dalton, Elmer, Hunnewell, Keytesville, LaPlata, Macon, Shelbina, and Shelbyville. (Application ¶13 and Appendix C).

⁵ As explained in detail in the Application, MO 5 is not seeking to redefine the study area for any rural LEC; MO 5 is merely seeking to redefine several LEC service areas for the limited purpose of designating a competitive ETC. (Application ¶13.)

⁶ In the Matter of Federal-State Joint Board on Universal Service, *Virginia Cellular, LLC* Application for Designation as an Eligible Telecommunications Carrier In the Commonwealth of Virginia, Memorandum Opinion and Order, CC Docket No. 96-45, FCC 03-338 (rel. January 22, 2004).

⁷ In the Matter of Federal-State Joint Board on Universal Service, *Highland Cellular, Inc.*, Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia, CC Docket No. 96-45, FCC 04-37 (rel. April 12, 2004).

The Spectra wire centers included within the proposed MO 5 ETC service area have an average population density of 50.83 persons per square mile in Zone 1, which is nearly identical to the composite population density of 49.50 persons per square mile in Zone 1, and an average population density of 13.37 persons per square mile in Zone 2, as compared to a composite population density of 16.23 persons per square mile in Zone 2; and

In each and every instance where MO 5 seeks redefinition of the ILEC service area, the population densities within the portions of those study areas sought to be included in the MO 5 ETC service area either fall below or are virtually identical with the overall population densities upon which the LEC level of support has been based.⁸

Thus, the Commission determines that under the population density analysis, there is no cream skimming.

Even if this were not the case, the FCC has formulated a procedure to virtually eliminate the concern of cream skimming, even where the population density might not be as it is in the present case:

[A]s the Commission concluded in Universal Service Order, the primary objective in retaining the rural telephone company's study area as the designated service area of a competitive ETC is to ensure that competitors will not be able to target only the customers that are the least expensive to serve and thus undercut the incumbent carrier's ability to provide service to the high-cost customers. Rural telephone companies now have the option of disaggregating and targeting high-cost support below the study area level so that support will be distributed in a manner that ensures that the per-line level of support is more closely associated with the cost of providing service. Therefore, any concern regarding "creamskimming" of customers that may arise in designating a service area that does not encompass the entire study area of the rural telephone company has been substantially eliminated.⁹

Consequently, even if MO 5 were not able to demonstrate that cream skimming is not an issue based on population density, there would be no basis to find that cream skimming exists.

Redefinition of Service Areas

The Commission has designated MO 5 as an eligible telecommunications carrier in the non-rural study areas of Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri, and CenturyTel of Missouri, and the complete rural study area of Chariton Valley Telephone Company. Further, the Commission designated MO 5

⁸ Direct Testimony of Jonathan D. Reeves ("Reeves Direct") 4:12 – 7:2.

⁹ Petitions for Reconsideration of Western Wireless Corporation's Petition for Designation as an Eligible Telecommunications Carrier in the State of Wyoming, 16 FCC Rcd 19144, 19149 (2001) (emphasis added, footnotes omitted). See also Pine Ridge, supra, 16 FCC Rcd at 18141, where the FCC used identical language in designating Western Wireless as an ETC for an area that is less than the ILEC's entire study area.

an ETC in the partial study areas of Alltel, Grand River Mutual, Mark Twain, and Spectra. For these partial rural study areas, pursuant to Section 214(e)(5) of the Communications Act of 1934, *as amended*, and Federal Communications Commission (FCC) Rule 54.207, the Commission designated MO 5 as an ETC in the complete wire centers as follows:

Alltel Missouri

Laclede
Mendon
Rothville
Sumner

Grand River Mutual

Browning
Linneus
Meadville
Purdin

Mark Twain

Bethel
Leonard

Spectra

Brunswick
Clarence
Dalton
Elmer
Hunnewell
Keytesville
La Plata
Macon
Shelbina
Shelbyville

The Commission finds that: (1) MO 5's redefinition will not result in cream skimming; (2) the rural carriers whose service areas MO 5 seeks to redefine will not be harmed by the redefinition of their study areas to conform to MO 5's licensed service area; (3) the rural carriers whose service areas MO 5 seeks to redefine will not be required to recalculate costs as a result of a service area redefinition; and (4) no other administrative burdens have been placed on the rural carriers whose service areas MO 5 seeks to redefine as a result of a service area redefinition. Accordingly, the Commission approves MO 5's request to redefine the service areas of Alltel, Grand River Mutual, Mark Twain, and Spectra.

IT IS ORDERED THAT:

1. The Motion to Amend Report and Order filed by Missouri RSA No. 5 Partnership on January 25, 2007, is granted.
2. The Report and Order issued on September 21, 2006, is hereby amended as set out above to redefine the service areas of Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, Mark Twain Rural Telephone Corporation, and Spectra Communications Group, LLC, d/b/a CenturyTel.
3. This order shall become effective on March 11, 2007.
4. This case may be closed on March 12, 2007.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur.

Dippell, Deputy Chief Regulatory Law Judge

In the Matter of the Tariff Filing of Algonquin Water Resources of Missouri, LLC, to Implement A General Rate Increase for Water and Sewer Service Customers in its Missouri Service Areas

Case No. WR-2006-0425

Sewer §14. The Commission ordered that the proposed sewer service tariff sheet submitted on May 5, 2006, by Algonquin Water Resources of Missouri, LLC for the purpose of increasing rates for retail sewer service to customers be rejected.

Water §16. The Commission ordered that the proposed water service tariff sheets submitted on May 5, 2006, by Algonquin Water Resources of Missouri, LLC for the purpose of increasing rates for water service to customers be rejected.

APPEARANCES

Dean L. Cooper, Esq. and Paul Boudreau, Esq., Brydon, Swearngen & England, P.C., 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri, 65102, for Algonquin Water Resources of Missouri, LLC.

Christina L. Baker, Esq., Assistant Public Counsel, Office of the Public Counsel, 200 Madison Street, Suite 650, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Keith R. Krueger, Esq. and Blane Baker, General Counsel's Office, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

SENIOR REGULATORY LAW JUDGE: Ronald D. Pridgin

REPORT AND ORDER

Issue Date: March 13, 2007

Effective Date: March 23, 2007

Procedural History

On May 5, 2006, Algonquin submitted to the Commission proposed tariff sheets, effective for service on and after June 4, 2006, that are intended to implement a general rate increase for water and sewer service provided in its Missouri service area. Algonquin's proposed tariffs would increase its Missouri jurisdictional revenues by approximately \$584,390 for its water service, and its Missouri jurisdictional revenues by approximately \$309,272 for its sewer service. The Commission issued an Order and Notice on May 12, in which it gave interested parties until June 1 to request intervention. No parties asked for intervention.

The parties agreed to a test year consisting of the twelve months ending September 30, 2005, updated for known and measurable changes through September 30, 2006. The Commission held a local public hearing on December 6, 2006, and an evidentiary hearing on January 22 24, 2007.

II. Discussion

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The Commission in making this decision has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

In making its Findings of Fact and Conclusions of Law, the Commission is mindful that it is required, after a hearing, to "make a report in writing in respect thereto, which shall state the conclusion of the commission, together with its decision, order or requirement in the premises." Because Section 386.420 does not explain what constitutes adequate findings of fact, Missouri courts have turned to Section 536.090, which applies to "every decision and order in a contested case," to fill in the gaps of Section 386.420. Section 536.090 provides, in pertinent part:

Every decision and order in a contested case shall be in writing, and . . . the decision . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and

shall include a concise statement of the findings on which the agency bases its order.

Missouri courts have not adopted a bright-line standard for determining the adequacy of findings of fact. Nonetheless, the following formulation is often cited:

The most reasonable and practical standard is to require that the findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence.

Findings of fact are inadequate when they "leave the reviewing court to speculate as to what part of the evidence the [Commission] believed and found to be true and what part it rejected." Findings of fact are also inadequate that "provide no insight into how controlling issues were resolved" or that are "completely conclusory."

A. Jurisdiction

Algonquin is a public utility, a sewer corporation, and a water corporation, as those terms are defined in Section 386.020(42), (48) and (58), RSMo 2000. As such, Algonquin is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

B. Burden of Proof

Section 393.150.2 provides in part, "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . water corporation or sewer corporation, and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

C. Ratemaking Standards and Practices

The Commission is vested with the state's police power to set "just and reasonable" rates for public utility services, subject to judicial review of the question of reasonableness. A "just and reasonable" rate is one that is fair to both the utility and its customers; it is no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested." In 1925, the Missouri Supreme Court stated:

The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. *** These instrumentalities are a part of the very life blood of the state, and of its people, and a

fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

The Commission's guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity. "[T]he dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental." However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service. "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."

The Commission has exclusive jurisdiction to establish public utility rates, and the rates it sets have the force and effect of law. A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission; neither can a public utility change its rates without first seeking authority from the Commission. A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's. Thus, "[r]atemaking is a balancing process."

Ratemaking involves two successive processes: first, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors. The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers. Revenue requirement is usually established based upon a historical test year that focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D) R$$

where:

RR=Revenue Requirement;

C= Prudent Operating Costs, including Depreciation Expense and Taxes;

V=Gross Value of Utility Plant in Service;

D=Accumulated Depreciation; and

R=Overall Rate of Return or Weighted Cost of Capital.

The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation. The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. Section 393.140(4) authorizes the Commission to prescribe uniform methods of accounting for utilities and Section 393.140(8) authorizes the Commission to examine a utility's

books and records and, after hearing, to determine the accounting treatment of any particular transaction. In this way, the Commission can determine the utility's prudent operating costs. Section 393.230 authorizes the Commission to value the property of electric utilities operating in Missouri, that is, to determine the rate base. Section 393.240 authorizes the Commission to set depreciation rates and to adjust a utility's depreciation reserve from time-to-time as may be necessary.

The Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a Rate of Return. For any utility, its fair Rate of Return is simply its composite cost of capital. The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

D. Overview

1. The Parties

Algonquin is a water and sewer utility and a public utility subject to Commission jurisdiction. The Staff of the Commission is represented by the Commission's General Counsel, an employee of the Commission authorized by statute to "represent and appear for the commission in all actions and proceedings involving this or any other law [involving the commission.]" The Public Counsel is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"

2. Algonquin's Proposed Rate Increase

As filed, Algonquin's tariffs would increase Algonquin's annual Missouri jurisdictional water revenues approximately \$584,390, and its annual Missouri jurisdictional sewer revenues approximately \$309,202.

3. Algonquin's Operations

Algonquin Water Resources of Missouri, LLC (Algonquin) is a Missouri limited liability company. Algonquin Water Resources of America (AWRA), a Delaware Corporation, owns a 100% ownership interest in Algonquin. AWRA is an indirect, wholly owned subsidiary of the publicly traded entity Algonquin Power Income Fund. This fund was established to own energy and infrastructure related assets in the United States and Canada.

Silverleaf Resorts, Inc. (Silverleaf), and AWRA entered into an Asset Purchase Agreement dated August 29, 2004. This agreement provided for the purchase of certain water and sewer systems owned by Silverleaf in the states of Texas, Illinois, and Missouri. The systems in Missouri include the water system at the Holiday Hills Resort (near Branson) and the water and sewer systems at the Ozark Mountain Resort (near Kimberling City) and Timber Creek Resort (near DeSoto). The utility systems, under both Silverleaf and Algonquin, are commonly referred to as "Resort

Utilities.” The total purchase price amounted to \$13.2 million of which \$3.8 million is attributable to the Missouri properties acquired.

Silverleaf is the predominate customer of Algonquin, having developed and sold condominiums and timeshares to which it also provided water and sewer service before selling the utility assets to Algonquin. When Silverleaf operated the water and sewer systems that Algonquin now owns, Silverleaf’s accounting of the utility assets failed to meet the standards that the Commission imposes upon utilities it regulates. It is Silverleaf’s lack of proper accounting of its water and sewer assets that leads to many of the complexities of this case.

E. The Issues

As required by the procedural schedule, the parties jointly filed a list of issues to be determined by the Commission. Each party also filed a statement of its position with respect to each issue. In setting out the issues developed by the parties and the parties’ stated positions on those issues, the Commission seeks only to inform the reader of these items. The parties’ framing of the issues may not accurately reflect the material issues under the applicable statutes and rules. Those issues as formulated by the parties are fully recited at the beginning of the discussion of each issue, set forth below.

1. Pre-1993 Plant

a. What amount, if any, should be reflected as plant-in-service for pre 1993 property?

When Silverleaf operated the Missouri sewer and water systems, it did so under rates the Commission approved in August, 1994. Yet Algonquin discovered that Silverleaf had utility plant in service in 1982 at the Ozark Mountain resort, and in 1984 at the Holiday Hills resort. Algonquin wants to have Silverleaf’s investment in plant that Silverleaf failed to properly record included in rate base.

Algonquin estimates that unrecorded investment in pre 1993 distribution and collection facilities should increase plant-in-service by \$729,427, that unrecorded investment in pre 1993 water supply, treatment and sewage treatment facilities should increase plant-in-service by \$1,184,606, and that investment associated with sewer system properties at Holiday Hills that Algonquin did not acquire should decrease plant-in-service by \$238,072. This increase in those accounts, Algonquin points out, would be before depreciation.

Algonquin asserts that Staff’s insistence that every penny of investment be backed up by paper ignores the reality that the plant was actually in service before 1993, and ignores the reality that Algonquin’s predecessor, Silverleaf, was (and still is) a timeshare developer, and had no reason as a timeshare developer to keep books the same way that a regulated utility would. Finally, Algonquin states that because Staff does not dispute Algonquin’s numbers, but merely the underlying concept to come up with the numbers, that should the Commission adopt

Algonquin's position, its numbers (amount of unrecorded plant to be in rate base) should be accepted.

Staff argues that it did not exclude all pre 1993 rate base, as Algonquin asserts, but that it included roughly \$540,000 in rate base, net of depreciation, to the extent that it found supporting evidence. Staff asserts that Algonquin has the burden of proof, and that estimates of plant do not carry the day; rather, Algonquin must produce documents such as invoices, checks and contracts to prove cost. Staff states that even to Algonquin's knowledge, the Commission has never used estimates of cost to establish rate base.

Staff argues that Algonquin's attempt to recover any amount over Staff's rate base number is an "end run" around Algonquin's promise to not recover any acquisition premium from the ratepayers. An acquisition premium results when one buys utility property for more than book value. Staff alerted Algonquin of this acquisition premium issue while Algonquin's purchase of Silverleaf was pending.

In that sale case, Case No. WO 2005 0206, Staff warned Algonquin that it considered roughly \$2.4 million of the \$3.8 million purchase price for Silverleaf's Missouri utility assets to be an acquisition premium that Algonquin could not recover from ratepayers. In fact, even Algonquin's witness is unsure of how Algonquin arrived at the value it decided to pay Silverleaf for its Missouri, Illinois and Texas utility assets. Algonquin agreed not to attempt to recoup any acquisition premium the Commission may determine in a future rate case. The Commission has not allowed acquisition premiums into rate base in the past.

Further, Staff posits that Silverleaf, in the sale of its timeshares, included the cost of utility plant in its timeshare sales price, meaning that Silverleaf has already recovered its utility plant cost. As a result, if the Commission allows the estimated plant into rate base, customers will pay twice for the same rate base amount. Staff's method of disallowing this plant may result in Silverleaf being paid twice for the same facility, once from its timeshare sales, and again from Algonquin, which would result in lower rates for Silverleaf.

Finding: The Commission agrees with Staff's position that Algonquin did not meet its burden. Algonquin purchased utility assets in Missouri, Texas and Illinois for the sum of \$13.2 million. Without any proof of the value of the Missouri assets, Algonquin simply claims that \$3.8 million of that \$13.2 million is attributable to Missouri assets. The Commission finds that \$2.4 million of the \$3.8 million purchase price for Silverleaf's Missouri jurisdictional assets is an acquisition premium, and therefore unrecoverable from Missouri jurisdictional ratepayers.

Conclusion: The Commission concludes that the proper amount of pre-1993 plant that should be placed into rate base is \$543,235, net of depreciation and Contribution In Aid of Construction (CIAC).

b. What is the appropriate level of post 1992 plant that should be included as plant-in-service?

Algonquin maintains that its post 1992 plant is worth about \$4.7 million, supported by Larry Loos' rebuttal and corresponding exhibits. Staff argues for a \$3.4 million amount, supported by its EMS runs.

Finding:The Commission finds this issue to be redundant. The rate base issues of excess capacity, construction cost overrun, and CIAC appear to comprise the disputed post 1992 plant.

Conclusion:The Commission concludes that it will address this issue in its Conclusions for excess capacity, construction cost overrun, and CIAC.

2. Excess Capacity

Do Algonquin's facilities include plant held for future use, which should not be included in plant in service, because they include excess capacity?

If so, what is the value of the facilities that should not be included as plant-in-service?

This issue involves only the water systems, as Staff concedes there is no excess capacity in the sewer systems. Staff originally recommended a disallowance of approximately \$474,000. At hearing, Staff modified its position, asking for a disallowance of \$187,972.

Algonquin hypothesizes that there is no excess well capacity or storage at any of its Missouri resorts. Staff agrees with Algonquin that 1,500 gallons per minute (gpm) is a reasonable flow for two hours' worth of fire protection. At that flow level, Algonquin asserts that it has no excess capacity.

Algonquin stresses the dilemma of a utility deciding whether to build plant: it can be criticized for its inability to provide safe and adequate service if the Commission believes it has built too little plant; it can be criticized for taking having capacity not used and useful for the public if the Commission believes it has built too much. Regardless of whether there may be excess capacity for some time, Algonquin still believes the plant as is was the wisest and most prudent investment. Further, Algonquin quarrels with Staff's choice to disallow the cost of the alleged excess capacity based upon a percentage of the alleged excess; in other words, Algonquin disputes Staff's claim that a 20% excess translates into a 20% disallowance.

Staff counters that it warned Algonquin during its sale case with Silverleaf that Staff believed the water system was overbuilt. Despite admitting the difficulty in quantifying over-capacity, Staff recommends a 9% disallowance of the Holiday Hills tank, a 68% disallowance for the tank at Ozark Mountain, and a 28% disallowance for the tank at Timber Creek.

Finding:The Commission finds that Algonquin's facilities do not include plant only held for future use. Algonquin, or its predecessors, reasonably constructed plant to meet current needs, while reasonably estimating future growth, without overburdening current customers.

Conclusion:The Commission concludes that Algonquin has no plant held for future use that should be excluded from rate base.

3. Construction Cost Overrun

Were some of the costs of constructing the facilities imprudently incurred? If so, how much should the plant-in-service accounts be reduced?

Algonquin's predecessor, Silverleaf, sought bids to complete Holiday Hills Well No. 2. Algonquin claims that Staff would require it, or Silverleaf, in this instance, to have perfect hindsight about its management decisions. This, according to Algonquin, is in contrast to the legal requirement that the company use due diligence to address all relevant factors available to it at the time. When the contractor who bid the job was unable or unwilling to complete the Holiday Hills Well No. 2 project according to contract, Algonquin thought it best to move on to the second lowest bidder, rather than engage in protracted and risky litigation against the lowest bidder.

Algonquin's witness on this topic, Charles Hernandez, relied solely on conversations with Michael Brown, a Silverleaf employee, and on materials from Construction Management Services, for his opinion. He was unsure of the number of change orders and the amount of cost increase. He also did not analyze whether remaining with Larry Schneider Construction, the lowest bidder on the job, would have been worth it. All of his knowledge on this topic appears to come from conversations he had with Mike Brown; Mr. Hernandez has no first hand knowledge of this project.

In contrast with Algonquin's evidence, Staff produced performed its own audit of this project. Staff's audit showed that Silverleaf was not ready to go forward with the project in a timely fashion, and that Silverleaf, not the contractor, was the source of delay. Staff witness Vesely testified that Silverleaf's change from the lowest to the second lowest bidder, the loss of the value of work done by the low bidder, and the excess capitalized interest during the delay period amounted to \$186,373. Under cross examination, Mr. Vesely agreed that an alleged \$25,624 billing error from Construction Management Services should not be included in Staff's adjustment.

Finding: The Commission finds that \$160,749 of the costs to complete Holiday Hills Well No. 2 were imprudently incurred. Staff's evidence from its audit on this issue is more credible than Algonquin's hearsay evidence.

Conclusion: The Commission concludes that the plant-in-service account should be reduced \$160,749.

4. Contributions in Aid of Construction

What is the amount of contributions in aid of construction that should be used to reduce Algonquin's plant-in-service accounts?

The tariffs of Algonquin's predecessor, Silverleaf, provided that when a customer requested the extension of water mains or collecting sewers to the customer, the customer must bear the cost of the extension and contribute the water mains or collecting sewers, at no cost to the utility. Such contributions are referred to as contributions in aid of construction ("CIAC"), and are not included in the rate base of the utility, because the utility has no investment in those facilities.

Algonquin asserts a double-standard from Staff; Staff criticizes Algonquin for estimating its pre 1993 plant-in-service, and states that Algonquin should have documentation for the plant to be included in rate base, but when Staff has no documentation to prove CIAC, Staff glosses over the lack of documentation by

estimating what the developer (Silverleaf) must have contributed. This conflicts with Algonquin's tariffs that require a written application and a contract for CIAC.

Staff counters that Silverleaf failed to enforce the terms of its own tariff, in that it failed to record main extensions made by its affiliate development company as CIAC in accordance with the provisions of its tariff. Moreover, allowing Algonquin to recover what Silverleaf should have booked as CIAC would permit Algonquin to benefit from Silverleaf's malfeasance of not enforcing its tariffs.

Finding: The Commission finds that Algonquin has plant that should not be in rate base because it is Contribution in Aid of Construction. Silverleaf's tariff sheets regarding CIAC were binding upon Silverleaf. Neither Silverleaf nor Algonquin should be allowed to include the costs of these extensions of water mains and collecting sewers in rate base merely because Silverleaf failed to enforce the terms of its own tariff sheets. Doing so would result in improperly shifting the burden of paying for such extensions from the customer that requested and required them to the Company's ratepayers as a group. Algonquin will be required to record as CIAC the total cost of all such extensions that were required by the tariff sheets to be recorded as CIAC.

Conclusion: The Commission concludes that the amount that shall be recorded as net CIAC for each of Algonquin's systems is as follows: Holiday Hills (water) -- \$548,779; Ozark Mountain (water) -- \$119,771; Ozark Mountain (sewer) -- \$108,215; Timber Creek (water) -- \$241,698; and Timber Creek (sewer) -- \$191,313.

5. Depreciation Rates

What depreciation rates should be applied to the various elements of Algonquin's plant in service?

Depreciation is an accounting convention under which the value of an asset is reduced proportionately over the course of its useful life. At the end of its life, the asset is considered to have lost all value except residual salvage value. If the accounting convention were perfect, an asset would be fully depreciated at the time it is actually retired, that is, removed from service. In ratemaking, depreciation is an operating expense, the purpose of which is to return to the investors their original investment in an asset as it is consumed in the public service. "The purpose of the annual allowance for depreciation and the resulting accumulation of a depreciation reserve is . . . to enable the utility to recover the cost of such property to it." Depreciation expense is booked to the depreciation reserve, which amount is deducted in ratemaking from the original cost basis of the utility's plant-in-service or rate base. The resulting net rate base is the present value of the investors' capital assets devoted to public service.

The Constitution requires that the investors' original capital outlay be returned to them in rates as the utility's assets are expended in the public service:

A water plant, with all its additions, begins to depreciate in value from the moment of its use. Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs but for making good the depreciation and replacing the parts of the property when they come to the end of their life. . . . [The Company] is entitled to see that from earnings

the value of the property invested is kept unimpaired, so that at the end of any given term of years the original investment remains as it was at the beginning.

Algonquin argues that depreciation reserve ratios should generally fall below 50%, and that Staff's rates result in several accounts having reserve ratios of over 100%, making them unacceptable. Staff states that the high depreciation ratios it suggests are a result of Algonquin having plant out of service, but not yet retired off the books.

The disputed water accounts are: Well Pump – Electric Pump Equipment, Computer Equipment and Software, and Office Furniture and Equipment. The disputed sewer accounts are: Receiving Wells, Pumping Equipment, Computer Equipment and Software, Office Furniture and Equipment, Sewer Plant and Sewer System Development – Engineering.

Finding: The Commission finds that Staff's depreciation rates should be applied to the disputed accounts because those rates more accurately match the reasonably expected service lives of those assets than Algonquin's rates do. Adopting Algonquin's rates would artificially increase the service life of some assets beyond the realm of reasonable, such as doubling service lives of office furniture, computer equipment and software. While Algonquin's approach actually lowers rates by decreasing depreciation expense, it also unreasonably increases the rate base on which Algonquin can earn a return on investment, resulting in ratepayers paying Algonquin's creditors and shareholders for assets that are not, or should not, be serving the customers any longer.

Conclusion: The Commission concludes that the proper depreciation rates are as described in the Direct Testimony of Staff Witness Rosella Schad, Exhibit 20, Schedules 2 1 and 2 2.

6. Capital Structure

What capital structure should the Commission apply to Algonquin's investment in determining the proper rate of return on Algonquin's rate base?

Algonquin argues that the Commission should use the actual capital structure of its parent, Algonquin Power Income Fund, which is 58.21% equity and 41.79% long term debt. This structure, Algonquin argues, is preferable over Staff's "mythical" structure because it more accurately reflects reality, and is similar to recent capital structures the Commission approved in the KCPL and Empire rate cases. Algonquin claims that Staff's argument that it cannot accurately analyze Canadian markets, such the Toronto Exchange where Algonquin's parent stock is traded, is nonsensical because of the similarities of American and Canadian currencies and economies.

Staff argues for a hypothetical capital structure because the actual capital structure of Algonquin Power Income Fund is organized to distribute more cash flow to shareholders than the capital structure of a regulated water utility would be. Staff recommends a capital structure of 47.88% equity and 52.12% long term debt, which is more akin to the structures of American regulated water utilities.

Finding: The Commission finds that Algonquin's capital structure should be the same as the capital structure of its ultimate parent company, Algonquin Power

Income Fund, as of the end of the September 30, 2006 update period. The Commission agrees that Algonquin's parent's actual capital structure more accurately reflects the capital market in which Algonquin must compete for investment dollars than a hypothetical capital structure would.

Conclusion: Algonquin's capital structure is 58.21% equity and 41.79% long term debt.

7. Return on Equity

What return on equity should the Commission apply to Algonquin's investment in determining the proper rate of return on Algonquin's rate base?

The Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized. The United States Supreme Court, in two frequently cited decisions, has established the constitutional parameters that must guide the Commission in its task. In the earlier of these cases, *Bluefield Water Works*, the Court stated that:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.

In the same case, the Court provided the following guidance as to the return due to equity owners:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

The Court restated these principles in *Hope Natural Gas Company*, the later of the two cases:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Two principal methods have emerged for determining the cost of Common Equity: these are the "market-determined" approach and the "comparable earnings"

approach. The market-determined approach relies upon stock market transactions and estimates of investor expectations. Examples of market-determined methods are the discounted cash flow ("DCF") and the capital asset pricing model ("CAPM"). The comparative earnings approach relies upon the concept of "opportunity cost," that is, the return the investment would have earned in the next best alternative use. The comparative earnings approach requires a comparative study of earnings on common equity in enterprises of similar risk, regardless of whether the enterprises are regulated or unregulated.

In the final analysis, it is not the method employed, but the result reached, that is important. The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."

The annual form of the DCF method of calculating a fair return on common equity can be expressed algebraically by this equation:

$$k = D1/PS + g$$

where: k is the cost of equity;

g is the constant annual growth rate of earnings, dividends and book value per share;

$D1$ is the expected next period annual dividend; and

PS is the current price of the stock.

Assuming that dividends grow at a constant annual rate, g , this equation can be solved for k , the cost of equity. The term $D1/PS$ is called the dividend yield component of the annual DCF model, and the term g is called the growth component of the annual DCF model.

The CAPM describes the relationship between a security's investment risk and its market rate of return. This relationship identifies the rate of return that investors expect a security to earn so that its market return is comparable with the market returns earned by other securities that have similar risk. The general form of the CAPM is as follows:

$$k = R_f + \beta (R_m - R_f)$$

where:

k = the expected return on equity for a specific security;

R_f = the risk-free rate;

β = beta; and

$R_m - R_f$ = the market risk premium.

Algonquin's and Staff's analysis have many similarities. For example, both use a proxy group of four companies, having three of them in common. Both use a DCF method to estimate cost of equity. Yet, their recommendations on cost of equity are hundreds of basis points apart.

Algonquin's witness, Larry Loos, holds a baccalaureate degree in engineering and a Master of Business Administration, both from The University of Missouri. He is Director of the Enterprise Management Solutions Division at Black & Veatch

Corporation, an engineering firm, where he has been employed since 1971. In his duties at Black & Veatch, Mr. Loos has testified before the Commission several times, and has also done so before several other public utility commissions, upwards of over 100 times. In those times he's testified, Mr. Loos has testified as an expert on cost of capital about five times.

Algonquin's witness, Larry Loos, alleges that the ROE should be in the range of 11.25-12%. For support, Algonquin points to the Hope and Bluefield analysis the Commission recently performed in KCPL and Empire to arrive at ROEs of 11.25% and 10.9%, respectively.

Mr. Loos reminds the Commission that DCF consists of two terms: dividend yield and growth. For dividend yield, he used a ValueLine forecast of dividends and market price for 2007-09 for his lower limit, and forecast dividends and book value to establish an upper limit.

Also, Algonquin reminds the Commission that 75% of its revenues come from a single customer, Silverleaf, and that having one customer with so much control is a risk of unprecedented proportion, regardless of the type of business the customer is in. In addition, Silverleaf itself is in a risky business, the development and sales of timeshares. Moreover, Algonquin serves less than 1,000 accounts in Missouri, whereas Empire serves roughly 215,000 customers in four states, and KCPL serves about 500,000 customers in two states.

Despite this evidence, Staff continues to assert that Algonquin's risk is some 200 to 300 basis points lower than the risks of KCPL and Empire. The average returns on equity in the "Edward Jones" report have been in the 9% range, and in the "AUS" utility reports have been just above 10.

Staff focused on its witness, Matt Barnes, having better credentials and using a more reasonable method of coming up with ROE. While Mr. Barnes has less overall experience, Staff points out that his experience in the field of financial analysis exceeds that of the Algonquin witness. However, compared to the five times Mr. Loos has testified as a cost of capital witness, Mr. Barnes done so three times.

Finding:The Commission finds that Algonquin's operating risk is greater than that of a typical regulated water and sewer company, due to its being largely captive to one customer, which, in turn, is also in a risky business venture. The Commission therefore finds Algonquin's proposed return on equity recommendation more reasonable than that of Staff.

Conclusion:The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's Hope and Bluefield decisions. Pursuant to those decisions, returns for Algonquin's shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of Hope and Bluefield unmistakably requires a comparative method, based on a quantification of risk.

The Commission concludes that Algonquin's risk is higher than that of larger American water and sewer utilities. The Commission agrees with Algonquin that it has a higher risk than a "typical" regulated water utility due to its small size, lack of

diversity in customer base, and nearly exclusive dependence on resort and timeshare property. Algonquin is all but captive to a single customer, Silverleaf, which, in turn, is in the risky business of the development and sales of timeshares.

The Commission further takes notice of the fact there are solid public policy reasons for promoting investment in small water and sewer companies. Those reasons include, but are not limited to the following reasons: adequately maintaining, upgrading and expanding the existing infrastructure; attracting and compensating professional management that is more capable of managing a regulated utility facing increasingly complex and costly environmental regulations promulgated at the state and federal level; and encouraging the consolidation of properties that will ultimately result in lower costs for ratepayers than it would cost the ratepayers otherwise. Therefore, the Commission concludes that the low end of Algonquin's recommended range of 11.25% 12% is appropriate. The Commission will allow Algonquin a return on equity of 11.25%.

8. Payroll Expense

What is the appropriate level of payroll expense that Algonquin should be allowed to recover in its rates?

Algonquin argues that compensation for three employees, Wastewater/Water Utilities Superintendent, Missouri Facility Accountant, and Missouri Utilities Assistant, should all be included in rates. Algonquin claims that it added the Wastewater/Water Utilities Superintendent and Missouri Utilities Assistant in response to complaints and a specific request from Silverleaf, Algonquin's predominate customer. Moreover, Algonquin argues that Silverleaf, a former regulated utility, would understand that its request for these additional positions and the costs associated therewith would likely be recovered from Silverleaf in rates.

Staff agrees that 100% of the expense for the Missouri Facility Accountant should be in rates. However, it believes that only 50% of the Wastewater/Water Utilities Superintendent should be in rates, as that superintendent could spend time working on non Missouri utility operations. Also, Staff alleges that the Missouri Utilities Assistant should be disallowed entirely, since the position was created after Algonquin bought the system, and the Assistant's position is not needed, because neither the scope nor extent of the operations has expanded since the purchase. Staff admits that Algonquin should respond to its largest customer, Silverleaf, when it wants a personnel change, and that Silverleaf, having run the utility before Algonquin, certainly should understand that, through cost of service, it may have to pay for any personnel additions it requests.

Finding:The Commission finds that Algonquin's three employees, Wastewater/Water Utilities Superintendent, Missouri Facility Accountant, and Missouri Utilities Assistant, are all needed to provide safe and adequate service to Algonquin's customers.

Conclusion:The Commission concludes that Algonquin's three employees, Wastewater/Water Utilities Superintendent, Missouri Facility Accountant, and Missouri Utilities Assistant, are a part of Algonquin's cost of service, and should all be included in rates.

9. Rate Case Expense

1. Should the Commission allow Algonquin to recover in its rates any allowance for the rate case expenses that it incurred in presenting this case to the Commission?

2. If so, how much rate case expense did Algonquin prudently incur, and over how many years should the rate case expense be amortized?

Algonquin requests that the Commission allow it its estimated \$225,000 in rate case expense, amortized over five years. Algonquin cites to several Commission orders that said that the Commission must allow prudently incurred rate case expense, or risk violating the company's procedural due process rights. Algonquin states that no law required it to first file a small company rate case before filing a formal rate case, and that filing the small company case likely would not have resulted in agreement, thereby delaying the inevitable formal rate case to the company's detriment.

Algonquin also pointed to its predecessor's dissatisfaction with the small company rate case procedure, stating that Silverleaf's rate increase under that procedure took approximately seventeen months. Further, even small company rate cases may require the legal expenses about which Staff complains. Finally, Staff's recommended \$5,000 is a random number, having no basis in fact, and assuming that Algonquin would not pursue the formal rate case to which it is entitled.

Staff argues that Algonquin should have used the small company rate case procedure, and that Algonquin filed prematurely by filing before Staff could review Algonquin, rather than Silverleaf, data. Also, Staff maintains any delay Silverleaf experienced in its small company case was its own doing, not Staff's doing. Staff points to evidence showing that it has processed small water company rate cases in an average of about ten months since FY 2004. Staff maintains any financial problems other small water companies have had are independent of the small company rate case procedure. When broken down, Staff asserts that the rate case expense amounts to more than two dollars per week for each of the time share units at Timber Creek, contrasted with KCPL's rate case expense costing each ratepayer about 11 cents per month, and Aquila's rate case expense costing each ratepayer about seven cents per month. Staff witness Boateng testified that he found \$174,954 in actual rate case expense from the documents the Commission requested during the hearing.

Finding: The Commission finds that it should allow Algonquin to recover in its rates some allowance for the rate case expenses that it incurred in presenting this case to the Commission. But the Commission rejects both Algonquin's and Staff's recommendations, and will adopt its own.

The Commission finds Algonquin's request for \$225,000 to be amortized over a five year period to be unreasonably high. Algonquin's \$225,000 request is based upon estimates. And, to the extent that Algonquin has evidence for its request, that evidence was supplied to the Commission only upon Commission request during the hearing, and is unsupported by foundational testimony as to the reasonableness of the charges on the bills and invoices.

On the other hand, the Commission also finds Staff's request for \$5,000 to be unreasonably low. Algonquin is not obligated to use the Commission's small company rate increase procedure, and should not be punished for choosing the formal rate case option.

During this case, Staff has consistently maintained that Silverleaf and Algonquin had the business acumen to become and stay profitable, so that it has already passed on some costs to ratepayers. If this is so, then Algonquin's acumen must have alerted it to bypass the Commission's small company rate case procedure for a logical reason, such as Algonquin finding the process unwieldy or unfruitful. Like Algonquin's request, Staff's request for the nominal sum of \$5,000 is not supported by competent and substantial evidence.

The Commission finds that Algonquin should recover \$174,954 of rate case expense. Furthermore, noting that even Algonquin assents to a longer amortization period, the Commission will lengthen the amortization period.

Conclusion: The Commission concludes that Algonquin prudently incurred \$174,954 of rate case expense, to be amortized over seven years. However, the Commission encourages those utilities eligible to use the small company rate case procedure, including Algonquin, to do so prior to filing a formal rate case. In addition, the Commission will closely scrutinize rate case expense to ensure that the company proves that its legal fees and expert fees are prudently incurred.

10. Rate Design

Should the Commission's order establish separate rates for each of Algonquin's three service territories, or should the Commission's order establish a unified rate for water service to Algonquin's service to the Ozark Mountain and Holiday Hill service territories?

Algonquin states that despite the complete lack of a public outcry for a change in rate design, it does not object to a separate rate for water and sewer services at Timber Creek, and sewer services at Ozark Mountain. However, it believes it should have a single potable water rate for Ozark Mountain and Holiday Hills because of the operational and geographic similarities between the two operations. Finally, Algonquin remarks that a separate irrigation rate for non-potable water used to irrigate the Holiday Hills golf course should be established.

Staff argues that separate rates should be established for each Algonquin territory. Staff emphasizes the differences, rather than the similarities, between Ozark Mountain and Holiday Hills. According to Staff, should single rates apply, Ozark Mountain will eventually subsidize Holiday Hills because it will someday be significantly smaller than Holiday Hills. Staff admits that single-tariff pricing allows for rate mitigation when needs for infrastructure occur in the system.

Finding: The Commission finds that in giving an overall rate increase to Algonquin, it would be unfair for some customers to receive rate decreases while other customers receive fairly substantial increases. There is not competent and substantial evidence for the Commission to find that the administrative costs and burdens upon Algonquin and Staff to establish and monitor a multiple tariff utility would provide an overall benefit to Algonquin ratepayers. Therefore, the Commission finds that it should order a unified rate.

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Conclusion: The Commission concludes that just and reasonable rates require a unified rate for water service to Algonquin's service to the Ozark Mountain and Holiday Hills service territories. Furthermore, the Commission concludes that just and reasonable rates should also include Algonquin's request to charge \$1.25 per thousand gallons of non potable water used for golf course irrigation.

11. Rate Mitigation

Should any increase in rates be phased in, or be otherwise mitigated?

If so, how?

Algonquin maintains that the Commission has no authority to order a phase in of rates. But, Algonquin does not oppose a phase-in for any part of an individual rate increase beyond 100%, assuming that Algonquin would allow it to charge carrying costs to address the loss of revenue. Absent the chance to charge those carrying costs, Algonquin asserts that the phase-in would deprive it of the opportunity for a reasonable return on investment.

OPC favors a two-step phase-in Algonquin mentioned in the hearing, even at the revenue requirement Staff proposes. Staff does not oppose Algonquin's position on this issue.

Finding: The Commission finds this issue in Algonquin's favor. While rate shock is a concern for the Commission, the Commission finds that even under the proposed rate mitigation plan, the brunt of the rate increase would be passed onto ratepayers this spring, with the remainder of it to follow in November. Any such phase-in of rates would give little benefit to ratepayers and may, in fact, impose a revenue requirement upon Algonquin that is less than its cost of service.

Conclusion: The Commission concludes that Algonquin's rate increase should not be phased in.

IT IS ORDERED THAT:

1. That the proposed water service tariff sheets submitted under Tariff File No. JW 2006 0847 on May 5, 2006, by Algonquin Water Resources of Missouri, LLC for the purpose of increasing rates for water service to customers are hereby rejected. The specific sheet rejected is:

P.S.C. Mo. No. 2

2nd Revised Sheet No. 4, Canceling 1st Revised Sheet No. 4

2. That the proposed sewer service tariff sheet submitted under Tariff File No. JS 2006 0848 on May 5, 2006, by Algonquin Water Resources of Missouri, LLC for the purpose of increasing rates for retail sewer service to customers are hereby rejected. The specific sheet rejected is:

P.S.C. Mo. No. 2

2nd Revised Sheet No. 4, Canceling 1st Revised Sheet No. 4

3. That Algonquin Water Resources of Missouri, LLC shall file proposed water and sewer service tariff sheets in compliance with this Report and Order.

4. That all pending motions, not otherwise disposed of herein, are hereby denied.

5. That this Report and Order shall become effective on March 23, 2007.
6. That this case may be closed on March 24, 2007.

Murray, Clayton, and Appling, CC., concur;
Davis, Chm., concurs, with separate
concurring opinion attached;
Gaw, C., dissents;
and certify compliance with the provisions
of Section 536.080, RSMo.

*Note: At the time of publication, no dissents have been issued.

**In the Matter of a Management Audit of Aquila, Inc., d/b/a Aquila Networks-
MPS and Aquila Networks-L&P.**

Case No. EO-2006-0356

Electric §13. The Commission ordered that Staff's report describing the results of its management audit of Aquila, Inc. be accepted and that Aquila, Inc. is ordered to comply with the recommendations contained in the report.

**ORDER ACCEPTING STAFF'S MANAGEMENT AUDIT REPORT AND
DIRECTING AQUILA, INC. TO COMPLY WITH STAFF'S
RECOMMENDATIONS**

Issue Date: March 13, 2007

Effective Date: March 23, 2007

On June 13, 2006, the Commission directed its Staff to conduct a management audit of Aquila, Inc. Staff was directed to investigate the impact on Missouri consumers of Aquila's past decisions regarding 1) incentive compensation; 2) executive compensation; 3) employee bonus payments; 4) pension and other post-employee benefits funding controls; 5) the Aries generating facility; 6) the South Harper generating facility; 7) investment in unregulated activities; 8) efforts to protect Aquila's regulated activities from the company's involvement in unregulated activities; and 9) activity that was illegal, inappropriate or improper under state or federal statutes or regulations. In addition, Staff was directed to complete its ongoing investigation of allegations of possible illegal activities at Aquila.

Staff completed its investigation and filed a final report on October 31, 2006. Staff's report incorporated comments from Aquila regarding that report. The Office of the Public Counsel filed its response to Staff's report on November 30.

Staff's report describes Staff's investigation into each of the topics assigned to Staff in the Commission's June 13 order. Staff offers specific recommendations for future actions by Aquila regarding some of those investigative topics. Those recommendations are as follows:

Incentive Compensation

- a. Review present incentive compensation programs to determine that they are serving as a cost effective motivation to employees.

Executive Compensation

- b. Review and utilize methodologies to fully determine, define and document the total amount of executive compensation.
- c. Re-examine the Company's staffing levels, staff responsibilities and attendant executive compensation levels to ensure such compensation is commensurate with executive responsibilities.
- d. Adjust executive compensation levels based upon the results of the examination.

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- e. Give adequate consideration to all available options when planning for future capacity requirements that will ensure the development of cost-effective decisions.

Protection of Regulated Activities from the Company's Involvement in Unregulated Activities

- f. Provide advance notice to the Commission prior to investing in future unregulated activities along with documentation of all known and potential impacts those activities may have on Aquila's Missouri utility customers. Include in the Company's notice to the Commission all plans the Company has to ensure that Aquila's Missouri customers will not be negatively impacted by investing in future unregulated activities.

Staff's report does not ask the Commission to affirmatively order Aquila to comply with those recommendations. However, in its response, Public Counsel asks the Commission to order Aquila to comply. Public Counsel also asks the Commission to order Aquila to file a report within six months describing the results of the reviews and readjustments required by the recommendations related to Incentive Compensation and Executive Compensation. Public Counsel further asks that Aquila be required to comply with the recommendations related to the South Harper Generating Facility and to Protection of Regulated Activities from the Company's Involvement in Unregulated Activities on an ongoing basis.

Public Counsel's request for an order requiring Aquila to comply with Staff's recommendations is reasonable, and is not opposed by any party. The Commission will accept Staff's Report and will require Aquila to comply with the recommendations made in that report.

IT IS ORDERED THAT:

1. The Commission accepts Staff's report describing the results of its management audit of Aquila, Inc.

2. Aquila, Inc. is ordered to comply with the following recommendations offered by Staff in its report:

Incentive Compensation

a. Review present incentive compensation programs to determine that they are serving as a cost effective motivation to employees.

Executive Compensation

b. Review and utilize methodologies to fully determine, define and document the total amount of executive compensation.

c. Re-examine the Company's staffing levels, staff responsibilities and attendant executive compensation levels to ensure such compensation is commensurate with executive responsibilities.

d. Adjust executive compensation levels based upon the results of the examination.

3. Aquila Inc. shall file a report no later than July 30, 2007, describing the results of the reviews and readjustments required by the recommendations related to Incentive Compensation and Executive Compensation.

4. Aquila, Inc. is ordered to comply, on an ongoing basis, with the following recommendations offered by Staff in its report:

The South Harper Generating Facility

e. Give adequate consideration to all available options when planning for future capacity requirements that will ensure the development of cost-effective decisions.

Protection of Regulated Activities from the Company's Involvement in Unregulated Activities

f. Provide advance notice to the Commission prior to investing in future unregulated activities along with documentation of all known and potential impacts those activities may have on Aquila's Missouri utility customers. Include in the Company's notice to the Commission all plans the Company has to ensure that Aquila's Missouri customers will not be negatively impacted by investing in future unregulated activities.

5. This order shall become effective on March 23, 2007.

Davis, Chm., Murray and Appling, CC., concur
Gaw, C., dissents, dissent to follow
Clayton, C., dissents

Woodruff, Deputy Chief Regulatory Law Judge

*Note: At the time of publication, no dissent has been issued.

**In the Matter of an Investigation into Various Issues Related to the Missouri
Universal Service Fund.**

Case No. TO-98-329

Telecommunications §1. The Commission ordered that requests for reimbursement by telecommunications companies from the Missouri Universal Service Fund administrator shall be made no later than the 15th day of each month, and reimbursements shall be dispatched between the first and the fifth day of the following month.

ORDER ADJUSTING ASSESSMENT PERCENTAGE AMOUNT

Issue Date: March 15, 2007

Effective Date: March 25, 2007

On March 16, 2005, the Commission issued an Order Granting Staff Motion, in which it established an initial assessment percentage amount of 0.0018 for the low-income and disabled portion of the Missouri Universal Service Fund. On March 8, 2007, the Missouri Universal Service Board, on the recommendation of the Fund Administrator, determined that it is necessary to increase the assessment percentage amount from 0.0018 to 0.0029. On March 8, 2007, the Staff of the Commission filed a Motion for Commission Order Regarding Assessment and Motion for Expedited Treatment. Pursuant to that request, the Commission issued an Order notifying carriers and other entities that a request to change the assessment percentage amount had been made and establishing an intervention deadline.

One party, the Missouri Independent Telephone Company Group ("the MITG") sought to intervene. As the MITG companies have pointed out, they are already Parties in this docket. As such, they need not be granted intervention again to file in this matter.

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The MITG did not oppose the change in the assessment percentage amount, but requested that any Order changing the assessment be issued in sufficient time for the carriers to alter their billing systems prior to the date of the change. The MITG also requested that the implementation be accomplished in such a way as to avoid the necessity of assessing a portion of a customer's bill at one percentage and the remainder at another. Telecommunications carriers tend to have "rolling" billing periods, and local exchange carriers bill for the current month's service, whereas interexchange carriers bill in arrears. This would make the change in assessment percentage overly complicated when it is applied to charges for services rendered on or after a certain date. Therefore, the Commission will require that the new assessment percentage to be applied to all services on a customer's May bill. This will allow sufficient time for carriers to change their billing systems to the new percentage. In addition, carriers will be required to include a notice in the May customer bills that explains the change in the assessment percentage.

Finally, the Staff requested that the Commission order a change in the timing of payments to the MoUSF Administrator. This Order will not address that issue, as it was brought to the Commission's attention only through the Staff's most recent filing. To make that change in this Order would not allow carriers sufficient time to evaluate and respond to Staff's proposal. Moreover, handling the issues in two Orders will not unnecessarily complicate matters.

IT IS ORDERED THAT:

1. The Missouri Universal Service Fund administrator shall begin assessing carriers at the new percentage rate of 0.0029.
2. Telecommunications companies shall apply this new percentage rate to all telecommunications services for which a bill is rendered in May (or the first bill to that customer after May 1, 2007), and bills thereafter.
3. Telecommunications companies shall include a notice explaining the change in the assessment percentage in customers' April or May bills (or the first bill to that customer after May 1, 2007).
4. No other terms of assessment, operation or funding of the Missouri Universal Service Fund are altered by this Order.
5. The Data Center of the Commission shall send a copy of this Order to all certificated telecommunications companies, except payphone providers and shared tenant services providers.
6. That this order shall become effective on March 25, 2007.

Davis, Chm., Murray, Clayton and Appling, CC., concur.
Gaw, C., dissent.

Dale, Chief Regulatory Law Judge

In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Natural Gas Service Provided to Customers in the Company's Missouri Service Area.

Case No. GR-2007-0003

Gas §18. The Commission ordered that the Stipulation and Agreement filed on March 8, 2007, be approved as a resolution of all issues in this case. Furthermore, the Commission ordered that the proposed gas service tariff sheets submitted on July 7, 2006, by Union Electric Company d/b/a AmerenUE be rejected and that Union Electric is authorized to file the tariff sheets agreed to as part of the Stipulation and Agreement and may request that the tariff sheets be allowed to become effective on April 1, 2007.

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: March 15, 2007

Effective Date: March 25, 2007

Syllabus: This order approves the stipulation and agreement submitted by the parties.

On July 7, 2006, Union Electric Company d/b/a AmerenUE submitted proposed tariff sheets (YG 2007 0008) intended to implement a general rate increase for natural gas service provided to retail customers in its Missouri service territory. On July 11, the Commission suspended the Company's proposed tariff sheets until June 4, 2007.

On March 8, 2007, Union Electric Company d/b/a AmerenUE, the Staff of the Commission, the Office of the Public Counsel, the Missouri Department of Natural Resources, the Missouri School Boards' Association, and the Missouri Retailers Association filed a stipulation and agreement to resolve all pending issues in this case. On the same date, the signatory parties filed a motion asking the Commission to approve the stipulation and agreement by March 15, to allow the proposed rate changes to go into effect on April 1. A copy of the stipulation and agreement is attached to this order as Attachment 1.

Not all parties signed the stipulation and agreement. However, Commission Rule 4 CSR 240-2.115(2) provides that if no party objects to a nonunanimous stipulation and agreement within seven days of its filing, the Commission may treat that stipulation and agreement as unanimous. No party has filed a timely objection to the stipulation and agreement and the Commission will treat it as unanimous.

On March 14, the Commission held an on-the-record presentation regarding the proposed stipulation and agreement. At that proceeding, the Commission questioned the signatory parties, as well as the party that did not sign but did not object to the stipulation and agreement.

As a part of the stipulation and agreement, the parties agreed to specific tariff language that AmerenUE will file to implement the agreed upon annual gas revenue

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increase of \$6 million, effective for services rendered on and after April 1, 2007. That tariff has not yet been filed but the stipulation and agreement asks the Commission to authorize AmerenUE to file such a tariff. The stipulation and agreement also asks the Commission to allow that tariff, after it is filed, to become effective on April 1, 2007. AmerenUE agrees not to file a natural gas rate case for three years from the date the Commission approves this stipulation and agreement.

The Commission has the legal authority to accept a stipulation and agreement as offered by the parties as a resolution of issues raised in this case. Furthermore, Section 536.090, RSMo Supp. 2005, provides that when accepting a stipulation and agreement, the Commission does not need to make either findings of fact or conclusions of law. The requirement for a hearing is met when the opportunity for hearing has been provided and no proper party has requested the opportunity to present evidence. Since no one has requested a hearing in this case, the Commission may grant the relief requested based on the stipulation and agreement.

Based on the agreement of the parties and the testimony received at the on-the-record presentation, the Commission believes that the parties have reached a just and reasonable settlement in this case.

IT IS ORDERED THAT:

1. The Stipulation and Agreement filed on March 8, 2007, is approved as a resolution of all issues in this case (See Attachment 1).
2. All signatory parties are ordered to comply with the terms of the Stipulation and Agreement.
3. The proposed gas service tariff sheets (YG 2007 0008) submitted on July 7, 2006, by Union Electric Company d/b/a AmerenUE are rejected.
4. Union Electric Company d/b/a AmerenUE is authorized to file the tariff sheets agreed to as part of the Stipulation and Agreement. Union Electric Company d/b/a AmerenUE may request that the tariff sheets be allowed to become effective on April 1, 2007.
5. This order shall become effective on March 25, 2007.

Davis, Chm., Murray, Clayton, and Appling, CC, concur.
Gaw, C, dissents with separate dissenting opinion to follow.

Woodruff, Deputy Chief Regulatory Law Judge

***NOTE:** The Stipulation and Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

DISSENTING OPINION OF COMMISSIONER STEVE GAW

This Stipulation permits AmerenUE to refuse service to any new customers using more than 40,000 Ccf, about the amount used by a small shopping center. In the Agenda, prior to the vote on this case, AmerenUE stated that this provision was desired specifically because of requests that had been received or were anticipated to be received from new Ethanol plants. This, is of great concern to this Commissioner. Economic development is critically important to the people of the state. It is particularly important in rural areas of the state that are highly dependent on agriculture and struggling with challenges to local economic conditions.

The benefits of the development of Ethanol plants in rural Missouri should not be ignored. Nor should the decision about whether such a plant or any new industry providing for jobs and economic growth be left exclusively in the hands of a utility. Yet, this is exactly what the proposed tariff attached to the Stipulation and Agreement states.¹ The explanation given for this portion of the Stipulation is that the capacities of all three transmission lines serving the AmerenUE system are at or near capacity. The parties stated at the on-the-record conference the ability of AmerenUE to refuse to serve such a customer was necessary to preserve the reliability of AmerenUE in serving existing customers. While reliability is an important goal, allowing the utility to present a solution that prevents significant and important economic development in rural Missouri, without a plan to solve load problems, is unacceptable.

There are two issues which should be addressed by the Stipulation and Agreement that are not. First, there is a question as to the legal authority that would allow the company, with a statutory obligation to provide service, to refuse service to a customer within its service territory. The legality of such a waiver should be addressed prior to granting it. Second, this Commission should demand a plan from AmerenUE as to how it intends to address the transmission capacity constraints. Failure to do so would appear on the surface to prevent AmerenUE from serving the growth in load over time for all customers, in addition to the significant impediments that result to economic development in the AmerenUE territory.

Further, this Stipulation continues to allow the unfair charging of former customers of AmerenUE who reconnect to the system at the same address within 12 months, as though they had never left the system. As stated in the recent Atmos case,² this Commissioner believes that consumers should not be charged by a utility for services they are not receiving.

¹ Schedule 1, page 72 of 84, attached to the Stipulation and Agreement in Case No. GR-2007-0003, Union Electric Company Gas Service, Tariff P.S.C. Mo. No. 2, Original Sheet No. 42.1 states in part: Application for firm system gas service to new General Service sales customers with an annual load exceeding 40,000 Ccf will be granted only if in the Company's sole judgment, sufficient gas supplies, storage availability and/or pipeline capacity exists .

² Case No. GR-2006-0387.

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This Stipulation also provides for the merging of PGA prices for consumers in different areas, served by different pipelines. The merging of the prices of the districts, even with the credits and surcharges,³ moves away from the concept of having consumers pay for flowed through cost of the gas they receive. The result may lead to subsidization of one territory's ratepayers by the other territory's ratepayers. It appears to this Commissioner that this subsidization would be made by only the northern area. The negative impact on ratepayers in this area is enhanced because this rate is based upon volumes of gas used. Consequently, the colder winters in the north will mean increased usage and enhanced cost to those consumers.

While some theorize that the difference in prices will decrease between supplies from the different transmission lines, that is still speculation. Staffs theory is that future changes in gas supply, will cause upward price movement to those on the Panhandle Eastern Pipeline System (PEPL) and downward price movement on the Texas Eastern Transmission Corporation System (TETCO). However, this is speculation on the staffs part and does not take into account the access to gas by the northern system from the Rocky Mountain Energy line currently under construction. The theory loosely speculates that the price of gas to customers on the northern AmerenUE system could be reduced because costs associated with the three systems served by AmerenUE will converge. However, if staff is incorrect and costs remain different in the transmission systems, then the decision to move toward one PGA rate for all of the AmerenUE systems is again moving away from the policy of a pass-through of gas costs and based on a suspect theory.

There may be occasions when benefits to all of the customers would warrant this policy move to a single PGA. However, given the uncertainty as to the future prices of gas and transportation costs on the relevant transmission lines, now is the wrong time to make this decision. This decision could easily be deferred until the next rate case when there will be historical data to indicate whether the staff s theory regarding the convergence of the prices on the different transmission systems is correct.

Finally, while conservation and efficiency efforts are at least present in this Stipulation, conservation efforts do not appear to involve company contributions. With the reduction in the volumetric component in rates, AmerenUE will have less risk to its revenue stream. With this decreasing risk should come additional company efforts to conserve energy. Yet, additional contributions of the company toward conservation are missing. The effort is instead made with ratepayer dollars. This Commissioner would like to see a consistent policy from this Commission promoting investment in conservation and energy efficiency as well as greater effort by utilities.

For these reasons, I must dissent.

³ Contrary to normal PGA charges to customers set by actual volumetric design, these credits and surcharges, used to attempt to account for the lower priced Panhandle system, is the same for all customers regardless of the amount of gas a consumer uses.

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In the Matter of the Joint Application of New Florence Telephone Company, Tiger Telephone, Inc., and Direct Communications Rockland, Inc., for an Order Authorizing Direct Communications Rockland, Inc., to Purchase or Acquire, Take or Hold all of the Issued and Outstanding Capital Stock of Tiger Telephone, Inc.

Case No. TO-2007-0139

Telecommunications §8. Generally The Commission ordered that New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. are authorized to enter into and perform in accordance with the terms of the Stock Purchase Agreement and that Leonard May, Garrin Bott, Kip Wilson, Jeremy Smith, Scott Hendrickson and Elizabeth Dunn are authorized to purchase or acquire, take or hold all of the total issued and outstanding capital stock of Tiger Telephone, Inc.

ORDER AUTHORIZING SALE OF STOCK

Issue Date: March 22, 2007

Effective Date: March 31, 2007

Procedural History

On October 2, 2006, New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. filed a Joint Application seeking authorization to transfer to Direct Communications, or an entity designated by Direct Communications, all of the capital stock of TigerTel, which includes all of the stock of New Florence. The Commission issued its notice of this application on October 5, directing that any applications for intervention be filed no later than October 25. There were no requests to intervene.

On February 26, the Staff of the Commission filed its Memorandum, recommending, with certain conditions, that the Commission approve the requested relief. Finally, on March 6, 2007, Joint Applicants filed a response to Staff's recommendation stating that it does not oppose the conditions suggested by Staff. Also, because Joint Applicants would like to tentatively schedule the closing of this transaction on April 2, 2007, they request that any Commission approval be effective by April 1.

The Companies

New Florence is a Missouri corporation, subject to the Commission's jurisdiction, and engaged in the business of providing basic local telecommunications service to approximately 470 customers.

TigerTel is a Missouri corporation engaged in the business of acquiring, operating and managing telecommunications companies. TigerTel owns all of the stock of New Florence. The sole shareholder of TigerTel is Robert D. Williams.

Direct Communications is an Idaho corporation and engaged in the business of acquiring and operating communications businesses. In this matter, Direct Communications seeks to acquire all of the stock of TigerTel, which includes all of the stock of New Florence.

The Application

In Case No. TC-2006-0184, the Commission approved a Stipulation and Agreement resolving a complaint filed by Staff against New Florence. The following relevant language is from the Commission's order:

In addition, if New Florence has not arranged its sale to new, independent, owners by October 2, 2006, it will be obligated to pay an additional \$250,000 to the Public School Fund by October 3.

The stipulation and agreement also provides that Staff will recommend to the Commission that New Florence, or its new owners, be certified for receipt of federal Universal Service Fund disbursements, if Staff finds that the company's management is independent, has no relationship or ties to current owners and has sufficient knowledge and skill to be acceptable to Staff.

Joint Applicants filed this application to comply with this language of the Stipulation and Agreement.

TigerTel and Direct Communications entered into a Stock Purchase Agreement on September 29, 2006; thus, satisfying the condition of the above agreement that New Florence arrange its sale by October 2, 2006. Joint Applicants also state that the Boards of Directors of each applicant has resolved that the applicant may be a party to this transaction. Additionally, Joint Applicants aver that the proposed transaction is not detrimental to the public interest. In support thereof, Joint Applicants state that Direct Communications has operated telephone exchange systems in Idaho under a certificate granted by the Idaho Public Utilities Commission since 1952. The company provides local service to 1,500 customers and qualifies as a rural company for purposes of the Telecommunications Act of 1996.

Joint Applicants further state that after the sale of stock, New Florence will continue to operate in much the same manner as it does currently. There will be no change in rates or methods of operation and the present employees will be retained. Lastly, Joint Applicants point out that the proposed transaction satisfies the conditions that will enable Staff to recommend that the Commission certify New Florence for receipt of Universal Service Fund support. In this regard, Joint Applicants ask that the Commission so certify New Florence upon the closing of the proposed transaction.

In an Amended and Supplemental Application, the Applicants also request authorization from the Commission for TigerTel to borrow \$1,700,000 from Zions First National Bank to finance the purchase TigerTel. On February 16, 2007, Joint Applicants filed a Second Amended Application informing the Commission that

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Robert D. Williams (seller) is the sole shareholder of TigerTel and that TigerTel is the sole shareholder of New Florence. Also in this filing, applicants inform the Commission that Direct Communications has designated Leonard May, Garrin Bott, Kip Wilson, Jeremy Smith, Scott Hendrickson and Elizabeth Dunn as the purchasers.

Staff Memorandum

The Public Interest

Staff opines that the proposed transaction will not be a detrimental to the public interest. Staff defines the public as those customers in Missouri receiving service from New Florence. In support of its opinion, Staff states that through data requests it has found that the purchasers of TigerTel will enter into a management contract with Direct Communications to provide management and support service, accounting, billing and other related services. Staff further states that Direct Communications operates telephone exchange in Idaho, Utah, Washington and Oregon. All of Direct Communications' companies qualify as rural telephone companies for the purposes of the federal Telecommunications Act of 1996.

To further verify Direct Communications' abilities, Staff contacted the agencies that regulate direct in the above states. Through its contacts, Staff has found that Direct Communications:

- provided quality telecommunications service;
- offers advance services such as broadband to their rural customers;
- has no abnormal level of customer complaints;
- is a well-run independent telephone company; and
- responds to the needs of customers and regulatory commissions.

Further, Staff determined that none of the purchasing shareholders have been indicted, charged or convicted of any federal or state felony proceedings.

Although not required in stock acquisition cases, Staff believes that Direct Communications has sufficient technical, financial and managerial resources and abilities to provide service. Finally, to ensure that the management contract has been formalized, Staff recommends that the purchasing shareholders provide Staff with a copy of the management contract with Direct Communications.

Accounting Issues

Staff states that there will be no acquisition adjustment resulting from the proposed sale of stock and that the value of New Florence's assets and liabilities will not be restated for either financial or regulatory purposes. As noted above, all of the accounting, management, regulatory consulting and human resources administration will be handled by Direct Communications. To provide Staff with the necessary information as to the final valuation of this transaction, Staff recommends that the purchasing shareholders provide Staff with all closing journal entries to record the stock sale.

Federal Universal Service Funds

Staff states that New Florence does not receive universal service funds as of September 30, 2004. The Commission declined to certify that the company was using the support in accordance with the law. However, under the Stipulation and Agreement resulting from Staff's complaint against the company, it was agreed that Staff would recommend such certification upon the sale of the company and a showing that the management of the company has no ties with the current owners.

Staff has determined that the purchasing shareholders and Direct Communications are independent, have no relationship to the current owners and have sufficient knowledge and skill to provide basic local telecommunications services. Further, upon consummation of the transaction, the service agreement with the sole shareholder (Robert D. Williams) of TigerTel will be terminated. Staff recommends that, upon closing of the transaction, the purchasing shareholders file a notice with the Commission that the Stock Purchase Agreement has been executed and that the certification be effective as of the closing date of the transaction.

Decision

Staff lists 14 suggested ordered paragraphs. As Joint Applicants do not object to Staff's suggested conditions, the Commission will adopt them. Furthermore, Staff discusses several Commission rules under Chapter 32 – Telecommunications Service Review. Specifically, Staff notes the requirements under section .050 (Customer Service), .060 (Engineering and Maintenance), and .080 (Service Objectives and Surveillance Levels) and Financing Issues. The content of the financing issues are proprietary. However, Staff suggests that the following as a condition in this regard:

If Tiger Telephone Inc.'s Total Debt/EBITDA ratio should exceed 5.15x or Tiger Telephone, Inc.'s Fixed Charge Coverage ratios should fall below the lender's required ratio, then Tiger Telephone must, within 30 days, provide a report to the Staff of the Commission demonstrating that this event was not caused by an increase in TigerTel's financial risk (this calculation shall be done on a quarterly basis based on a trailing twelve month basis and shall start as soon as a full 12 months of operating history is available). If TigerTel cannot demonstrate to Staff's satisfaction that the deterioration of these ratios was due to factors other than an increase in TigerTel's financial risk, then TigerTel must, within 30 days, provide a report to Staff demonstrating that the downgrade will not have a negative impact on TigerTel's continued quality of service to its Missouri customers or cause a reduction in its investment in its basic telecommunications services. In the event that TigerTel is unable to demonstrate the aforementioned items to the Commission's satisfaction, TigerTel shall be required to take the necessary financial action to reduce its Total Debt/EBITDA ratio to below 5.15x or the Fixed Charge Coverage ratio to

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above the lender's ratio by the next quarterly report in which these ratios are evaluated.

Joint Applicants do not oppose these conditions. The Commission shall adopt them.

The Commission has reviewed the application and Staff's memorandum, which are hereby admitted into evidence. There are no pleadings filed by any other party. The Commission finds that the proposed transfer of assets will provide the customers of New Florence with continued service, under the same rates and terms. The Commission finds that the proposed transaction is not detrimental to the public interest and shall be approved.

IT IS ORDERED THAT:

1. The purchasing shareholders, Leonard May, Garrin Bott, Kip Wilson, Jeremy Smith, Scott Hendrickson and Elizabeth Dunn, are each joined as parties to this matter.

2. New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. are authorized to enter into and perform in accordance with the terms of the Stock Purchase Agreement.

3. Leonard May, Garrin Bott, Kip Wilson, Jeremy Smith, Scott Hendrickson and Elizabeth Dunn are authorized to purchase or acquire, take or hold all of the total issued and outstanding capital stock of Tiger Telephone, Inc.

4. New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. are authorized to execute and deliver a Deed of Trust, Security Agreement and Financing Statement.

5. New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. are authorized to enter into and perform and accordance with the terms of the Secured Guaranty.

6. New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. are authorized to execute and deliver a mortgage, security agreement and financing statement for the purpose of placing a lien on New Florence's assets and securing the loan to Tiger Telephone, Inc.

7. New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. are authorized to do any and all other things as may be reasonable necessary in furtherance of all acts specifically authorized.

8. Nothing in this order shall be considered a finding by the Commission of the value of these transactions for ratemaking purposes, and that the Commission reserves the right to consider the ratemaking treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.

9. The depreciation rates for New Florence continue to be authorized.

10. Leonard May, Garrin Bott, Kip Wilson, Jeremy Smith, Scott Hendrickson and Elizabeth Dunn shall provide to the Staff of the Commission, within 60 days of the final closing, all closing journal entries.

11. Leonard May, Garrin Bott, Kip Wilson, Jeremy Smith, Scott Hendrickson and Elizabeth Dunn shall provide to the Staff of the Commission, within 60 days of

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final closing, a copy of the management contract with Direct Communications Rockland, Inc.

12. In any rate proceeding, New Florence's cost of capital shall be based upon its business risk and a reasonable amount of financial risk; New Florence's cost of capital shall not be increased due to unnecessary increased risk because of Tiger Telephone, Inc.'s or New Florence's policies.

13. New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. shall comply with the Staff of the Commission's suggested condition, with regard Tiger Telephone Company's Debt/EBITDA ratio, described in the body of this order.

14. This order shall become effective on March 31, 2007.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur.

Jones, Senior Regulatory Law Judge

In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area*

Case No. GR-2006-0422

Gas §18. The Commission ordered that the tariff sheets filed by Missouri Gas Energy, a division of Southern Union Company, on May 1, 2006 be rejected. The Commission also granted authorization to Missouri Gas Energy, to file a tariff sufficient to recover the revenues that were determined by the Commission in this order.

APPEARANCES

Paul Boudreau, James Swearingen, Dean Cooper, Russ Mitten, Janet Wheeler, and Diana Carter, Attorneys at Law, Brydon, Swearingen & England, 312 E. Capitol Avenue, Jefferson City, Missouri 65102, for Missouri Gas Energy, a division of Southern Union Company.

Stuart W. Conrad, Attorney at Law, Finnegan, Conrad & Peterson, LLC, 3100 Broadway Street, Suite 1209, Kansas City, Missouri 64111, for Midwest Gas Users Association.

Jeremiah D. Finnegan, Attorney at Law, Finnegan, Conrad & Peterson, LLC, 3100 Broadway Street, Suite 1209, Kansas City, Missouri 64111, for Central Missouri State University, University of Missouri- Kansas City and Jackson County.

Mark W. Comley, Attorney at Law, Newman, Comley & Ruth, 601 Monroe, Suite 301, Post Office Box 537, Jefferson City, Missouri 65102, for the City of Kansas City.

Jeffrey Keevil, Attorney at Law, Stewart & Keevil, 4603 John Garry Drive, Suite 11, Columbia, Missouri 65203, for Trigen-Kansas City Energy Corporation.

*This case was appealed to the Missouri Court of Appeals (SD29278) and affirmed. See 293 S.W.3d 63 (Mo. App. S.D. 2009).

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Marc Poston, Attorney at Law, Office of the Public Counsel, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public. **Kevin A. Thompson, Robert Franson, Lera Shemwell, Robert Berlin, David Meyer, Steven Reed**, Attorneys at Law, Governor Office Building, Suite 800, 200 Madison Street, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Kennard L. Jones

REPORT AND ORDER

Issue Date: March 22, 2007

Effective Date: March 30, 2007

Summary

In this report and order, the Commission finds that Missouri Gas Energy, a division of Southern Union Company, is entitled to a rate increase sufficient to generate a revenue increase of approximately \$27,206,968.

FINDINGS OF FACT

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

Procedural History

On May 1, 2006, Missouri Gas Energy, a division of Southern Union Company, filed tariff sheets designed to implement a general rate increase for natural gas service in the amount of \$41,651,345. The tariff sheets carried an effective date of June 2, 2006.

On May 12, 2006, the Commission suspended MGE's tariff until March 30, 2007. The maximum amount of time allowed for suspension under the controlling statute.¹ The Commission also directed that notice of MGE's tariff filing be provided to the public, setting June 1, 2006, as the deadline for the submission of applications to intervene.

The Commission granted timely applications to intervene that were filed by Trigen-Kansas City Energy Corporation, Midwest Gas Users Association, University of Missouri-Kansas City and Central Missouri State University. The Commission also granted requests to intervene, filed out of time, by The City of Kansas City, Missouri and the County of Jackson, Missouri. The Commission denied an untimely request to intervene by Cornerstone Energy, Inc. The Commission found that the former out-of-time requests were supported by good cause, while the latter was not.

On July 13, 2006, the Commission established the test year for this case as the 12-month period ending December 2005, updated for known and measurable changes through June 30, 2006. The parties also settled on a further true-up period

¹ Section 393.150, RSMo 2000.

through October 31, 2006, for the purpose of updating certain cost components. Also in its order, the Commission established a procedural schedule with the first day of the hearing beginning on January 8, 2007.

The Commission conducted local public hearings at which the Commission heard comments from MGE's customers regarding MGE's request for a rate increase. The hearings were held in Kansas City, Joplin, Republic, Warrensburg, Nevada, St. Joseph and Slater, Missouri.

The parties prefiled direct, rebuttal and surrebuttal testimony. The evidentiary hearing began on January 8, 2007, and continued through January 17. True-up testimony was entered into the record during the course of the hearing and with consent of all of the parties the true-up hearing was canceled as being unnecessary.

Partial Stipulations and Agreements

Prior to the start of the evidentiary hearing, MGE, Staff, OPC, MGUA, UMKC, CMSU and the County of Jackson, Missouri submitted a Partial Nonunanimous Stipulation and Agreement with regard to customer class cost of service. Although the City of Kansas City and Trigen did not enter the agreement, they did not oppose it. The Commission approved the agreement. The Commission also approved an unopposed Partial Nonunanimous Stipulation and Agreement, filed by MGE and Staff, concerning depreciation schedules.

Overview

MGE is a division of Southern Union Company. As a division, MGE has no separate corporate existence apart from Southern Union. MGE's divisional headquarters is located in Kansas City, Missouri and provides service to customers in Kansas City, St. Joseph, Joplin and other cities in western Missouri. MGE is a local distribution company, sometimes referred to by the acronym, "LDC." That means that MGE purchases natural gas from a supplier, pays to transport the gas to Missouri over one or more interstate pipelines, and then distributes the natural gas to its customers in this state. Southern Union is headquartered in Wilkes-Barre, Pennsylvania. In addition to MGE, Southern Union has one other division in New England that acts as an LDC.

Noted earlier, as an LDC, MGE must purchase natural gas from supply sources, transport the gas over an interstate pipeline, and then distribute it to its customers. This Commission does not have any authority to regulate the price that MGE must pay to purchase and transport gas over the interstate pipeline. The purchase price of natural gas is set by the market and transportation rates are regulated by the Federal Energy Regulatory Commission (FERC). As a result, this rate case has nothing to do with those aspects of the cost of natural gas.

The price that MGE must pay to purchase and transport natural gas is passed through, dollar for dollar, to its customers through the PGA/ACA process. Therefore, if MGE is to recover its cost of distributing natural gas to its customers, and earn a profit, it must have another source of income. It is those costs, and that source of income, that are at issue in this rate case.

MGE began the rate case process when it filed its tariff on May 1, 2006. In doing so, MGE asserted that it was entitled to increase its rates enough to generate

an additional \$41,651,345 in general revenues per year. MGE set out its rationale for increasing its rates in the direct testimony that it filed along with its tariff on May 1. In addition to its filed testimony, MGE provided work papers and other detailed information and records to the Staff of the Commission, Public Counsel and other intervening parties to determine whether the requested rate increase is just and reasonable.

Because of the complexity of a rate case, there are a multitude of matters about which the parties could disagree. However, there was agreement between the parties about many matters; hence, those potential issues were not brought before the Commission. Where the parties disagreed, they prefiled written testimony for the purpose of bringing those issues to the attention of the Commission. All parties were given an opportunity to prefile three rounds of testimony – direct, rebuttal, and surrebuttal. Prior to the start of the hearing, the parties submitted a Joint Statement of Issues that required resolution by the Commission.

As noted, the issues of depreciation and class cost of service were resolved by Stipulation and Agreement and will not be further addressed in this report and order. The remaining issues will be addressed in turn. The issue description for each issue is taken from the statement of issues. Factual matters will be addressed in the Findings of Fact section. If an issue also contains a legal aspect, that portion of the issue will be addressed in the Conclusions of Law section.

Generally, all parties agree that MGE has experienced a revenue deficiency. However, this does not mean that MGE operated at a loss. In fact, it did earn a return of between 5.74% and 8.29%.² For the calendar year of 2005 MGE's overall rate of return was 7.49%. And for 2006 it was considerably lower due to weather being 77% of normal.³

The Issues

1. Capital Structure

Issue Description: *What is the appropriate capital structure (i.e., the relative proportions of long-term debt, short-term debt, preferred equity, and common equity) to use in calculating MGE's cost of service?*

Determining an appropriate capital structure for MGE is complicated by the fact that MGE is a division of Southern Union and does not issue its own debt or equity. Therefore, MGE does not have its own capital structure.

As a substitute for its non-existent capital structure, MGE proposes to use a hypothetical capital structure consisting of 46% equity and 54% debt. MGE's proposed structure is as follows:⁴

² Transcript, Page 950, Lines 12-24.

³ Transcript, Page 590, Lines 12-16.

⁴ Hanley Direct, Ex. 1, Page 3.

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Common Equity 46%
Long-Term Debt 44.09%
Short-Term Debt 9.91%

However, if the Commission does not adopt the proposed hypothetical capital structure, MGE is willing to accept the actual capital structure of Southern Union as of October 31, 2006.⁵

Southern Union has an identifiable capital structure.⁶ Staff recommends that the Commission use the actual consolidated capital structure of Southern Union, as of October 31, 2006. The following is the capital structure offered by Staff.⁷

Common Equity 36.06%
Long-Term Debt 55.92%
Preferred Stock 4.71%
Short-Term Debt 3.3%

OPC did not take a position on this issue.

It is important to note that the capital structure recommended by Staff contains a much smaller proportion of common stock than does the structure recommended by MGE. It costs the company more to issue equity than it does to incur debt. Therefore, a capital structure that uses a lot of debt with relatively low levels of equity is less expensive for the company. That means, all else being equal, a capital structure that includes a low percentage of equity and a large percentage of debt will be less costly, resulting in a lower rate of return, and consequently a lower revenue requirement and lower rates to customers.

However, a high percentage of debt in a capital structure has an effect on the cost of equity. The shareholders in a company – the holders of equity – are subordinate to holders of debt. Generally, the company must pay the interest on debt, such as bonds issued by the company, before it can pay dividends to its shareholders or before it can invest profits in other ways that benefit the shareholders. If a company's gross income goes down, the risk is borne by the shareholders. Furthermore, if the company has to be liquidated, the holders of debt get paid first. The shareholders get whatever is left over. Therefore, a company with a capital structure that includes a high percentage of debt is more risky for shareholders. The shareholders will consequently demand a higher rate of return to compensate them for the increased risk caused by the high level of debt.

Southern Union's capital structure, as proposed by Staff, contains a good deal more debt and less equity than the capital structure proposed by MGE. That means the capital structure proposed by Staff poses more risk to the shareholder than that proposed by MGE. MGE contends that the use of its proposed capital structure, one using proxy companies to reflect the capital structure of a stand-alone

⁵ Transcript, Page 170, Lines 17-23.

⁶ Transcript, Page 60, Line 24.

⁷ Murray True-Up, Ex. 205, Page 3, Lines 1-3.

LDC, is particularly appropriate in light of Southern Union's transition to being primarily a transportation and storage company.

This issue was discussed by the Commission in MGE's last rate case.⁸ As discussed in that case, the capital structure of Southern Union is the result of its management decisions. Hence, Southern Union, and ultimately MGE, must operate with the result of its decisions. MGE stresses that the make-up of Southern Union has changed so dramatically, that use of a hypothetical capital structure is warranted. This premise, however, does not change the Commission's reasoning in MGE's last rate case. Therefore, the capital structure, as proposed by Staff, shall be used.

2. Rate Design

Issue Description: What is the appropriate rate design for residential, small general service, large volume service and large general service classes?

Historically, MGE has operated under a rate design that allows it to recover a portion of its fixed cost through a customer charge. The remaining portion is recovered through volumetric rates, the amount of gas MGE sells to its customers. Currently, MGE recovers 55% of its fixed cost through a customer charge and 45% of its fixed cost through volumetric rates.⁹ Since 1996, the annual average usage per residential customer has generally declined.¹⁰ MGE posits that because of this decline, coupled with the fact that 90% of its customer base is residential, it has been unable to earn its Commission authorized rate of return.¹¹ Hence, MGE seeks Commission approval of a Straight-Fixed Variable (SFV) rate design for the Residential class because of the under-recovery of its costs through volumetric rates and because of the high degree of heat sensitivity effecting the class.¹² The SFV design is one through which the company will recover all of its fixed costs through a fixed, monthly customer charge. Although its preferred rate design is the SFV design, as an alternative MGE proposes a design consisting of a weather normalization adjustment mechanism applicable to Residential, Small General Service and Large General Service classes.¹³ The only class omitted is the Large Volume Service class.

Staff agrees that the SFV design should be implemented.¹⁴ Staff argues that customers in the Residential class are homogeneous with respect to the cost of serving them and that it is unfair to collect these costs through a volumetric rate

⁸ Report and Order, Commission Case No. GR-2004-0209, *issued*, September 21, 2004.

⁹ Transcript, Page 634, Lines 2-5.

¹⁰ Feingold, Schedule RAF-7.

¹¹ Transcript, Page 632, Pages 2-8.

¹² Transcript, Page 686, Lines 14-23.

¹³ Transcript, Page 16, Lines 19-23.

¹⁴ Staff Post Hearing Brief, Page 18.

design.¹⁵ Staff goes on to reason that the volumetric rate design causes high-use customers to subsidize the cost of low-use customers. Staff also reasons that the SFV design will reduce volatility of customer bills. An additional benefit of the proposed rate design, set out by Staff and the company, is that the objective of the shareholders and ratepayers will be better aligned because the utility's revenues will no longer depend on how much gas it sells. Currently, MGE has an incentive to sell more gas to at least recover its costs. The current rate design therefore discourages natural gas conservation efforts on the part of the company. If the SFV design is adopted, the company is committed to offering several natural gas conservation initiatives. Finally, the SFV design will promote accuracy. Under the current design, presumptions are made about sales volumes to try to match MGE's fixed cost. In this instant, there is often over or under payment. The proposed rate design eliminates this concern with regard to the Residential class.

OPC opposes any change in the current rate design.¹⁶ Although OPC opposes the SFV design, as a participant in an energy task force it agreed that the Commission should incorporate rate designs that remove the disincentive for utilities to pursue programs aimed at reducing usage.¹⁷ OPC's recommendation in support of the current rate design does not remove the company's disincentive to pursue programs aimed at reducing natural gas usage.¹⁸ As discussed above, the SFV rate design does just that. Also, as discussed above, declining customer usage coupled with the current rate design, will exacerbate MGE's inability to recover its fixed costs. OPC does not dispute that customer usage is declining and will continue to do so through 2010 to 2020, as put forth by MGE's witness in light of a forecast set out by the American Gas Association.¹⁹

Although OPC opposes the SFV design because it lessens the customer's ability to have control over the amount of his or her bill,²⁰ OPC agrees that that under the SFV design customers would save by reducing their natural gas usage.²¹ Further, OPC agrees that customers will not pay as much in colder-than-normal winters.²² Under the SFV design, weather is removed from the risk factor calculation.²³ OPC opposed the SFV design as unjustifiable in a separate matter because the company had not proposed any meaningful conservation programs.²⁴ Notwithstanding, in this matter MGE has proposed conservation programs. Also,

¹⁵ Staff's Post Hearing Brief, Page 18.

¹⁶ Transcript, Page 562, Pages 6-16.

¹⁷ Transcript, Page 566, Lines 4-10.

¹⁸ Transcript, Page 537, Lines 10-15.

¹⁹ Transcript, Page 534, Lines 1-18.

²⁰ Transcript, Page 537, Lines 10-18.

²¹ Transcript, Page 580, Lines 23-25.

²² Transcript, Page 579, Lines 14-18.

²³ Transcript, Page 92, Lines 6-12.

²⁴ Transcript, Page 541, Lines 4-9.

MGE has had in place a Low Income Weatherization program for some time.²⁵ Lastly, OPC particularly opposes the SFV design in conjunction with tariff language regarding seasonal disconnects,²⁶ which will be discussed below.

The Commission points out that MGE and Staff propose a SFV design only for MGE's Residential class and not for its Small General Service class because it is more heterogeneous than the Residential class.²⁷ The Commission finds MGE and Staff's arguments for a rate design that will protect MGE from the vagaries of weather to be persuasive. The Commission shall approve the SFV rate design for MGE's residential class.

3. Unrecovered Cost of Service Amortization

Issue Description: Should MGE recover \$15.6 million in rates amortized over five years for alleged revenue loss due to lower customer gas use for the period of January through June of 2006?

Staff and OPC argue that to authorize this expense would constitute retroactive ratemaking.²⁸ MGE agrees that to grant this request would constitute retroactive ratemaking.²⁹ Because all parties of interest³⁰ agree that this request is illegal, the Commission will deny MGE's proposal.

4. Property Tax Refund

Issue Description: What is the proper treatment of \$5,554,068 in property tax refunds received by MGE during the test year of 2005?

During the test year of 2005, MGE received a refund of property taxes paid during 2002, 2003 and 2004. Staff proposes to put that money in a deferred account and to amortize it over five years; reducing the amount of property tax expense that would otherwise be included in rates.³¹ Staff contends that to do so does not constitute retroactive ratemaking because the money was received during the test year.³² However, Staff contends that in this regard, rates were properly set for the years 2002, 2003, and 2004.³³ Then Staff goes on to state that in light of the

²⁵ Transcript, Page 541, Lines 10-13.

²⁶ Transcript, Page 571, Lines 15-18.

²⁷ Transcript, Page 684, Lines 13-20.

²⁸ Transcript, Page 1006, Lines 8-12.

²⁹ Transcript, Page 284, Lines 19-25.

³⁰ The only parties arguing this issue are MGE, Staff and OPC.

³¹ Transcript, Page 848, Lines 12-20.

³² Transcript, Page 850, Lines 21-25.

³³ Transcript, Page 851, Lines 21-22.

company having recovered the taxes, this expense was set too high in rates.³⁴ In setting rates, there is always a risk that the expense for property taxes will be under or over estimated. The company therefore has the risk of not recovering its property taxes. In this case, the property tax expense was set too high, just as cost of service was set too low in the preceding issue.

MGE argues that Staff's proposal constitutes retroactive ratemaking and that the Missouri Supreme Court has determined, in setting rates, that the Commission can consider past excess recovery by a utility only insofar as it is relevant to a determination of what rate is necessary to provide a just and reasonable return.³⁵ Interestingly, Staff notes in its opening argument that "the test year concept is to take a snapshot of the company's incoming revenues and outgoing expenses and work with those to determine the appropriate rates." Although Staff goes further to propose inclusion of the refund in rates, Staff's statement is consistent with the argument put forth by MGE.

Based on its Conclusions of Law and the above findings, the Commission will deny Staff's request to amortize the property taxes refunded to MGE in 2005.

5. Weather Normalization

***Issue Description:** What is the appropriate measure of normal weather to be used in calculating 1) MGE's revenue requirement and 2) the billing determinants to be used in establishing MGE's volumetric rate elements?*

The Commission has historically used a 30-year average in determining what the normal temperature should be.³⁶ Staff gathers its information from the National Oceanic Atmospheric Administration (NOAA). Currently, the NOAA's period for calculating a normal climate is the 30-year period between January 1, 1971 and December 31, 2000.³⁷ The "normal" temperature is ultimately used to determine what the cost of each unit of gas should be. MGE proposes to use what is described as a 10-year rolling average to determine normal weather.

MGE argues Staff's recommendation of the 30-year period is flawed because Staff's proposal fails to consider circumstances that reasonable can be expected to occur while rates are in effect.³⁸ MGE goes on to argue that "the theory underlying the policy should generate a result that has some relationship to reality; otherwise, what we do here is just a formality."³⁹ MGE points out that if the

³⁴ Transcript, Page 854, Lines 3-4.

³⁵ Transcript, Page 855, Lines 11-17.

³⁶ Transcript, Page 671, Line 25 – Page 672, Line 2

³⁷ Transcript, Page 675, Lines 22-25.

³⁸ Transcript, Page 665, Lines 2-7.

³⁹ Transcript, Page 668, Lines 9-11.

Commission adopts the SFV rate design, weather normalization will not be an issue for its residential customers.⁴⁰

Staff has problems with the 10-year normal because it's too short to provide the necessary stability. Temperature variations can span across decades. Also, the rolling average will change every year and depending on which year is the test year we could end up with different normals.⁴¹ Staff's position is that the 30-year normal is a better reflection than the 10-year rolling average of what is normal.⁴²

As noted above, the Commission has historically used the 30-year normal. As MGE has stated, under the SFV rate design this will not be an issue for 90% of the company's customers. The Commission continues to use the 30-year normal and finds that it should be consistent when applying a method of weather normalization between utilities. In the absence of more convincing evidence that this methodology should be changed, the Commission will continue to adopt the 30-year weather normalization as proposed by Staff.

6. Low Income Weatherization

Issue Description: What is the appropriate level of low-income weatherization funding to be used in calculating MGE's cost of service and how should such funding be allocated among the geographic regions of MGE's service territory?

MGE currently provides \$367,000 of ratepayer funds to the weatherization program in Clay, Platte and Jackson Counties.⁴³ An additional \$132,368 is administered throughout the rest of MGE's service territory for a total of \$500,000. The program was initiated in 1994 and currently serves between 200-300 customers per year.⁴⁴ Among other things, the program includes appliance replacement, installation of insulation and energy audits.⁴⁵ As a result of demand for the program, the City of Kansas City, the program administrator, requests an additional \$250,000. Kansas City states that the funds are exhausted before the end of each year.⁴⁶ Approximately \$1,700 per person is spent through the program.⁴⁷ Kansas City states that it will be able to serve an additional 100-150 customers with the additional \$250,000.

Staff and MGE support additional funding for the program. However, they agree that the additional funding should be \$100,000 rather than \$250,000. Further,

⁴⁰ Transcript, Page 668, Lines 14-21.

⁴¹ Transcript, Page 742, Lines 16-25.

⁴² MGE's current tariff. P.S.C Mo. No. 1, Fourth Revised Sheet No. 96.

⁴³ Transcript, Page 132, Lines 15-16.

⁴⁴ Transcript, Page 135, Lines 17-19.

⁴⁵ Transcript, Page 137, Lines 18-24.

⁴⁶ Transcript, Page 134, Lines 6-16.

⁴⁷ Transcript, Page 136, Lines 10-11.

at Staff's suggestion, they agree that an additional \$20,000 should be used to evaluate the program's effectiveness.⁴⁸ MGE states that the \$100,000 increase is sufficient in light of the fact that Kansas City does not have much of a backlog and that a 20-25% increase at this time makes sense.⁴⁹

The Commission finds that the existing low-income weatherization program has been successful and should be continued with additional funding. In light of the growing concern regarding energy conservation, the Commission will direct MGE to fund the low-income weatherization program with an additional \$250,000 to be allocated in the same proportion as the current program.

7. Natural Gas Conservation

***Issue Description:** Should funding for natural gas conservation programs be included in MGE's cost of service?*

As discussed earlier, under the SFV rate design, MGE's disincentive to promote natural gas conservation is removed. With the disincentive removed, the company is willing to "offer" conservation programs to better align themselves with the interest of the customer.⁵⁰ The company offers \$705,000 to be included in rates to go toward a gas water heater rebate program.⁵¹ The Commission notes, however, that this program is particularly in the company's interest as it provides an incentive for customers to switch from electric to gas water heaters.⁵² Additionally, the company is offering \$45,000 to be included in rates to educate the public about energy conservation.⁵³ This program would be an on-line audit (energy calculator) linked to the Department of Energy.⁵⁴ MGE anticipates lowering its return requirement by \$1 million under the SFV design and using that money for conservation programs.⁵⁵ The Commission shall approve the conservation program proposed by Staff and MGE.

⁴⁸ Transcript, Page 811, Lines 7-13.

⁴⁹ Transcript, Page 625, Lines 2-14.

⁵⁰ Transcript, Page 390, Lines 20-25.

⁵¹ Transcript, Page 440, Lines 9-11.

⁵² Transcript, Page 441, Line 23 - Page 442, Line 4.

⁵³ Transcript, Page 439, Lines 7-25.

⁵⁴ Transcript, Page 627, Lines 3-10.

⁵⁵ Transcript, Page 808, Lines 6-25.

8. Environmental Response Fund

Issue Description: Should the environmental response fund proposed by MGE be adopted and what, if any, level of environmental costs should be used in calculating MGE's cost of service? MGE requests that the amount of the fund be \$500,000, annually.

MGE is seeking authority to establish an environmental response fund of \$500,000 annually, through rates, to meet its obligation to pay costs associated with several manufactured gas sites purchased by Southern Union.⁵⁶ The company proposes that \$500,000 be set aside every year until such time as the costs are incurred.⁵⁷ MGE agrees that the costs associated with the clean-up are impossible to know.⁵⁸ MGE's contractual obligation with regard to the clean up of these sites is to seek rate recovery.⁵⁹ This proposal was rejected when presented to the Commission in MGE's last rate case.⁶⁰ The premises underlying that discussion have not changed.

In the future, MGE may incur an unknown and unknowable amount of financial liability for the cleanup of environmental hazards left over from the operation of manufactured gas facilities 100 to 125 years ago.⁶¹ Manufactured gas facilities were used before the advent of interstate natural gas pipelines in the 1940s. Before there were interstate pipelines, gas could not be transported over long distances so gas companies manufactured gas by heating coal or oil and collecting the gas that was driven off in the process. The primary byproduct that came from this process is tar, which contains hazardous carcinogens. This is what primarily drives investigation and remediation of the sites.⁶² MGE agrees that it is not possible to ascertain the costs of investigation and remediation.⁶³ That the magnitude of the costs associated with this effort is impossible to know is again noted by MGE.⁶⁴ Further, to date, MGE has not paid any costs associated with the environmental clean up.⁶⁵

That these costs are not known and measurable precludes their inclusion in rates. Furthermore, the creation of a pre-funded source for the payment of these

⁵⁶ Transcript, Page 885, Lines, 15-22.

⁵⁷ Transcript, Page 918, Lines 14-17.

⁵⁸ Transcript, Page 899, Lines 8-13 and Page 909, 23-25.

⁵⁹ Transcript, Page 904, Lines 23-25.

⁶⁰ Transcript, Page 917, Lines 12-16.

⁶¹ Transcript, Page 900, Lines 1-3.

⁶² Transcript, Page 895, Lines 2-9.

⁶³ Transcript, Page 896, Line 23 – Page 897, Line 6.

⁶⁴ Transcript, Page 899, Lines 8-13.

⁶⁵ Transcript, Page 908, Lines 12-17.

cleanup costs would remove much of Southern Union's incentive to ensure that only prudently incurred and necessary costs are paid. If the money has already been recovered from ratepayers and is being held in the Fund, Southern Union would have little incentive to not pay it out to settle claims brought against it. Although the Fund would be subject to audit by Staff and Public Counsel and they could seek a prudence adjustment, the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line. For these reasons, the Commission finds that MGE's proposal to create an Environmental Response Fund shall be rejected.

9. Infinium Software

Issue Description: Should the Unrecovered cost associated with MGE's Infinium Software be included in rates through an amortization and, if so, over what period of time?

MGE purchased the Infinium Software in 1995 and the estimated life was 10 years. The company switched to different software, Oracle, in 2005.⁶⁶ Although the original investment was almost fully amortized, each year after 1995, until 2001, enhancements and modifications were made to the Infinium system. Each enhancement was given a new 10-year life rather than being amortized for the remaining life of the Infinium system.⁶⁷ MGE is now requesting amortization of the remaining balance of the entire system,⁶⁸ which is approximately \$1.23 million.⁶⁹

The enhancements to the system were included in rate base in MGE's last rate case in 2004.⁷⁰ MGE is currently earning a return on those enhancements until they come out of rate base.⁷¹ MGE points out that it continues to use the Infinium Software for a time entry system, which it intends to do until March of 2007 if it converts the payroll system over to Oracle.⁷²

OPC argues that the system is not used and useful and opposes MGE's proposal.⁷³ In this regard, OPC refers to *State ex rel. Union Electric v. P.S.C.*, 765 S.W.2d 618 (Mo. App. 1988) in its post hearing brief. That case states that:

The property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in rate base.

⁶⁶ Transcript, Page 1264, Lines 2-8.

⁶⁷ Transcript, Page 1264, Lines 11-21.

⁶⁸ Transcript, Page 1260, Lines 14-16.

⁶⁹ Transcript, Page 1035, Line 12-13.

⁷⁰ Transcript, Page 1266, Line 23 – Page 1267, Lines 2.

⁷¹ Transcript, Page 1267, Lines 21-24.

⁷² Transcript, Page 1257, Lines 9-18.

⁷³ Transcript, Pages 1284 -1285.

However, MGE made an adjustment to remove the plant investment in the software out of its rate base, which means MGE will not earn a return on the plant.⁷⁴ With the concept of “use and useful” being the premise of OPC’s opposition, its argument must be rejected. Both Staff and MGE point out that the plant is not included in rate base. Therefore, the company will not earn a return on the property. The concept of “used and useful” thus becomes irrelevant. The Commission finds that the property shall be amortized over 5 years as proposed by Staff and MGE.

10. Rate Case Expense

Issue Description: What is the appropriate amount and treatment of rate case expense, including amortization of prior rate case expense, in this case?

From MGE’s last rate case in 2004, the Commission authorized the company to amortize its rate case expense over three years. A balance of \$148,971 remains to be amortized as of March 2007.⁷⁵ MGE proposes to amortize the current rate case expense with the remaining \$148,971 over a three-year period.⁷⁶ Although in its pre and post hearing briefs Staff argues that to allow MGE to amortize the remaining rate case expense would constitute retroactive ratemaking, there is no mention of this argument during the hearing. In fact, Staff’s position is that the rate case expense be normalized.⁷⁷ The Commission will therefore disregard Staff’s argument that recovery of this expense would constitute retroactive ratemaking.

The Commission resolved this issue in MGE’s last rate case to allow the company to recover, what was determined to be prudent costs, through amortization over three years. The Commission will not vacate its order in that regard. Staff and MGE propose to amortize the remaining rate case expense with that incurred in this case. The Commission will grant that request and allow MGE to amortize the combined amounts over a three-year period.

11. Emergency Cold Weather Rule AAO Recovery

Issue Description: What is the proper rate treatment for costs deferred under the Emergency Cold Weather Rule AAO Recovery Mechanism?

MGE is requesting about \$900,000 through an AAO as a result of complying with the Emergency Cold Weather Rule.⁷⁸ On September 21, 2006, the Commission issued an order granting authority for an AAO for cost incurred under

⁷⁴ Transcript, Page 1266, Lines 15-20 and Page 1267, Lines 6-9.

⁷⁵ Transcript, Page 1040, Lines 1-3.

⁷⁶ Transcript, Page 1044, Lines 10 -13.

⁷⁷ Transcript, Page 1045, Lines 21–24.

⁷⁸ Transcript, Page 1074, Line 11.

the cold-weather rule. In that order, the Commission directed the parties to brief and present testimony on this issue.

Staff testified that \$901,331 represents the difference between the amount that the company could have collected under the old cold weather rule and the amount that MGE actually collected.⁷⁹ Staff recommends that this amount be amortized over three years.⁸⁰ Consistent with the Commission's order of September 21, 2006, the Commission will grant MGE's request to amortize the deferred cost through an AAO and finds that \$901,331 shall be amortized over a three-year period.

12. Seasonal Disconnects

Issue Description: Should the seasonal disconnect tariff language proposed by MGE be approved?

Of its 450,000 customers, MGE has about 1,275 customers who voluntarily disconnect their service for period of up to seven months. MGE seeks approval to include in its tariff, language that will require those who "seasonally" disconnect to pay their portion of the fixed costs to provide service that they would have otherwise paid had they remained on the system. The customer would also have to pay the already-approved \$45 reconnection fee. The maximum a customer would have to pay to be reconnected after voluntarily disconnecting for 7 months would be \$237.50.⁸¹ Staff calculated this figure to be \$209.36.⁸² Based on a SFV rate design, MGE estimates that the cost of those who seasonally disconnect is about \$140,000.⁸³ Staff estimates this figure to be \$114,447.⁸⁴

MGE recognizes that today, this is not a substantial issue. MGE's intent is to discourage seasonal disconnection in the future.⁸⁵ However, there is no proposed language to protect customers who voluntarily disconnect for hospital stays, military obligations, or for students who vacate in the summer to return in the fall.⁸⁶ OPC argues that the proposed language will force customers to pay for a service they did not use during the time of disconnection, and it fails to take into account the various reasons a customer would need to be disconnected.⁸⁷

⁷⁹ Harrison Direct, Page 17, Lines 7-9.

⁸⁰ Harrison Direct, Page 17, Lines 20-21.

⁸¹ Transcript, Page 1095, Lines 8-20.

⁸² Transcript, Page 1113, Lines 4-6.

⁸³ Transcript, Page 1085, Lines 14-17.

⁸⁴ Transcript, Page, 1113, Lines 4-6.

⁸⁵ Transcript, Page 599, Lines 12-14.

⁸⁶ Transcript, Page 1094, Lines 20-24.

⁸⁷ Transcript, Page 1149, Lines 3-7.

Currently, customers pay a fixed charge of \$11.65 per month. According to MGE, under the SFV rate design, this figure could increase to \$27.50.⁸⁸ Essentially, MGE requests that the fixed monthly charge be increased while proposing language that punishes customers for disconnecting during a time of the year when gas is not needed. MGE's intent is to discourage people from disconnecting. However, under the higher fixed charge the opposite might occur. There is no way to predict what effect a SFV rate design will have on seasonal disconnection.

What is certain is that this currently not a big problem for MGE. Those who seasonally disconnect represent only .3% of MGE's residential customer base. The Commission realizes that it recently approved seasonal disconnection language in Atmos Energy Corporations' rate case.⁸⁹ However, in that case the customers who took advantage of seasonal disconnection comprised 10% of the company's residential customers. Also, the Atmos reconnection charge, at \$24.00, is substantially lower than that of MGE. These distinctions justify the Commission taking a different course in this case. The Commission will, therefore, deny MGE's request to include language in its tariff regarding seasonal disconnection.

13. Kansas Property Tax AAO

Issue Description: Should the Kansas Property Tax AAO be continued past the expiration date ordered by the Commission in Case No. GU-2005-0095?

In Case No. GU-2005-0095, the Commission granted MGE an Accounting Authority Order allowing it to record on its books a regulatory asset representing the expenses associated with property taxes. The property tax concerns natural gas storage held by MGE in the state of Kansas.⁹⁰ MGE contends that it should not have to pay the tax and informs the Commission that the matter is now before the Supreme Court of Kansas.

Staff agrees with MGE that there is no reason to vacate the Commission's prior Order. It also agrees that this issue involves no money and will make no difference with regard to revenue requirement.⁹¹ OPC opposes this request arguing that the AAO is inappropriate because the costs to be deferred are not known and measurable.⁹²

In its order initially granting the AAO, the Commission reasoned that an AAO is appropriate if MGE demonstrates that the costs to be deferred are "extraordinary, unusual and unique, and not recurring." In this case, the costs that MGE seeks to continue deferring are property taxes. In most cases, the payment of property taxes by a utility would not be a fit subject for an AAO. MGE, like all

⁸⁸ Transcript, Page 1103, Line 6.

⁸⁹ Commission Case No. GR-2006-0387. Report and Order, issued February 22, 2007.

⁹⁰ Transcript, Pages 1288-1289.

⁹¹ Transcript, Page 1291, Lines 9-19.

⁹² Robertson Direct, Page 19.

investor-owned utilities, routinely pays property taxes. Again, like all investor-owned utilities, MGE is routinely allowed to recover the taxes it pays from its ratepayers through the inclusion of those tax payments in its cost of service when its rates are calculated in a rate case.

The Kansas property tax on gas held in storage in that state is unusual in that MGE, which does not serve customers in Kansas, has never before had to pay property tax in Kansas. However, if the Kansas taxes are found to be legal in the ongoing court challenge, and MGE is required to pay the tax, it should be able to recover those tax payments for future years through its rates when it includes those taxes in its cost of service in a future rate case.

The problem is that, at the moment, MGE can not include the Kansas taxes in its cost of service in this rate case. As a general rule, for an item of cost to be included in a utility's cost of service, that item of cost must be both known and measurable. A utility's customers should not be expected to pay, through their rates, for costs that are speculative and uncertain. MGE's Kansas tax liability is now *measurable* – it has received a bill from the Kansas tax authorities for the 2004 year. Future tax bills can be estimated – but its Kansas tax liability is not yet *known* because of the uncertainty resulting from the ongoing legal challenge. If MGE prevails in court, it may never have to pay the Kansas property taxes.

The amount of taxes that MGE might have to pay in Kansas is significant to both MGE and to its ratepayers. It would not be appropriate to allow MGE to recover millions of dollars from its ratepayers for taxes that it might never have to pay. On the other hand, taxes are a legitimate cost of doing business for which ratepayers should be responsible. It would not be fair to MGE's shareholders to shift that burden on to them if those taxes ultimately must be paid. Furthermore, it was MGE's decision to challenge the legality of the Kansas taxes, a decision that could greatly benefit its ratepayers, that has placed MGE in this difficult position. If MGE had accepted the Kansas taxes without challenge, it could have simply passed the added taxes on to its ratepayers through this rate case. Instead, by looking out for the interest of its ratepayers, it has created the possibility that it will not be able to recover several million dollars to which it would otherwise be entitled. It is that conundrum that makes an AAO the appropriate means for dealing with the potential Kansas tax liability.

Having been granted an AAO, MGE may continue to defer the cost of paying the Kansas property taxes for consideration in a future rate case after the legality of those taxes is determined and the costs are both known and measurable. If those taxes are found to be illegal and MGE does not have to pay them, then the deferred amounts will simply be written off the balance sheet and neither the ratepayers nor the shareholders will be harmed. If, on the other hand, MGE ultimately must pay the taxes, it will be able to make its case for the inclusion of its additional tax liability into its cost of service in a future rate case.

This uncertainty surrounding MGE's obligation to pay a significant amount of taxes is an unusual and unique situation that is not likely to recur. As such, it meets the Sibley standard for the granting a continued AAO, which is appropriate.

14. Return on Equity

Issue Description: *What is the appropriate return on equity to use in calculating MGE's cost of service?*

Determining an appropriate return on equity is without a doubt the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them. In contrast, determining a return on equity requires speculation about the desires and requirements of investors when they choose to invest their money in Southern Union rather than in some other investment opportunity. As a result, the Commission can not simply find a rate of return on equity that is unassailably, scientifically, mathematically, or legally correct. Such a "correct" rate does not exist. Instead, the Commission must use its judgment to establish a rate of return on equity that will be attractive enough to investors to allow the utility to fairly compete for the investors' dollar in the capital market, without permitting an excessive rate of return on equity that would drive up rates for MGE's ratepayers. In order to obtain guidance about what rate of return on equity is appropriate, the Commission must turn to expert advice offered by financial analysts.

Three financial analysts offered recommendations regarding an appropriate return on equity in this case. MGE's witness, Frank Hanley, comparing the four cost-of-common-equity models⁹³ to proxies arrived at an initial return on equity of 11.5%. Hanley then argues that this return should be increased because MGE faces more risk because it is smaller than the average company in the proxy group and because it lacks protection from the vagaries of weather. In light of these added risks, Hanley increased his suggested return on equity by 45 basis points to arrive at 11.95%.⁹⁴ However, Hanley reduces this amount by 35 basis points, to 11.6%, if the SFV rate design were adopted.⁹⁵ Hanley then deducts another 10 points.⁹⁶ Staff's witness David Murray, relying on the DCF model and testing its reasonableness using the CAPM, arrived at a recommended return on equity in the range of 8.35 – 8.95%. He then adjusted this amount upward by 30 basis points because the average bond rating for the proxy group he used was "A" and that of Southern Union is "BBB". His resulting range for return on equity was thus, 8.65 – 9.25%.⁹⁷ Public Counsel's witness, Russell Trippensee, suggests that the return on equity be in the

⁹³ The four models are: 1) Discounted Cash Flow Model (DCF); Risk Premium Model (RPM); Capital Asset Pricing Model (CAPM); and Comparable Earnings Model (CEM).

⁹⁴ Hanley Direct, Page 74, Lines 1-4.

⁹⁵ Transcript, Page 80, Lines 10-18.

⁹⁶ Transcript, Page 80, Lines 16-18.

⁹⁷ Murray Direct, Page 37, Lines 7-23.

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range of 7.70% to 8.65%. Trippensee argues that risk associated with earnings variability is essentially eliminated under the SFV rate design.⁹⁸

Between the three experts, there is obvious disagreement on this issue. The more varying suggestions are between MGE and OPC, which is at best a difference of 2.95%. Staff and MGE, both using the DCF model, differ at best by 2.35%. Of course the credibility of all of the experts was challenged. Trippensee's expertise was even challenged to the extent of MGE moving to strike his testimony because he had not conducted an independent evaluation but instead simply critiqued those of Staff and MGE.

The Commission's obligation under the law, and as a matter of practical necessity, is to allow Southern Union an opportunity to earn a return that will allow it to compete in the capital market. No one, including ratepayers, benefits if MGE is starved for capital.

Hanley's recommended return on equity, on behalf of MGE, was 11.5%. Staff's suggestion, at best, is 9.25%. OPC's is even lower than that offered by Staff. The Commission notes that Staff, using the DCF model arrived at a return on equity for Southern Union of 10.83 to 13.43%.⁹⁹ This range does not consider proxies for MGE but rather considers the risks specifically associated with Southern Union. Because Staff argues that the actual capital structure of MGE should be used, Staff's recommended range of 8.65% to 9.25% is inconsistent with Staff's findings of an ROE directly associated with that capital structure.

OPC's recommendation holds very little weight as it did not perform any independent study on this issue. Rather, OPC seemed to have simply looked to Staff's recommendation and opined that Staff and MGE's recommendations do not reflect a reduction in risk associated with the SFV rate design.¹⁰⁰ It doesn't appear that OPC recognizes that at least one of Staff's proxy companies had a SFV rate design. All of the companies had some sort of revenue decoupling rate design. Additionally, although MGE's residential class comprises 90% of its customer base, only 65% of the company's revenue is from its residential customers.¹⁰¹ MGE's small commercial class, alone, accounts for \$35-40 million.¹⁰²

MGE's witness uses four cost-of-common-equity models to arrive at his eventual recommendation of 11.5%.¹⁰³ MGE's results of the Discounted Cash Flow, Risk Premium and Capital Asset Pricing models are 10.43%, 10.53% and 10.44%, respectively. The average of those is 10.47%. However, when averaged with Comparable Earnings Model, resulting in a 14.25% ROE, this average goes to 11.41%. The Commission finds that the Comparable Earnings model result, almost

⁹⁸ Rebuttal Testimony, Page 1, Lines 1-6.

⁹⁹ Transcript, Page 246, Lines 8-13.

¹⁰⁰ Trippensee Rebuttal, Page 12, Lines 1-6.

¹⁰¹ Transcript, Page 176, Lines 21-25

¹⁰² Transcript, Page 177, Lines 12-15.

¹⁰³ Hanley Direct, Schedule FJH-1.

400-points different than the other 3 models, is not credible and should be excluded. Additionally, Mr. Hanley supplied the Commission with a list of authorized returns on common equity for gas companies with an average ROE of 10.53.¹⁰⁴ This is consistent with the resulting average of the three models discussed above.

From his original recommendation of 11.5% Mr. Hanley makes upward adjustments of 30 and 15 basis points due to MGE's size and its lack of protection from weather. To account for an SFV rate design for MGE, he makes a downward adjustment of 35 points to arrive at 11.6 and recommends 11.5. What is interesting about this downward adjustment is that it only reduces the ROE by 20 points. An SFV rate design protects the company from the vagaries of weather. Mr. Hanley first added 15 points for a lack of protection and then deducted 35 for such protection.

All of the parties agree that a determination of ROE is a complicated judgment call. The Commission is persuaded by Staff's conclusion of an ROE of 10.83 – 13.43%. This range is based on a recommended ROE for Southern Union, not an LDC standing alone. The Commission has found that the actual capital structure of Southern Union shall be used. Staff's conclusion is consistent with this finding. Because there must be consideration of the SFV rate design afforded MGE, the Commission will adopt the low end, 10.83%, of Staff's conclusion. Also, under Staff's DCF model, 10.83% is the projected cost of common equity.¹⁰⁵ This is where the Commission will start. Staff and MGE agree that the value of the SFV rate design is 30-35 basis points. As these suggestions are estimates, the Commission finds that the value of the SFV rate design is 32.5 points. A reduction of .325 from 10.83 results in a ROE of 10.5%. The Commission finds that MGE's return on equity shall be 10.5%, which is validated by the conclusions of the cost models, used by MGE and Staff, discussed above.

CONCLUSIONS OF LAW

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

MGE is a public utility, and a gas corporation, as those terms are defined in Section 386.020(42) and (18), RSMo 2000. As such, MGE is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

Section 393.140 (11), RSMo 2000, gives the Commission the authority to regulate the rates that MGE may charge its customers for natural gas. When MGE filed a tariff designed to increase its rates, the Commission exercised its authority under Section 393.150, RSMo 2000, to suspend the effective date of that tariff for 120 days beyond the effective date of tariff, plus an additional six months.

In determining the rates that MGE may charge its customers, the Commission is required to determine that the proposed rate is just and

¹⁰⁴ Hanley Direct, Schedule FJH-17.

¹⁰⁵ Murray Direct, Schedule 18.

reasonable.¹⁰⁶ MGE has the burden of proving that its proposed increase is just and reasonable.¹⁰⁷

Unrecovered Cost of Service Amortization

All parties to this matter agree that to allow MGE to amortize this expense would constitute retroactive ratemaking. A well worded, although colloquial definition, is set out by Staff's witness Oligschlaeger as:

the setting of rates to allow a utility to recover the specific costs of past events incurred by the utility so as to make utility shareholders "whole" or, conversely, it is the setting of rates to reimburse customers related to past over-earnings of a utility so as to make the customers "whole"¹⁰⁸

In light of the fact that all parties agree that to allow this cost to be amortized and included in current rates would constitute retroactive ratemaking, the Commission's conclusion must be consistent with that of all of the parties. Concluding that it would constitute retroactive ratemaking, the Commission will not allow MGE's request to amortize this lost.

Property Tax Refund

MGE argues that to amortize this refund and include it in current rates would constitute retroactive ratemaking. MGE points out that if the Commission allows Staff's request in this regard, it must also allow MGE's request under the issue of Unrecovered Cost of Service Amortization. Staff's reason for arguing that its request would not constitute retroactive ratemaking is that the money was received during the test year.

MGE's position assumes that Staff's request would constitute retroactive ratemaking. Then, in comparing this issue with Unrecovered Cost of Service, MGE argues that if the Commission adopts Staff's position on this issue it must adopt MGE's position under the previous issue. This argument simply begs the question of whether the Commission will allow retroactive ratemaking. Staff's position hinges on the test year.

The Commission will not adopt a position that would constitute retroactive ratemaking. As pointed out by MGE, "retroactive ratemaking is the setting of rates which permit a utility to recover past excess losses of which require it to refund past excess profit collected under at ate that did no perfectly match expenses plus rate-of-return with the rate actually established."¹⁰⁹ The same case goes on to hold that these past occurrences may be considered insofar as it is necessary to determine what a just and reasonable rate would be going forward.

Like the issue of Unrecovered Cost of Service, the Commission concludes that to adopt Staff's request in this regard would constitute retroactive ratemaking.

¹⁰⁶ Section 393.150.2 RSMo 2000.

¹⁰⁷ Section 393.150.2, RSMo 2000.

¹⁰⁸ Oligschlaeger Rebuttal, Page, 4, Lines 6-10.

¹⁰⁹ State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41 (1979).

Infinium Software

OPC argues that the system is not used and useful and opposes MGE's proposal. In this regard, OPC refers to *State ex rel. Union Electric v. P.S.C.*, 765 S.W.2d 618 (Mo. App. 1988) in its post hearing brief. That case states that:

The property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties if a utility can be included in rate base.

However, MGE made an adjustment to remove the plant investment in the software out of its rate base, which means MGE will not earn a return on the plant. With the concept of "use and useful" being the premise of OPC's opposition, its argument must be rejected. Both Staff and MGE point out that the plant is not included in rate base. Therefore, the company will not earn a return on the property. The Commission concludes that the concept of "used and useful" then becomes irrelevant and will allow continued amortization of the software as proposed by MGE and Staff.

DECISION

After its findings of fact and conclusions of law, the Commission has reached the following decision regard the issues as identified by the parties.

1. Capital Structure

Issue Description: *What is the appropriate capital structure (i.e. the relative proportions of long-term debt, short-term debt, preferred equity, and common equity) to use in calculating MGE's cost of service?*

Common Equity	36.06%
Long-Term debt	55.92%
Preferred Stock	4.71%
Short-Term Debt	3.3%

2. Rate Design

Issue Description: *What is the appropriate rate design for residential, small general service, large volume service and large general service classes?*

The rate design for the residential class shall be the Straight-Fixed Variable Design proposed by Staff. To the extent that they are consistent with the Stipulation and Agreement regarding class cost of service, the current rate designs shall remain in effect for all non-residential classes.

3. Unrecovered Cost of Service Amortization

Issue Description: *Should MGE recover \$15.6 million in rates amortized over five years for alleged revenue loss due to lower*

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customer gas use for the period of January through June of 2006?

No. The Commission rejects MGE's proposal on this issue.

4. Property Tax Refund.

Issue Description: What is the proper treatment of \$5,554,068 in property tax refunds received by MGE during the test year of 2005?

The Commission denies Staff proposal to amortize this refund. MGE will be allowed to keep this money as a gain.

5. Weather Normalization

Issue Description: What is the appropriate measure of normal weather to be used in calculating 1) MGE's revenue requirement and 2) the billing determinants to be used in establishing MGE's volumetric rates?

The Commission adopts Staff position that the 30-year normal will be used and rejects MGE's proposal that a 10-year rolling average should be implemented.

6. Low Income Weatherization

Issue Description: What is the appropriate level of low-income weatherization funding to be used in calculating MGE's cost of service and how should such funding be allocated among the geographical regions of MGE's service territory?

The Commission adopts the City of Kansas City's proposal to allocate \$250,000 to the Low-Income Weatherization program.

7. Natural Gas Conservation

Issue Description: Should funding for natural gas conservation programs be included in MGE's cost of service?

Yes. The Commission adopts Staff and MGE's proposal to allocate \$705,000 for a water heater rebate program and \$45,000 for educating MGE's customers about weather conservation.

8. Environmental Response Fund

Issue Description: Should the environmental response fund proposed by MGE be adopted and what, if any, level of environmental costs should be used in calculating MGE's cost of service? MGE requests that the amount of the fund be \$500,000, annually.

The Commission rejects the Environmental Response Fund proposed by MGE.

9. Infinium Software

Issue Description: *Should the unrecovered cost associated with MGE's Infinium Software be included in rates through an amortization and, if so, over what period of time?*

The Unrecovered cost associated with MGE's Infinium Software should be included in rates and amortized over 5 years as proposed by Staff and OPC.

10. Rate Case Expense

Issue Description: *What is the appropriate amount and treatment of rate case expense, including amortization of prior rate case expense, in this case?*

MGE shall be allowed to amortize the combined amounts over a three-year period.

11. Emergency Cold Weather Rule AAO Recovery

Issue Description: *What is the proper rate treatment for costs deferred under the Emergency Cold Weather Rule AAO Recovery Mechanism?*

The Commission will grant MGE's request to amortize the deferred cost through an AAO.

12. Seasonal Disconnects

Issue Description: *Should the seasonal disconnect tariff language proposed by MGE be approved?*

No.

13. Kansas Property Tax AAO

Issue Description: *Should the Kansas Property Tax AAO be continued past the expiration date ordered by the Commission in Case No. GU-2005-0095?*

MGE is allowed to continue the Kansas Property Tax AAO beyond the date ordered in Commission Case No. GU-2005-0095 until a final determination is made on this issue by the Kansas courts.

14. Return on Equity

Issue Description: *What is the appropriate return on equity to use in calculating MGE's cost of service?*

The appropriate return on equity is 10.5%.

IT IS ORDERED THAT:

4. The tariff sheets filed by Missouri Gas Energy, a division of Southern Union Company, on May 1, 2006, and assigned tariff number YG-2006-0845, are rejected.

5. Missouri Gas Energy, a division of Southern Union Company, is authorized to file a tariff sufficient to recover the revenues as determined by the Commission in this order.

6. This Report and Order shall become effective on March 30, 2007.

Davis, Chm., Murray, and Appling, CC., concur;
Gaw, C., dissents, with separate dissenting
opinion to follow;
Clayton, C., dissents;
and certify compliance with the provisions
of Section 536.080, RSMo.

**DISSENTING OPINION OF COMMISSIONERS
ROBERT M. CLAYTON III AND STEVE GAW**

These Commissioners dissent from the majority's Report and Order that continues the untested and company beneficial shift in PSC policy for utility rate design.¹ The Order grants the Straight Fixed Variable (SFV) rate design under the guise of "declining customer usage coupled with the current rate design... exacerbate[ing] MGE's inability to recover it[s] fixed costs."² The SFV rate design is clearly beneficial to utilities by eliminating virtually all volatility in its regulated revenues. It accomplishes this goal by decreasing a consumer's ability to control costs through conservation and increasing costs to low volume users (including low income consumers). The traditional rate design of both a volumetric and fixed rate element has been used and supported by Commission Staff for years. Until this year, the Commission considered it to be the fairest rate design for high and low volume users.

The SFV rate design also shifts all risk from fluctuating weather from an equitable sharing mechanism and places the risk on consumers. The traditional rate design encouraged conservation due to the combination of these elements. The SFV rate design decreases the incentive to conserve. The majority awards the SFV rate design without sufficient conservation and energy efficiency programs. These Commissioners believe it is critical that a significant effort toward conservation and efficiency be required before this rate design is allowed.

The majority states that "[i]f the SFV design is adopted, the company is committed to offering several natural gas conservation initiatives."³ However, the \$1,500,000 projected program expenditures on which the majority relies is completely funded by ratepayer dollars, lacks any contribution or commitment by the utility and adds up to less than 1 % of MGE's gross revenues. The same majority recently used the 1% of gross revenues standard (which these Commissioners

¹ See Dissent of Commissioners Clayton and Gaw in PSC case no. GR-2006-0387.

² See this majority's Report and Order at p. 11.

³ Id.

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argued was insufficient), in Atmos' last rate case as the minimum level that the utility, not the ratepayers, should expend in order to receive a SFV rate design. Now, in this Order, the majority abandons both the 1% threshold and the mandate of utility funding and places all of the cost of the conservation "commitments" on ratepayers.

These Commissioners are also concerned that despite the significant reduction risk granted on behalf of the company, the majority has failed to reflect that reduction of risk in the company's Return on Equity (ROE) award. The majority awards the same ROE to MGE as was granted in the last rate case with no downward adjustment. Not only is this Report and Order inconsistent with prior Commission decisions, it is also contrary to the national trend of declining Commission-granted ROES.

These Commissioners are disturbed by the majority's pattern of disregarding risk reductions as a major element to consider in setting ROE when it should benefit ratepayers, and yet, in contrast, consistently increasing the ROE while there is a perceived elevation in risk when it benefits the utility. In MGE's last rate case, the majority ultimately granted a return of 10.5%, which these Commissioners believed to be too high for reasons specified in the dissent in case number GR-2004-0209. This Order also grants a return of 10.5%, while reducing the risks of the company through stabilized revenues. Such a decision unjustifiably increases profit margins while unjustly shifting costs to ratepayers. Logic suggests a decrease in a utility's ROE when there is decreased risk to maintain a degree of balance between the company and ratepayers. This, unfortunately, was not the approach Staff presented nor that adopted by the majority.

Conservation efforts and efficiency improvements are vital if we are to attempt to reduce consumption, reduce overall costs to consumers and become more energy independent and environmental friendly as a nation. The use of a SFV rate design lowers the incentive of attaining all of these goals absent significant and comprehensive energy efficiency programs. It also increases costs to many low income ratepayers who attempt to save money through lower usage and lower bills. Such a shift should not be considered without sufficiently balanced programs to benefit other stakeholders. It should only be considered as a part of a significant effort toward the goals of conservation and efficiency and with a plan for protecting low income ratepayers. The efforts made here do not rise to the level that justifies giving MGE the SFV rate design. In conclusion, these Commissioners believe that rates can not be considered just and reasonable. For these reasons these Commissioners dissent.

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company

Case No. GR-2006-0387

Gas §18. The Commission authorized Atmos Energy Corporations to file new tariffs with a Straight Fixed Variable rate design which was to be accompanied by a commitment to implement a substantial energy efficiency and conservation program.

**ORDER DENYING APPLICATION FOR REHEARING
AND CLARIFYING REPORT AND ORDER**

Issue Date: March 27, 2007

Effective Date: March 27, 2007

On February 22, 2007, the Commission issued its Report and Order in which it rejected the general rate increase tariff of Atmos Energy Corporation and authorized Atmos to file new tariffs with a Straight Fixed Variable rate design to be accompanied by a commitment to implement a substantial energy efficiency and conservation program. The Commission's order was given an effective date of March 4, 2007. On March 2, 2007, the Office of the Public Counsel filed a timely application for rehearing. On March 9, 2007, Atmos filed a response in opposition to Public Counsel's application.

Public Counsel makes numerous arguments that the evidentiary record does not support the Commission's findings. The Commission fully considered the substantial and competent evidence in the case and it is unnecessary to repeat those findings and arguments in this order.

Public Counsel also argues that the Commission unlawfully left the record open for the addition of evidence with regard to the energy and conservation plan to be implemented. Public Counsel argues that the Report and Order suggests that the Straight Fixed Variable Rate Design cannot be put in place without the Commission first having approved the energy efficiency and conservation program. That was not the Commission's intention and any contradictory language by the Commission in its Report and Order should be clarified.

The Commission fully contemplated that the Fixed Rate Design tariffs might be filed and become effective before the final details of the energy and conservation program were established. However, the Commission required that Atmos make a commitment to contribute 1% of its annual gross non gas revenues to be used for the program and to have the program in place no later than August 31, 2007. The Commission determined that 1% of non gas revenues contributed to such a program would result in a substantial program. Atmos has clearly made the commitment to contribute the required funds to the energy conservation and efficiency program. Both Public Counsel and Atmos informed the Commission via its pleadings that the

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preliminary meetings for setting up the program have taken place. The Commission is satisfied that Atmos has complied with the Commission's Report and Order.

Section 386.500.1, RSMo 2000, provides that the Commission shall grant an application for rehearing if "in its judgment sufficient reason therefor be made to appear." In the judgment of the Commission, Public Counsel has failed to establish sufficient reason to grant its application for rehearing. The application for rehearing shall be denied.

IT IS ORDERED THAT:

1. The Office of the Public Counsel's Motion for Rehearing is denied.
2. The Report and Order is clarified as stated herein.
3. This order shall become effective on March 27, 2007.

Davis, Chm., Murray, and Appling, CC., concur.
Gaw and Clayton, CC., dissent.

Dippell, Deputy Chief Regulatory Law Judge

In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area

Case No. ER-2007-0002

Electric §20. The Commission approved the stipulation and agreement concerning class cost of service and certain rate design issues, filed on March 22, 2007. This partial stipulation resolves many issues regarding class cost of service and rate design, but it specifically does not resolve three rate design and miscellaneous tariff issues: Ameren's proposal to implement economic development and retention riders, Ameren's proposed Industrial Response Pilot, and the "SafetyNet" proposal that customers be provided credits of \$25 per day for electric outages that extend beyond 48 hours.

**ORDER APPROVING PARTIAL STIPULATION AND AGREEMENT
CONCERNING CLASS COST OF SERVICE AND CERTAIN RATE
DESIGN ISSUES FILED ON MARCH 22, 2007**

Issue Date: April 5, 2007

Effective Date: April 15, 2007

On March 22, 2007, during the course of the hearing of this case, several parties filed a partial nonunanimous stipulation and agreement concerning class cost of service and certain rate design issues. The partial stipulation and agreement was signed by the following parties: the Staff of the Commission; the Office of the Public Counsel; AARP; Consumers Council of Missouri, Missouri Energy Group; Missouri Industrial Energy Consumers; Missouri Retailers Association; Noranda Aluminum, Inc.; and The Commercial Group. The partial stipulation and agreement

reflected the agreement of the signatory parties regarding several issues that would otherwise have been the subject of testimony presented to the Commission at the evidentiary hearing conducted from March 12 through March 29, 2007.

The partial stipulation resolves many issues regarding class cost of service and rate design, but it specifically does not resolve three rate design and miscellaneous tariff issues. Those unresolved issues are as follows:

1. AmerenUE's proposal to implement economic development and retention riders (Rider EDRR, Rider EDR)
2. AmerenUE's proposed Industrial Response Pilot (Rider DRP)
3. The "SafetyNet" proposal that customers be provided credits of \$25 per day for electric outages that extend beyond 48 hours.

In addition, the parties orally agreed, on the record, that Missouri Association for Social Welfare's proposal to implement an essential services rate was not resolved by the partial stipulation and agreement. The Commission received testimony and other evidence on all four unresolved issues and will address each issue in its report and order.

The partial stipulation and agreement is nonunanimous in that it was not signed by all parties. However, Commission rule 4 CSR 240-2.115(2) provides that other parties have seven days in which to object to a nonunanimous stipulation and agreement. If no party files a timely objection to the stipulation and agreement, then the Commission may treat it as a unanimous stipulation and agreement. More than seven days have now passed since the partial stipulation and agreement was filed. Union Electric Company d/b/a AmerenUE did not sign the stipulation and agreement and initially filed a limited objection to the stipulation. Subsequently, however, AmerenUE withdrew that objection. No other party has objected. Therefore, the Commission will treat the partial stipulation and agreement as a unanimous partial stipulation and agreement.

The Commission conducted an on-the-record presentation regarding this and other partial stipulations and agreements on March 28. At that time, the Commission questioned the parties about the various stipulations and agreements.

After reviewing the partial stipulation and agreement and after hearing the arguments and explanations of the parties, the Commission finds that the partial stipulation and agreement concerning class cost of service and certain rate design issues should be approved as a resolution of the issues addressed by that partial stipulation and agreement. In approving this partial stipulation and agreement, the Commission is only accepting the agreement of the parties to resolve these particular issues in this particular case. The Commission is not endorsing any particular position with regarding to these issues and its approval of this partial stipulation and agreement should not be interpreted as such an endorsement in any future case.

IT IS ORDERED THAT:

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1. The partial stipulation and agreement concerning class cost of service and certain rate design issues, filed on March 22, 2007, is approved as a resolution of the issues addressed in that partial stipulation and agreement. A copy of the partial stipulation and agreement is attached to this order as Exhibit A.

2. The signatory parties are ordered to comply with the terms of the partial stipulation and agreement.

3. This order shall become effective on April 15, 2007.

Davis, Chm., Murray, Gaw,
Clayton and Appling, CC., concur

Woodruff, Deputy Chief Regulatory Law Judge

In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area

Case No. ER-2007-0002

Electric, §20. The Commission approved the parties' tier one partial stipulation and agreement. The issues settled were rate base adjustments, revenue and expense adjustments, production cost model, revenue and kWh sales.

Electric, §22. The Commission approved the parties' tier one partial stipulation and agreement. The issues settled were rate base adjustments, revenue and expense adjustments, production cost model, revenue and kWh sales.

Electric, §39. The Commission approved the parties' tier one partial stipulation and agreement. The issues settled were rate base adjustments, revenue and expense adjustments, production cost model, revenue and kWh sales.

ORDER APPROVING TIER I PARTIAL STIPULATION AND AGREEMENT
FILED ON MARCH 15, 2007

Issue Date: April 11, 2007

Effective Date: April 21, 2007

On March 15, 2007, during the course of the hearing of this case, several parties filed a partial nonunanimous stipulation and agreement as to certain issues. This agreement was referred to by the parties as the Tier I Agreement. The partial stipulation and agreement was signed by the following parties: Union Electric Company d/b/a AmerenUE; the Staff of the Commission; the Missouri Department of

Economic Development; State of Missouri, Office of Administration; Missouri Industrial Energy Consumers; and Noranda Aluminum. The partial stipulation and agreement reflected the agreement of the signatory parties regarding several issues that would otherwise have been the subject of testimony presented to the Commission at the evidentiary hearing conducted from March 12 through March 29, 2007.

The partial stipulation and agreement is nonunanimous in that it was not signed by all parties. However, Commission rule 4 CSR 240-2.115(2) provides that other parties have seven days in which to object to a nonunanimous stipulation and agreement. If no party files a timely objection to the stipulation and agreement, then the Commission may treat it as a unanimous stipulation and agreement. More than seven days have now passed since the partial stipulation and agreement was filed and no party has raised an objection. Therefore, the Commission will treat the partial stipulation and agreement as a unanimous partial stipulation and agreement.

The Commission conducted an on-the-record presentation regarding this and other partial stipulations and agreements on March 28. At that time, the Commission questioned the parties about the various stipulations and agreements.

After reviewing the partial stipulation and agreement and after hearing the arguments and explanations of the parties, the Commission finds that the partial stipulation and agreement filed on March 15 should be approved as a resolution of the issues addressed by that partial stipulation and agreement. In approving this partial stipulation and agreement, the Commission is only accepting the agreement of the parties to resolve these particular issues in this particular case. The Commission is not endorsing any particular position with regarding to these issues and its approval of this partial stipulation and agreement should not be interpreted as such an endorsement in any future case.

IT IS ORDERED THAT:

1. The partial stipulation and agreement filed on March 15, 2007, is approved as a resolution of the issues addressed in that partial stipulation and agreement. A copy of the partial stipulation and agreement is attached to this order as Exhibit A.

2. The signatory parties are ordered to comply with the terms of the partial stipulation and agreement.

3. This order shall become effective on April 21, 2007.

Davis, Chm., Murray, Gaw,
Clayton and Appling, CC., concur

Woodruff, Deputy Chief Regulatory Law Judge

In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area

Case No. ER-2007-0002

Electric, §22. The Commission approved the parties' tier two partial stipulation and agreement. The revenue and expense issues settled between Company and Staff were resolved by Company agreeing to the Staff's positions for revenue requirement calculations for these revenue and expense issues in exchange for an additional \$5.5 million of revenue requirement to be imputed into the Staffs revenue requirement calculations.

Electric, §39. The Commission approved the parties' tier two partial stipulation and agreement. The revenue and expense issues settled between Company and Staff were resolved by Company agreeing to the Staff's positions for revenue requirement calculations for these revenue and expense issues in exchange for an additional \$5.5 million of revenue requirement to be imputed into the Staffs revenue requirement calculations.

ORDER APPROVING TIER II PARTIAL STIPULATION AND AGREEMENT FILED ON MARCH 26, 2007

Issue Date: April 11, 2007

Effective Date: April 21, 2007

On March 26, 2007, during the course of the hearing of this case, two parties filed a second partial nonunanimous stipulation and agreement as to certain issues. This agreement was referred to by the parties as the Tier II Agreement. The partial stipulation and agreement was signed by the following parties: Union Electric Company d/b/a AmerenUE and the Staff of the Commission. The partial stipulation and agreement reflected the agreement of the signatory parties regarding several issues that would otherwise have been the subject of testimony presented to the Commission at the evidentiary hearing conducted from March 12 through March 29, 2007.

The partial stipulation and agreement is nonunanimous in that it was not signed by all parties. However, Commission rule 4 CSR 240-2.115(2) provides that other parties have seven days in which to object to a nonunanimous stipulation and agreement. If no party files a timely objection to the stipulation and agreement, then the Commission may treat it as a unanimous stipulation and agreement. More than seven days have now passed since the partial stipulation and agreement was filed and no party has raised an objection. Therefore, the Commission will treat the partial stipulation and agreement as a unanimous partial stipulation and agreement.

The Commission conducted an on-the-record presentation regarding this and other partial stipulations and agreements on March 28. At that time, the Commission questioned the parties about the various stipulations and agreements.

After reviewing the partial stipulation and agreement and after hearing the arguments and explanations of the parties, the Commission finds that the partial

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stipulation and agreement filed on March 26 should be approved as a resolution of the issues addressed by that partial stipulation and agreement. In approving this partial stipulation and agreement, the Commission is only accepting the agreement of the parties to resolve these particular issues in this particular case. The Commission is not endorsing any particular position with regarding to these issues and its approval of this partial stipulation and agreement should not be interpreted as such an endorsement in any future case.

IT IS ORDERED THAT:

1. The partial stipulation and agreement filed on March 26, 2007, is approved as a resolution of the issues addressed in that partial stipulation and agreement. A copy of the partial stipulation and agreement is attached to this order as Exhibit A.

2. The signatory parties are ordered to comply with the terms of the partial stipulation and agreement.

3. This order shall become effective on April 21, 2007.

Davis, Chm., Murray, Gaw,
Clayton and Appling, CC., concur.

Woodruff, Deputy Chief Regulatory Law Judge

**In the Matter of the Resource Plan of Kansas City Power & Light Company
Pursuant to 4 CSR 240-22**

Case No. EO-2007-0008

Electric, §14 Rules and Regulations. The Commission approved the parties' stipulation and agreement and accepted their 2006 integrated resource plan. The Commission finds that KCPL's resource acquisition strategy described in its 2006 IRP filing meets the requirements stated in Commission Rule 4 CSR 240-22.010(2)(A)-(C).

Electric, § 42 Planning and management. The Commission approved the parties' stipulation and agreement and accepted their 2006 integrated resource plan. The Commission found that KCPL's 2006 IRP filing, as modified and clarified by the stipulation and agreement, demonstrates compliance with the requirements of Commission Rule 4 CSR 240-22, and the stipulation and agreement is consistent with the public interest and shall be approved.

**ORDER APPROVING STIPULATION AND AGREEMENT
AND ACCEPTING 2006 INTEGRATED RESOURCE PLAN**

Issue Date: April 12, 2007

Effective Date: April 22, 2007

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Kansas City Power & Light Company (KCPL) filed its integrated resource plan (IRP), as required by 4 CSR 240 – Chapter 22, on July 5, 2006. On February 13, 2007, after extensive negotiations, KCPL, the Staff of the Commission, the Office of the Public Counsel, and the Missouri Department of Natural Resources filed a non-unanimous stipulation and agreement that purports to resolve all alleged deficiencies in KCPL's 2006 IRP filing.

The stipulation and agreement is identified as non-unanimous because one party, Praxair, Inc., did not sign. However, Commission Rule 4 CSR 240-2.115 provides that if no party objects to a non-unanimous stipulation and agreement within seven days of its filing, the stipulation and agreement may be treated as unanimous. Since no party has filed a timely objection to the stipulation and agreement, it will be treated as a unanimous agreement. On March 28, 2007, the Commission held a hearing to receive additional information about the stipulation and agreement.

The purpose of the Commission's integrated resource planning rule is to require Missouri's electric utilities to undertake an adequate planning process to ensure that the public interest in a reasonably priced, reliable, and efficient energy supply is protected. The stipulation and agreement promotes that policy by establishing a participatory process that will involve interested parties in KCPL's planning for its next IRP filing, due August 5, 2008. In particular, the agreement requires the signatory parties to hold semi-annual resource planning meetings until the 2008 IRP is filed. Furthermore, the stipulation and agreement specifies particular information that KCPL will be required to compile and include in its 2008 IRP filing.

Commission Rule 4 CSR 240-22.080(13) requires that after considering an electric utility's IRP filing, the Commission issue an order containing findings that the filing "either does or does not demonstrate compliance with the requirements of this chapter, and that the utility's resource acquisition strategy either does or does no

meet the requirements stated in 4 CSR 240-22.010(2)(A)-(C).¹ Furthermore, 4 CSR 240-22.010(1) provides that a Commission finding that a utility is in compliance with these rules is not to be construed as Commission approval of the utility's resource plans, resource acquisition strategies or investment decisions.

Based on the unopposed stipulation and agreement and the additional testimony provided at the stipulation hearing, the Commission finds that KCPL's 2006 IRP filing, as modified and clarified by the stipulation and agreement, demonstrates compliance with the requirements of Commission Rule 4 CSR 240-22. Furthermore, the Commission finds that KCPL's resource acquisition strategy described in its 2006 IRP filing meets the requirements stated in Commission Rule 4 CSR 240-22.010(2)(A)-(C). Finally, the Commission finds that the stipulation and agreement filed by the parties is consistent with the public interest and shall be approved.

IT IS ORDERED THAT:

1. The Stipulation and Agreement filed on February 13, 2007, is approved and the signatory parties are ordered to comply with its terms.
2. Kansas City Power & Light Company's 2006 integrated resource plan is accepted as being in compliance with Commission Rule 4 CSR 240 – Chapter 22.
3. The Commission's acceptance of Kansas City Power & Light Company's 2006 integrated resource plan does not indicate Commission approval of the utility's resource plan, resource acquisition strategies or investment decisions.

¹ 4 CSR 240-22.010(2) provides as follows:

(2) The fundamental objective of the resource planning process at electric utilities shall be to provide the public with energy services that are safe reliable and efficient, at just and reasonable rates, in a manner that serves the public interest. This objective requires that the utility shall –

(A) Consider and analyze demand-side efficiency and energy management measures on an equivalent basis with supply-side alternatives in the resource planning process;

(B) Use minimization of the present worth of long-run utility costs as the primary selection criterion in choosing the preferred resource plan; and

(C) Explicitly identify and, where possible, quantitatively analyze any other considerations which are critical to meeting the fundamental objective of the resource planning process, but which may constrain or limit the minimization of the present worth of expected utility costs. The utility shall document the process and rationale used by decision makers to assess the tradeoffs and determine the appropriate balance between minimization of expected utility costs and these other considerations in selecting the preferred resource plan and developing contingency options. These considerations shall include, but are not necessarily limited to, mitigations of –

1. Risks associated with critical uncertain factors that will affect the actual costs associated with alternative resource plans;
2. Risks associated with new or more stringent environmental laws or regulations that may be imposed at some point within the planning horizon; and
3. Rate increases associated with alternative resource plans.

4. This order shall become effective on April 22, 2007.
5. This case shall be closed on April 23, 2007.

Davis, Chm., Murray, Gaw, Clayton,
and Appling, CC., concur.

Dippell, Deputy Chief Regulatory Law Judge

**In the Matter of the Tariffs of Aquila, Inc., d/b/a Aquila Networks – MPS and
Aquila Networks – L&P Increasing Electric Rates for the Services Provided to
Customers in the Aquila Networks – MPS and Aquila Networks – L&P Service
Areas**

Case No. ER-2007-0004

Electric, § 22. In the settlement of a variety of issues, the parties agree on the additional revenue of \$59,339,481, subject to possible adjustment as specified in depreciation, Sibley Accounting Authority Order, and Rate of Return Valuations.

**ORDER APPROVING STIPULATION AND AGREEMENT
AS TO CERTAIN ISSUES**

Issue Date: April 12, 2007 Effective Date: April 22, 2007

On April 4, 2007, during the course of the hearing of this case, several parties filed a nonunanimous Stipulation and Agreement as to Certain Issues (Stipulation). The Stipulation was signed by the following parties: Aquila, Inc., Staff of the Commission; Office of the Public Counsel, AARP, Sedalia Industrial Energy Users Association, AG Processing, Inc., Federal Executive Agencies, Department of Natural Resources, and City of St. Joseph. The Stipulation reflected the agreement of the signatory parties regarding several issues that would otherwise have been the subject of testimony presented to the

Commission at the evidentiary hearing conducted from April 2 through April 13, 2007.

The Stipulation is nonunanimous in that it was not signed by all parties. However, Commission rule 4 CSR 240-2.115(2) provides that other parties have seven days in which to object to a nonunanimous stipulation and agreement. If no party files a timely objection to the stipulation and agreement, then the Commission may treat it as a unanimous stipulation and agreement. Each party to this case that did not sign the Stipulation has filed a notice advising the Commission that, although

not a signatory to the Stipulation, it does not object to the Stipulation¹. Further, more than seven days have now passed since the Stipulation was filed and no party has raised an objection. Therefore, the Commission will treat the Stipulation as a unanimous partial stipulation and agreement.

The Commission conducted an on-the-record presentation regarding the Stipulation on April 12, 2007. At that time, the Commission questioned the parties about the various stipulations and agreements.

After reviewing the Stipulation and after hearing the arguments and explanations of the parties, the Commission finds that the Stipulation filed on April 4, 2007, should be approved as a resolution of the issues addressed by that Stipulation. In approving Stipulation, the Commission is only accepting the agreement of the parties to resolve these particular issues in this particular case. The Commission is not endorsing any particular position with regard to these issues and its approval of this partial stipulation and agreement should not be interpreted as such an endorsement in any future case.

IT IS ORDERED THAT:

1. The Stipulation and Agreement as to Certain Issues filed on April 4, 2007, is approved as a resolution of the issues addressed in that stipulation and agreement. A copy of the stipulation and agreement is attached to this order as Exhibit A.
2. The signatory parties are ordered to comply with the terms of the partial stipulation and agreement.
3. This order shall become effective on April 22, 2007.

Davis, Chm., Murray, Clayton,
and Appling, CC., concur.
Gaw, C., dissents.

Voss, Regulatory Law Judge

¹ The Commercial Group, Union Electric Company, d/b/a AmerenUE, Kansas City, Missouri, and Jackson County, Missouri each filed notices of non-objection to the Stipulation on April 4, 2007.

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In the Matter of an Investigation into Various Issues Related to the Missouri Universal Service Fund

Case No. TO-98-329

Telecommunications, §1. The Commission ordered that requests for reimbursement by telecommunications companies from the Missouri Universal Service Fund administrator shall be made no later than the 15th day of each month, and reimbursements shall be dispatched between the first and the fifth day of the following month.

ORDER TO MODIFY REIMBURSEMENT PROCEDURES

Issue Date: April 19, 2007

Effective Date: April 29, 2007

On March 16, 2005, the Commission issued an Order Granting Staff Motion, in which it established an initial assessment percentage amount of 0.0018 for the low-income and disabled portion of the Missouri Universal Service Fund. On March 8, 2007, the Missouri Universal Service Board, on the recommendation of the Fund Administrator, determined that it is necessary to increase the assessment percentage amount from 0.0018 to 0.0029. On March 13, 2007, the Staff of the Commission filed a Motion that also requested the Commission modify the reimbursement procedures telecommunications carriers follow. On March 15, the Commission issued its Order modifying the assessment percentages, but delayed issuing an order on the reimbursement modification until potential intervenors had the opportunity to voice any opposition to it. No party or potential intervenor opposes the modification as proposed by the Staff.

In its March 17, 2005 Order, the Commission set in place a cycle that "requests for reimbursement [by telecommunications companies] shall be made no later than the 15th day of each month, and reimbursements shall be dispatched no later than the last day of each month." To more clearly delineate between the month-end balance in the Fund and outstanding checks, the Staff recommends that the Commission modify the reimbursement procedures to dispatch reimbursement between the first and the fifth day of the following month.

The Commission finds it reasonable and in the public interest to modify the reimbursement procedure as proposed by the Staff and ordered below.

IT IS ORDERED THAT:

1. Requests for reimbursement by telecommunications companies from the Missouri Universal Service Fund administrator shall be made no later than the 15th day of each month, and reimbursements shall be dispatched between the first and the fifth day of the following month.

2. The Missouri Universal Service Fund administrator shall begin disbursements in compliance with paragraph one above on the effective date of this Order.

3. No other terms of assessment, operation or funding of the Missouri Universal Service Fund are altered by this Order.

4. The Data Center of the Commission shall send a copy of this Order to all certificated telecommunications companies, except payphone providers and shared tenant services providers.

5. This order shall become effective on April 29, 2007.

6. This case may be closed on or after April 30, 2007.

Colleen M. Dale, Chief Regulatory Law Judge,
by delegation of authority pursuant to
Section 386.240, RSMo 2000.

In the Matter of the Application of USCOC of Greater Missouri, LLC for Designation as an Eligible Telecommunications Carrier Pursuant to the Telecommunications Act of 1996*

Case No. TO-2005-0384

Telecommunications, § 14.1 The Commission finds that U.S. Cellular has met all requirements of federal and state law and designates it as an eligible telecommunications carrier (ETC) throughout its Missouri service area. As an ETC, U.S. Cellular is designated as eligible to receive all available support from the federal Universal Service Fund, including support for rural, insular, and high-cost areas, and low-income customers.

Appearances

Karl Zobrist, Sonnenschein, Nath & Rosenthal, LLP, 4520 Main Street, Suite 1100, Kansas City, Missouri 64111, and

David A. LaFuria and Steven M. Chernoff, Lukas, Nace, Gutierrez & Sachs, Chtd., 1650 Tysons Boulevard, Suite 1500, McLean, Virginia 22101, for USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular.

Charles Brent Stewart, Stewart & Keevil, L.L.C., 4603 John Garry Drive, Suite 11, Columbia, Missouri 65203, for Spectra Communications Group, LLC, d/b/a CenturyTel and CenturyTel of Missouri, LLC.

Robert Gryzmala, Senior Counsel, One SBC Center, Room 3516, St. Louis, Missouri 63101, for Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri.

W.R. England, III and Brian T. McCartney, Brydon, Swearngen & England, P.C., 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri 65102-0456, for the Small Telephone Company Group.

Michael F. Dandino, Senior Public Counsel, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the Public.

William K. Haas, Deputy General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

*This case was appealed to the Missouri Court of Appeals (WD69976) and affirmed. See 285 S.W.3d 395 (Mo. App. W.D. 2009).

REGULATORY LAW JUDGE: Morris L. Woodruff, Deputy Chief Regulatory Law Judge

REPORT AND ORDER

Issue Date: May 3, 2007

Effective Date: May 13, 2007

Syllabus: This Report and Order finds that U.S. Cellular has met all requirements of federal and state law and designates it as an eligible telecommunications carrier throughout its Missouri service area.

Findings Of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Procedural History

On April 22, 2005, USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular, filed an application asking to be designated as an Eligible Telecommunications Carrier (ETC), pursuant to federal law. As an ETC, U.S. Cellular asks to be designated as eligible to receive all available support from the federal Universal Service Fund, including support for rural, insular, and high cost areas, and low-income customers.

On April 26, 2005, the Commission directed that notice of U.S. Cellular's application be given to all incumbent and competitive local exchange carriers certificated to provide service in Missouri, as well as to the news media and the members of the General Assembly. The Commission established May 16, 2005, as the deadline for submission of requests to intervene. Thereafter, on May 27, 2005, the Commission granted applications to intervene filed by Southwestern Bell Telephone, L.P., d/b/a SBC Missouri (AT&T Missouri);¹ Spectra Communications Group, LLC, d/b/a CenturyTel, and CenturyTel of Missouri, LLC (collectively CenturyTel); and the Small Telephone Company Group (STCG).²

¹ Southwestern Bell Telephone, L.P. is now doing business as AT&T Missouri and will be referred to as such in this report and order.

² The members of the Small Telephone Company Group are as follows: BPS Telephone Company; Choctaw Telephone Company; Craw-Kan Telephone Cooperative, Inc.; Ellington Telephone Company; Farber Telephone Company; Fidelity Telephone Company; Goodman Telephone Company; Granby Telephone Company; Grand River Mutual Telephone Corporation; Holway Telephone Company; IAMO Telephone Corporation; Kingdom Telephone Company; Le-Ru Telephone Company; Mark Twain Rural Telephone Company; Mid-Missouri

Each of the parties offered prefiled testimony. An evidentiary hearing was held on October 26 and 27, 2005. After considering the evidence that was offered at the hearing, the Commission found that U.S. Cellular had not presented sufficient evidence regarding how it intends to use the support it would receive from the Universal Service Fund to improve its network through improved coverage, signal strength, or capacity, in ways that would not otherwise occur without the receipt of high cost support. Rather than reject U.S. Cellular's application, the Commission issued an order on March 21, 2006, that allowed U.S. Cellular an opportunity to submit additional evidence on that issue. The Commission indicated that it would not further consider U.S. Cellular's application until that additional evidence was submitted.

U.S. Cellular submitted additional evidence regarding its plans on August 11, 2006. Thereafter, the Commission established a procedural schedule that allowed all parties an opportunity to file responsive testimony. An additional hearing was held on December 18 and 19, 2006. The parties submitted post-hearing briefs on January 31, 2007.

The Federal Universal Service Fund

The federal Universal Service Fund was established in the Telecommunications Act of 1996. The stated purpose of the fund is to ensure that telephone customers in rural and high cost areas, as well as low-income customers, have access to quality telecommunications services at reasonable and affordable rates.³ To meet that goal, the Universal Service Fund redistributes money paid into the fund by telecommunications customers to telecommunications service providers who serve rural and high cost parts of the country.

Before a telecommunications service provider is eligible to receive funding from the Universal Service Fund, it must be designated as an Eligible Telecommunications Company, referred to by the acronym ETC. Various incumbent local exchange carriers in rural parts of Missouri, competitive local exchange carriers serving those areas, and wireless telecommunications carriers have already been designated as an ETC, and currently receive funding from the federal Universal Service Fund. U.S. Cellular, a provider of wireless telecommunications service,⁴ has now applied for designation as an ETC in its service area.

The Requirements for Designation as an ETC

The Telecommunications Act established two factual criteria for determining whether an applicant may be designated as an ETC. First, the applicant must offer

Telephone Company; Miller Telephone Company; New Florence Telephone Company; New London Telephone Company; Northeast Missouri Rural Telephone Company; Orchard Farm Telephone Company; Peace Valley Telephone Company, Inc.; Seneca Telephone Company; Steelville Telephone Exchange, Inc.; and Stoutland Telephone Company.

³ 47 U.S.C. 254(b).

⁴ As a provider of wireless service U.S. Cellular can be described as a commercial mobile radio service (CMRS) provider.

the services that are supported by the Universal Service Fund throughout the service area for which the designation is received. The applicant can offer those services either through its own facilities, or a combination of its own facilities and the resale of another carrier's services. Second, the applicant must advertise the availability of such services and the charges therefore using media of general distribution.⁵

The Federal Communications Commission has designated, by regulation, nine services that are supported by the Universal Service Fund.⁶ The nine services designated for support are as follows: (1) Voice grade access to the public switched network; (2) Local usage; (3) Dual tone multi-frequency signaling or its functional equivalent; (4) Single-party service or its functional equivalent; (5) Access to emergency services; (6) Access to operator services; (7) Access to interexchange service; (8) Access to directory assistance; and (9) Toll limitation for qualifying low-income consumers.

U.S. Cellular represents in its application that it is a "full-service wireless carrier, which offers all of these services within the State of Missouri".⁷ Testimony presented by U.S. Cellular's witness, Kevin Lowell, established that U.S. Cellular offers the nine designated services in Missouri.⁸ U.S. Cellular also represents that if it is granted ETC status it will immediately advertise the availability of its services throughout its service area.⁹ Staff's witness, Adam McKinnie, confirmed that U.S. Cellular offers the nine designated services.¹⁰

The parties that challenge U.S. Cellular's application do so by arguing that U.S. Cellular fails to offer its services *throughout* the territory for which it seeks ETC designation. U.S. Cellular requests that it be given ETC designation throughout a large portion of Missouri, excluding only the west central portions of the state, centering on the Kansas City area. The proposed ETC designation would include the exchanges served by many incumbent local exchange companies (ILECs). The parties opposing U.S. Cellular's application offered extensive testimony demonstrating that U.S. Cellular is not capable of providing facilities-based wireless service in many of the ILEC study areas for which it is seeking ETC status.

U.S. Cellular concedes that its present facilities cannot provide wireless service to all of the ILEC study areas for which it is seeking ETC designation. For those areas that it cannot reach with its own facilities, U.S. Cellular proposes to serve any customer who requests service through what it described as a six-step process.

Under the six-step process, U.S. Cellular commits to provide service to a requesting customer within a reasonable period of time if service can be provided at reasonable cost by:

- (1) modifying or replacing the requesting customer's equipment;

⁵ 47 U.S.C. 214(e)(1).

⁶ 47 CFR 54.101(a).

⁷ *Application of USCOC of Greater Missouri, LLC ("U.S. Cellular") for Designation as an Eligible Telecommunications Carrier*, page 5.

⁸ Lowell Direct, Ex. 4, pages 2-4.

⁹ Wright Direct, Ex. 5, page 5, lines 16-22.

¹⁰ McKinnie Rebuttal, Ex. 9, page 3, lines 18-20.

- (2) deploying a roof-mounted antenna or other equipment;
- (3) adjusting the nearest cell tower;
- (4) adjusting network or customer facilities;
- (5) reselling services from another carrier's facilities to provide service; or
- (6) employing, leasing, or constructing an additional cell site, cell extender, repeater, or other similar equipment.¹¹

The maps showing U.S. Cellular's current wireless coverage reveal that the company will be able to serve many potential customers only by reselling wireless service from other wireless companies. U.S. Cellular would serve those customers through roaming agreements that it has in place with other wireless carriers.¹² Even though they would be served through facilities owned by another carrier, such customers would pay for service based on U.S. Cellular's rate plans.¹³ If providing service to a customer through a roaming agreement costs more than U.S. Cellular could recover from the customer under its rate plan, U.S. Cellular would absorb the extra cost.¹⁴

The STCG, CenturyTel, AT&T Missouri, and Public Counsel contend that offering service only by resale in large portions of its proposed ETC territory does not allow U.S. Cellular to meet the requirements for certification. In particular, the STCG points to 47 CFR §54.201(i), which states that a state commission cannot designate as an ETC a carrier that offers the supported services "exclusively through the resale of another carrier's services." On the basis of that regulation, the STCG argues that U.S. Cellular cannot be designated as an ETC in those portions of its requested service area for which it cannot currently offer services using its own facilities.

The Commission rejects the interpretation of the regulation proposed by the STCG. Such an interpretation conflicts with the clear language of 47 U.S.C. 214(e)(1), which specifically allows for the designation of a carrier that offers the supported services using a combination of its own facilities and resale of another carrier's services. There is nothing in that statute that would require the Commission to examine U.S. Cellular's current ability to provide facilities-based wireless service in each exchange before granting it designation in a larger service territory.

In support of its argument that would preclude designating U.S. Cellular as an ETC in ILEC study areas in which it does not currently provide signal coverage, the STCG refers to decisions made by this Commission in earlier cases. The first case cited by the STCG is a 2001 decision designating ExOp of Missouri as an ETC in the Kearney, Missouri exchange.¹⁵ ExOp was a wireline service provider that offered service using its own facilities only in the Kearney exchange. There was no

¹¹ Wright Direct, Ex. 5, page 8, lines 4-9.

¹² Transcript, page 544.

¹³ Transcript, page 545.

¹⁴ Transcript, page 546.

¹⁵ In the Matter of the Application of ExOp of Missouri, Inc. for Designation as a Telecommunications Company Carrier Eligible for Federal Universal Service Support, Commission Case No. TA-2001-251, Order Granting Designation as an Eligible Carrier Pursuant to Section 254 of the Telecommunications Act of 1996, issued May 15, 2001.

indication that ExOp offered services in any other exchange by resale. Nevertheless, ExOp sought designation as an ETC in all 184 exchanges in which it held a certificate to provide service. The Commission limited its designation of ExOp as an ETC to the Kearney exchange, finding that the Telecommunications Act “requires that a carrier both offer and advertise the services in question throughout its designated service area *upon designation*.”¹⁶

The STCG also cites a more recent ETC decision regarding the application of Missouri RSA No 5 Partnership.¹⁷ In that case, the Commission excluded a particular wire center from the company’s designated ETC area when it found that the company could not provide wireless service to that exchange.

The Commission’s decision in both the ExOp and Missouri RSA No. 5 Partnership cases can be distinguished from this case. In the ExOp case, the Commission specifically found that ExOp had “not shown that it will both offer and advertise the services in question in a larger area upon designation.”¹⁸ ExOp had installed wires in only one exchange and it did not demonstrate an intention to provide service by resale in other exchanges. Similarly, in the Missouri RSA No. 5 Partnership case, the Commission specifically found that the applicant “admitted that it would most likely have to report to the Commission that it could not serve those customers outside its service area if they requested service.”¹⁹ By contrast, in this case, U.S. Cellular has demonstrated the ability and the intention to offer services throughout the proposed area either using its own wireless signal or through resale.

U.S. Cellular has met the requirements of 47 U.S.C. 214(e)(1), which do not require U.S. Cellular to demonstrate its ability to provide *facilities-based* service in every exchange in which it requests designation as an ETC. The Commission will not attempt to impose a requirement that is not imposed by the controlling statute.

As a practical matter, the designation of U.S. Cellular as an ETC in exchanges in which it currently does not offer facilities-based service does not provide an unfair advantage to U.S. Cellular, nor does it unfairly disadvantage any of its competitors. This is true because, as an ETC, U.S. Cellular will receive universal service support only for those customers whom it serves over its own wireless network. It does not receive such support for customers it serves by resale of the services of other carriers.²⁰ In other words, U.S. Cellular cannot receive support from areas in which it does not have wireless coverage. Therefore, U.S. Cellular has a strong and appropriate incentive to expand its wireless coverage area to obtain more support.

By contrast, restricting U.S. Cellular’s designation as an ETC to areas where it already provides facilities-based service would be unfair to U.S. Cellular and would impose an unnecessary administrative burden on the Commission and its Staff. If the Commission were to limit the ETC designation in that way, U.S. Cellular would

¹⁶ *Id.* (emphasis in original).

¹⁷ *In the Matter of the Application of Missouri RSA No. 5 Partnership for ETC Designation*, Case No. TO-2006-0172, Report and Order, issued September 21, 2006.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Transcript, page 216, lines 4-6.

have to come back to the Commission every time it was ready to expand its wireless coverage area into a new, previously undesignated exchange, resulting in the relitigation of the same issues over and over again.²¹ Furthermore, U.S. Cellular can only offer its Lifeline services to low-income customers in an area if it has been designated as an ETC for that area. Therefore, designating U.S. Cellular as an ETC in an area may provide a benefit to the low-income residents of that area, even if U.S. Cellular cannot serve that customer over its own network.

Is U.S. Cellular's Application Consistent with the Public Interest?

Section 214(e)(2) of the Telecommunications Act requires that before designating an additional carrier as an ETC for an area served by a rural telephone company, the State Commission is required to find that the designation is in the public interest. Similarly, the Commission's regulation provides that the applicant for ETC designation must demonstrate "that the commission's grant of the applicant's request for ETC designation would be consistent with the public interest, convenience and necessity."²² Therefore, the Commission must determine whether granting U.S. Cellular ETC status is in the public interest.

U.S. Cellular contends that designating it as an ETC would serve the public interest by: 1) advancing universal service in Missouri by increasing the choices available to consumers; 2) offering affordable service; 3) improving service quality; 4) expanding the health and safety benefits that accompany cell phone service; 5) delivering economic development benefits to rural Missouri; and 6) stimulating a competitive response from the existing rural ILECs. In addition, U.S. Cellular contends that designating it as an ETC would not increase the existing burden on the federal universal service support mechanism.

U.S. Cellular has put together a list of benefits that would result from an expansion of cell phone service that could follow if it is designated as an ETC. Clearly, expansion of cell phone service would benefit consumers by giving them an additional option for phone service, by allowing them additional mobility, and by affording them increased safety while on the road or otherwise away from the end of a telephone wire. Indeed, most of the benefits U.S. Cellular describes are self-evident. The other parties do not disagree with the general idea that expanding the availability of cell phone service in rural Missouri would be a good thing. However, they argue, for various reasons, that designating U.S. Cellular as an ETC would not be in the public interest.

Is Competition a Good Thing? And Does Effective Competition Already Exist?

Several parties argue that effective competition for wireless service already exists in rural areas of the country, and indeed, U.S. Cellular concedes that it

²¹ Transcript, page 784, lines 14-22.

²² 4 CSR 240-3.570(2)(A)5.

currently faces wireless competition in all areas that it serves in Missouri.²³ Furthermore, they argue that while increased competition may be desirable in the abstract, increased competition in a high cost rural area that is subsidized by universal service funding may not ultimately benefit consumers. The concern is that the federal universal service fund would be required to support multiple ETCs in a fixed cost market, causing the cost of service to increase for each of the providers on a per customer basis.²⁴ In other words, the cost of providing telecommunications services to a high cost area would remain the same, but the customers from whom those costs could be recovered would be split between competing providers, reducing the amount that could be recovered by each competitor.

The arguments against encouraging competition in rural areas are interesting, but not persuasive. The Commission certainly expects that competition and support from the federal USF will encourage wireless carriers to expand into underserved and non-served portions of rural Missouri. But most importantly, the idea of excluding wireless carriers from ETC designation with the intent to block competition in rural areas is inconsistent with the Telecommunications Act of 1996. Section 253(b) of that Act provides that a state may impose requirements necessary to preserve and advance universal service and protect the public welfare, but may do so only "on a competitively neutral basis."²⁵ Therefore, the Commission may not reject U.S. Cellular's application in an effort to stifle competition.

Is U.S. Cellular Really Expanding the Area It Serves?

Some parties argue that the areas in which U.S. Cellular proposes to build additional cell towers using USF funding are mostly areas in which it currently provides service, not more rural areas that are not currently served.²⁶ In other words, they contend that U.S. Cellular is merely trying to improve the service it currently provides, and will not benefit customers who are not already served.

However, U.S. Cellular's proposed new cell sites will provide coverage to some areas that currently do not receive any coverage and will provide improved coverage to areas that need it.²⁷ All new cell sites are located in rural areas that are relatively low in population density.²⁸ As U.S. Cellular's witness explained, a wireless carrier cannot simply place a new cell tower in the midst of a large unserved area without regard to coverage, capacity, hand-off capabilities and back-haul requirements. Rather, U.S. Cellular's expansion plan is an attempt to responsibly expand its footprint, while using a sound wireless network design.²⁹

Are U.S. Cellular's Offerings Affordable?

²³ Transcript, Page 64, lines 5-8.

²⁴ Schoonmaker Direct, Ex. 15, Page 54, lines 12-17.

²⁵ 47 U.S.C. 253(b).

²⁶ Brown Supplemental Rebuttal, Ex. 30, page 6, lines 23-27; Stidham Supplemental Rebuttal, Ex. 32, page 3, lines 18-21.

²⁷ Johnson Supplemental Surrebuttal, Ex. 26, page 4, lines 14-17.

²⁸ Id., page 7, lines 8-11.

²⁹ Id., pages 4-5, lines 24-25, 1-3.

Some parties argue that the rates that U.S. Cellular has proposed to offer, particularly its Lifeline offerings, are not as affordable as the rates and Lifeline offerings of the incumbent wireline LECs. Of course, U.S. Cellular is offering a competitive service in a competitive market so this Commission does not need to be concerned about the affordability of its rates in general. If it prices the services it offers above the price set by the market, it will not attract customers. If it does not gain customers, it will not receive support from the universal service fund.³⁰ In any event, this Commission is preempted by federal law from regulating the rates charged for wireless service.³¹ The question of the affordability of U.S. Cellular's Lifeline offerings is more interesting.

Federal regulations require an ETC to make Lifeline service available to qualifying low-income consumers.³² The ETC is also required to effectively advertise the availability of its Lifeline service.³³ Low-income consumers who receive Lifeline service pay reduced charges for basic telecommunications services.³⁴

U.S. Cellular has committed to offer a \$25 per month, 400 minutes of anytime usage plan as its least expensive Lifeline service offering.³⁵ That plan has a nationwide calling scope, excluding Alaska and Hawaii, subject to roaming charges and a two-year service commitment.³⁶ Calls made to anywhere in the lower 48 states would not be subject to additional toll charges.³⁷ Lifeline customers may also subscribe to any other calling plan that U.S. Cellular offers and receive an \$8.25 per month discount.³⁸ U.S. Cellular reports that its most popular plan among Lifeline customers is a \$39.99 plan that offers greater access.³⁹

The incumbent wireline LECs offer less expensive basic service plans that offer unlimited local calling.⁴⁰ However, the plan offered by U.S. Cellular is fundamentally different than the basic plans that are offered by its wireline competitors. The basic plans offered by wireline companies offer unlimited local calling, but the number of lines that can actually be reached without incurring toll charges may be very limited. For example, residential customers of Holway Telephone Company pay a base rate of \$13.00 per month for a local calling area that includes only two exchanges with 495 residential and 54 business customers.⁴¹ If those customers want to call a

³⁰ Transcript, pages 209-210, lines 18-25, 1.

³¹ 47 U.S.C. 332(c)(3).

³² 47 C.F.R. 54.405(a).

³³ 47 C.F.R. 54.405(b).

³⁴ 47 C.F.R. 54.401(a)(2).

³⁵ Transcript, page 532, lines 17-25.

³⁶ Transcript, page 534, lines 4-18.

³⁷ Transcript, page 110, lines 2-3.

³⁸ Transcript, page 536, lines 9-12.

³⁹ Transcript, page 536, lines 13-16.

⁴⁰ Exhibit A to Wood Supplemental Surrebuttal, Ex. 27, is a chart showing the basic phone service offerings of the various ILECs that are competing in the area served by U.S. Cellular.

⁴¹ Wood Supplemental Surrebuttal, Ex. 27, Exhibit A.

number outside those small areas, they must pay toll charges. In contrast, a customer who chooses to purchase a basic plan from U.S. Cellular can make calls outside their own community, to the next town, or coast to coast, without incurring additional toll charges. When the expanded calling area provided by the wireless plans is considered, the basic rates offered by U.S. Cellular are at least as affordable as the basic offerings of the competing incumbent LECs. Giving consumers a greater choice in the type of telephone service they can purchase at affordable prices is a good result and clearly is in the public interest.

Would U.S. Cellular Make Improvements Even without USF Funding?

Some parties argue that granting U.S. Cellular's application is not in the public interest because U.S. Cellular has not demonstrated that the network improvements it has proposed would not occur absent the receipt of high cost support.

In its initial application, U.S. Cellular indicated that it would use the high cost support it received to build new wireless cell sites and other facilities in sixteen specified high cost areas that were in need of improved signal coverage.⁴² It committed to build these new facilities within 18 months after it was designated as an ETC.⁴³ After the initial hearing, the Commission found that U.S. Cellular had not presented sufficient evidence to show how it intended to use the support it would receive from the Universal Service Fund to improve its network. In an order issued on March 21, 2006, the Commission ordered U.S. Cellular to submit additional information on how it would use the funds it would receive if granted ETC status.

After March 21, 2006, a new Commission rule establishing filing requirements for applications to be designated as an ETC went into effect. A portion of that new rule, 4 CSR 240-3.570(2)(A)2, requires an applicant for designation as an ETC to submit a two-year plan "demonstrating with specificity, that high-cost universal service support shall only be used for the provision, maintenance and upgrading of facilities and services for which the support is intended in the Missouri service area in which ETC designation was granted." On August 11, 2006, U.S. Cellular submitted a new two-year build-out plan to comply with the Commission's ETC rule, as well as the Commission's March 21, 2006 order.

In its new build-out plan, U.S. Cellular commits to build 39 new cell towers in the first two years following the granting of ETC status. U.S. Cellular will also use USF funds to operate and maintain the new cell sites, as well as upgrade switching infrastructure needed to support the new cell sites.⁴⁴ U.S. Cellular explains that it maintains a list of cell sites that will need to be constructed in the future as its cellular network expands. Those cell sites are first prioritized and then U.S. Cellular determines which sites can be built consistent with the company's business plan. It refers to those sites as being above the line because they can be built without support from the USF. The sites that fall below the line cannot be economically built

⁴² Exhibit E to Application filed April 22, 2005.

⁴³ Transcript, page 120, lines 8-10.

⁴⁴ Compliance Filing of U.S. Cellular, August 11, 2006.

without USF support. U.S. Cellular represents that it will use USF funding to build those below-the-line cell sites.⁴⁵

U.S. Cellular's critics, including the Commission's Staff, contend that U.S. Cellular has failed to prove that the 39 cell sites it proposes to build with USF funds would not otherwise be built with U.S. Cellular's own funds. Indeed, it would not be in the public interest to allow U.S. Cellular to spend USF funds, rather than its own funds, while not increasing the number of sites that it will construct. Such a result would simply enrich U.S. Cellular's shareholders without any benefit to its Missouri customers.

U.S. Cellular's plans are problematic because the company is unable to draw a clear distinction between cell sites that can be built without support and those that can be built only with such support. It does not, and realistically cannot, maintain separate lists of sites that can be built with or without USF support.⁴⁶ As U.S. Cellular's witness, Nick Wright, explains:

U.S. Cellular is going to build some facilities in Missouri, irrespective whether it receives high-cost support. But it is not going to build facilities out to rural areas of Missouri nearly as fast as it would if it does receive high-cost support. If a community would most likely not see new or improved wireless coverage in the next 4 to 5 years, then using high-cost support next year to expedite service to that area will be enormously beneficial to that community.⁴⁷

If all or most sites are going to be built eventually with or without USF support, it will be difficult for the Commission to determine whether U.S. Cellular is appropriately spending the support it receives, or whether it is using the money to build cell sites in low-cost areas such as St. Louis, or, simply pocketing the money for the benefit of its shareholders, while building cell sites that it would have built anyway.

U.S. Cellular nicely illustrated this problem by its actions between the time it filed its initial application and the time it filed its new two-year build-out plan. In its initial application, U.S. Cellular indicated an intention to use USF funds to build sixteen cell sites, while representing that none of these sites could economically be constructed without highcost support. By the time it filed its two-year build-out plan a year and a half later, four of those sixteen sites had in fact already been built, without the benefit of USF support.⁴⁸

U.S. Cellular explained that it needed to build the four new cell sites earlier than planned because they had to be pushed up the priority list to shorten existing microwave hops, or because of a need to meet changing competitive conditions and to provide better service to its customers.⁴⁹ There is no reason to doubt U.S.

⁴⁵ Transcript, page 587, lines 7-11.

⁴⁶ Transcript, page 585, lines 8-22.

⁴⁷ Wright Supplemental Surrebuttal, Ex. 25, page 4, lines 6-10.

⁴⁸ McKinnie Supplemental Rebuttal, Ex. 29, page 12, lines 23-25.

⁴⁹ Johnson Supplemental Surrebuttal, Ex. 26, page 13, lines 3-16.

Cellular's explanation of why those four sites were built. But the building of those sites brings into focus the problem with U.S. Cellular's two-year build-out plan. It will be very difficult for the Commission to determine whether a particular cell site would have been built anyway, even without USF support.

U.S. Cellular already builds new cell sites throughout urban and rural portions of Missouri without receiving USF support. If it were known how much U.S. Cellular currently spends without USF support, the Commission could establish that level of spending as a base line and require U.S. Cellular to spend the funds it receives from the USF in addition to its base line spending. U.S. Cellular's witness, Alan Johnson, was able to testify to U.S. Cellular's average capital expenditures for construction of cell sites in its Missouri market, excluding St. Louis and the Joplin area, since 2003. Later, another U.S. Cellular witness, Nick Wright, testified that U.S. Cellular is spending an average of \$15-16 million on construction of cell sites each year.⁵⁰ However, the level of expenditures has fluctuated a great deal from year to year.⁵¹ Wright did, however, testify that U.S. Cellular would commit to spending any USF funding that it receives dollar for dollar over and above what it would otherwise spend.⁵²

One solution to the problem of ensuring that U.S. Cellular spends USF funding in addition to, rather than instead of its own investment money would be to establish an investment base line to ensure that U.S. Cellular spends its USF funding appropriately. However, the establishment of a reliable base line is difficult because a wireless carrier's capital budget can vary greatly from year to year.⁵³ Indeed, U.S. Cellular's capital budget has shown such variation in recent years.⁵⁴ Nevertheless, if the Commission is to ensure that U.S. Cellular is spending its USF funding appropriately, it will need to establish such a base line.

In recognition of the variability of U.S. Cellular's investment spending, the Commission will establish a two-year average base line of \$15 million per year, which is the amount that U.S. Cellular currently invests for construction of cell sites in its Missouri market, excluding St. Louis and the Joplin area, without wireless support. If U.S. Cellular invests less than \$15 million in the first year, it will need to increase its spending in the second year to bring the average for the two years up to the base line amount. If U.S. Cellular fails to comply with the base line investment requirement, the Commission will refuse to recertify U.S. Cellular to receive further USF funding and may seek the return of funds previously paid. In addition, the Commission may seek penalties against U.S. Cellular under Section 386.570, RSMo 2000, for violation of the Commission's order.

Telephone customers in rural Missouri will benefit from the designation of U.S. Cellular as an ETC. If, because of a fear of uncertainty, the Commission simply refuses to designate U.S. Cellular as an ETC, those benefits would be denied to

⁵⁰ Transcript, page 758, lines 19-20.

⁵¹ In-Camera Transcript, pages 732-733. The amount of dollars spent each year is highly confidential.

⁵² Transcript, page 758, lines 6-7.

⁵³ Johnson Supplemental Surrebuttal, Ex. 26, page 16-17, lines 18-27, 1.

⁵⁴ In-Camera Transcript, pages 732-733.

rural Missourians. On balance, the Commission finds that the detailed, after-the-fact, demonstration of how it spent USF funding, along with the establishment of an investment base line, will be sufficient to ensure that U.S. Cellular spends its USF funds appropriately.

Would Designating U.S. Cellular as an ETC Create a Burden on the USF System?

Some of the parties argue that designating U.S. Cellular as an ETC would not be in the public interest because designating yet another company as an ETC would create a burden on the USF system.

There is concern that the USF is rapidly expanding and that ultimately it could be forced to limit payments to the various ETCs.⁵⁵ The amount of USF funding that U.S. Cellular would receive in Missouri is only a small percentage of the very large amount of funding that is disbursed nationwide through the USF. Therefore, granting ETC status to U.S. Cellular in Missouri would not have an appreciable impact on the USF system as a whole. But each state's decision to grant ETC status to a new carrier does have an impact

on the total usage of the system, and the Commission should consider the impact on the total system as it considers U.S. Cellular's application.

Fortunately, U.S. Cellular's impact on the overall USF system is limited by the manner in which the support paid to a competitive ETC, such as U.S. Cellular, is measured. U.S. Cellular will receive support payments on a per customer basis only for those customers that it actually serves on a non-resale basis.⁵⁶ If it does not serve the customers, U.S. Cellular will not collect support payments. Furthermore, in the areas served by a Tier I carrier, such as AT&T Missouri, when a competitive ETC takes a customer away from the incumbent carrier, it also takes the incumbent's support payment, resulting in no net increase in the amount of support paid by the fund.⁵⁷ Overall, there is no reason to believe that designating U.S. Cellular as an ETC will unduly burden the USF system.

After considering the evidence and arguments of the parties, the Commission concludes that designating U.S. Cellular as an ETC is in the public interest.

Has U.S. Cellular Complied with the Commission's ETC Rule?

The Commission has recently promulgated a new rule – 4 CSR 240-3.570 – governing the decision to grant an application for ETC designation. Various parties contend that U.S. Cellular has failed to comply with one or more provisions of that rule. Some of the questions about compliance with the rule overlap with issues that the Commission has previously addressed in deciding that designating U.S. Cellular

⁵⁵ Transcript, page 789, lines 11-19.

⁵⁶ Transcript, page 208, lines 15-16.

⁵⁷ Transcript, page 208, lines 17-18.

as an ETC is in the public interest. Those overlapping issues will be briefly addressed as they relate specifically to the rule.

In considering U.S. Cellular's compliance with the detailed requirements of its rule, the Commission emphasizes that the purpose of the rule is to guide applicants and the Commission in making a determination of whether it is appropriate to designate an applicant as an ETC. The Commission does not intend to use the rule to ensure that a wireless carrier can never be designated as an ETC.

Some parties contend that U.S. Cellular has failed to comply with Commission rule 4 CSR 240-3.570(2)(A)3G, which requires an applicant for ETC designation to make "a statement as to how the proposed plan would not otherwise occur absent the receipt of high-cost support and that such support will be used in addition to any expenses the ETC would normally incur." That issue has already been addressed when the Commission found that designating U.S. Cellular as an ETC is in the public interest. It need not be addressed again.

Commission rule 4 CSR 240-3.570(2)(A)5 requires an applicant for ETC designation to demonstrate that "the commission's grant of the applicant's request for ETC designation would be consistent with the public interest, convenience and necessity." The Commission has already found that designating U.S. Cellular as an ETC is in the public interest, but the STCG's brief suggests that because U.S. Cellular is already providing service without USF support, the Commission must consider whether ETC designation will result in any additional competition or increased benefits for customers in rural Missouri.⁵⁸

That section of the rule simply requires a consideration of the impact on the public interest of the granting of the applicant's request for designation as an ETC. It does not require any specific finding of additional competition or increased benefits. The Commission has previously found that U.S. Cellular has demonstrated that its request for ETC designation is consistent with the public interest. No further consideration is required.

Commission Rule 4 CSR 240-3.570(2)(A)10 requires an applicant for ETC designation to make a commitment to offer a local usage plan comparable to the local usage plan offered by the ILEC in the areas the applicant seeks to serve. The Commission has already addressed this issue as it relates to the affordability of the services, including Lifeline services offered by U.S. Cellular. However, the STCG points out that the wireline ILECs offer a local usage plan that allows a customer to make unlimited local calls for a flat monthly rate. Since U.S. Cellular does not offer such a plan, the STCG argues that its local usage plan is not comparable to those offered by the ILEC and thus does not comply with the regulation.

As the Commission has previously found, many ILECs offer unlimited local calling, but only to a few exchanges. In contrast, U.S. Cellular offers a limited number of minutes of use for a fixed fee but allows a customer to make calls to locations in most of the country. Some customers will benefit from the plan offered by the ILECs while others will benefit from the plan offered by U.S. Cellular. The customers can choose for themselves which plan they prefer. The Commission's

⁵⁸ January 31, 2007, Post Hearing Brief of the Small Telephone Company Group, page 22.

rule does not require a wireless provider to become a wireline provider and it does not require U.S. Cellular to offer the same local usage calling plan as that offered by the ILECs. The rule requires only that their local usage calling plans be comparable. The Commission finds that the local usage plan offered by U.S. Cellular is comparable to the local usage plan offered by the ILECs and complies with the Commission's regulation.

Commission rule 4 CSR 240-3.570(2)(A)3 requires an applicant for ETC designation to submit a two-year plan demonstrating that USF funding will be used to "improve coverage, service quality or capacity on a wire center-by-wire center basis throughout the Missouri service area for which the requesting carrier seeks ETC designation. . . ." Several parties contend that because U.S. Cellular's plan does not propose to "improve coverage, service quality or capacity" in every wire center in which it seeks ETC designation, it does not comply with the rule.

U.S. Cellular agrees that improved network coverage is needed in every wire center for which it seeks ETC status and intends to continue to use the support it receives to improve coverage in additional areas.⁵⁹ The coverage maps that U.S. Cellular submitted as part of its application show many areas in Missouri in which it cannot currently provide service over its own facilities. The two-year plan that U.S. Cellular submitted along with its application would bring additional coverage to some of those areas but it does not eliminate the areas without coverage. U.S. Cellular's initial two-year plan is a start toward improving coverage, but it is only a start. Fortunately, additional two-year plans will follow because an ETC is required to annually seek recertification to continue to receive USF funding, and Commission rule 4 CSR 3.570(4)(B)1 requires that when seeking recertification, an applicant is required to submit an updated two-year improvement plan.

The amount of support that U.S. Cellular will receive from the USF could not conceivably allow it to completely build out its network to achieve that goal in just two years, and that result is not required by the Commission's rule. Neither does the rule require U.S. Cellular to provide a detailed plan about how it will ultimately complete the build out of its network. Too many facts are still unknown, and unknowable, to allow such a plan to be anything but fantasy and guesswork.

U.S. Cellular has committed to construct facilities to provide network coverage in every wire center within its Missouri service area that qualifies for high-cost support.⁶⁰ The company will explain precisely how it intends to accomplish that task in subsequent two year plans that it will file for Commission approval each year when it seeks recertification to receive USF funding. That is all that is required by the Commission's rule, and that is all that the Commission will require of U.S. Cellular.

Commission rule 4 CSR 240-3.570(2)(A)3A indicates that an initial two-year plan shall include "a detailed map of coverage area before and after improvements and in the case of CMRS providers, a map identifying existing tower site locations for CMRS cell towers." As a sub-issue to its challenge to the sufficiency of U.S.

⁵⁹ Johnson Supplemental Surrebuttal, Ex. 26, page 4, lines 3-5.

⁶⁰ Transcript, page 643, lines 2-6.

Cellular's two-year plan, CenturyTel argues that the coverage maps that U.S. Cellular submitted as part of its initial two-year plan are not sufficiently detailed.

As part of its two-year plan, U.S. Cellular submitted statewide maps showing its existing coverage and the areas that would receive improved coverage when additional cell towers are built under its plan.⁶¹ These maps provide a statewide overview and do not provide wire center-by-wire center details of the sort that are shown in the maps submitted by CenturyTel's witness Glenn H. Brown and the STCG's witness Robert Schoonmaker.

Certainly, the maps submitted by U.S. Cellular do not provide precise details about existing and expanded coverage on a wire center-by-wire center basis. But the rule does not require that level of detail. The purpose of the rule's map requirement is to provide the Commission and the Commission's Staff with the information they need to determine whether the two-year plan meets the other requirements of the rule. The witness for the Commission's Staff, Adam McKinnie, although he testified that U.S. Cellular's two-year plan is deficient in other respects, did not testify to any concern about the adequacy of the submitted maps. Furthermore, the Commission has found the maps submitted by U.S. Cellular to be sufficient for its review. On that basis, the Commission finds that the maps submitted by U.S. Cellular satisfy the requirements of its regulation.

As previously indicated, the Commission's Staff found that U.S. Cellular's two-year plan failed to comply with the Commission's rule in one respect. Commission Rule 4 CSR 240-3.570(2)(A)3D requires a two-year plan to include "the estimated amount of investment for each project that is funded by high-cost support." Staff is concerned that U.S. Cellular has presented only aggregated budgetary information for the projects it will build instead of specific estimated costs for each proposed project.⁶² Indeed, the estimated costs projected by U.S. Cellular simply contain a total amount of capital expenditures per year and a number of cell sites to be built in each year. U.S. Cellular does not attempt to break down the amount anticipated to be spent on each individual cell site.

Staff's interpretation of the regulation would require U.S. Cellular to offer a detailed estimate of the cost of constructing each individual cell tower site. Yet the costs associated with constructing each individual cell site can vary greatly, and cannot be known with any certainty until that site is completed.⁶³ The Commission does not interpret its regulation to require U.S. Cellular to use a crystal ball to make an estimate of the cost of cell sites that are likely still very early in the planning stages. After the individual cell sites are constructed, U.S. Cellular will be in a position to tell the Commission exactly how much it spent on each cell site as part of its annual recertification request. At that time Staff will be able to review actual numbers rather than mere guesses when it determines whether U.S. Cellular has properly spent the USF funds it receives. For that reason, the Commission interprets

⁶¹ August 11, 2006, Compliance Filing of U.S. Cellular, Appendices 4 and 5. *See also*, Johnson Supplemental Surrebuttal, Ex. 26, Attached Proprietary Exhibits A, B, and C.

⁶² McKinnie Supplemental Rebuttal, Ex. 29, page 8, lines 17-19.

⁶³ Johnson Supplemental Surrebuttal, Ex. 26, pages 14-15, lines 23-29, 1-4.

its regulation as allowing U.S. Cellular's two-year plan to include aggregate cost estimates for the construction of projects using USF funding.

The Commission's regulation imposes various additional requirements on an applicant for designation as an ETC. The evidence presented indicates that U.S. Cellular has complied with those other requirements of the rule⁶⁴ and no party has presented any contrary evidence. As a result, those requirements will not be further addressed.

The Commission finds that U.S. Cellular has complied with all applicable requirements of the Commission's ETC rule.

May U.S. Cellular Use USF Support to Make Network Improvements in AT&T Missouri's Wire Centers?

AT&T Missouri raises the issue of whether U.S. Cellular can use USF high-cost support to make network improvements in areas in which AT&T Missouri is the ILEC. AT&T Missouri provides phone service in most of Missouri's large cities, including St. Louis and Springfield, urban areas that are within U.S. Cellular's Missouri service area. But AT&T Missouri also provides phone service in many Missouri wire centers that are undeniably rural in character. However, as of July 1, 2006, as a Tier I carrier, AT&T Missouri receives no federal USF support for any of its wire centers; neither rural nor urban.⁶⁵ Hence, by definition, all of AT&T Missouri's wire centers are considered to be non-high cost. That also means that U.S. Cellular cannot receive support for any customers it serves in an AT&T Missouri wire center.⁶⁶

Both Federal law⁶⁷ and the Commission's regulation⁶⁸ require that U.S. Cellular spend any USF support it receives for "the provision, maintenance and upgrading of facilities and services for which the support is intended." All parties, including U.S. Cellular, agree that U.S. Cellular cannot use USF support to construct facilities in urban low-cost areas, such as St. Louis, because such spending would not be an "intended" use of the support. AT&T Missouri, however, contends that U.S. Cellular should also be precluded from spending USF funds to build any facility in any AT&T Missouri wire center, even if that wire center is entirely rural.

Under the FCC's rules, AT&T Missouri is not allowed to receive high-cost support to improve its facilities in those rural wire centers that are, in fact, if not in law, costly to serve. AT&T Missouri argues that allowing U.S. Cellular to spend the high-cost support dollars to build facilities in AT&T wire centers, which are defined by law as non high-cost wire centers, would place AT&T Missouri at a competitive disadvantage, and would violate the Telecommunications Act's principle of competitive neutrality.

⁶⁴ McKinnie Supplemental Rebuttal, Ex. 29, pages 5-13.

⁶⁵ Stidham Supplemental Rebuttal, Ex. 32, page 5, lines 11-12.

⁶⁶ Transcript, page 682, lines 4-8.

⁶⁷ 47 U.S.C. §254(e).

⁶⁸ 4 CSR 240-3.0570(2)(A)2.

AT&T Missouri's competitive neutrality argument must be rejected because U.S. Cellular will have an obligation to serve throughout its ETC service area, including AT&T Missouri's rural wire centers, regardless of whether it will be allowed to receive high-cost support for those customers. Those rural customers, who currently pay into the USF like all other phone customers, should not be denied the benefits of improved telecommunications service that the USF was intended to deliver.

In one sense, AT&T's argument is premature. The Commission does not need to finally decide in this application case the propriety of the details of U.S. Cellular's expenditures of USF support. That process will occur later, when the Commission examines those expenditures in detail during the annual recertification process. However, for the guidance of the parties, the Commission will state that, in its opinion, there is nothing in federal or state law that would prevent U.S. Cellular from spending USF support in the rural wire centers served by AT&T Missouri.

Is Designating Multiple Wireless Carriers as ETCs in the Public Interest?

CenturyTel and the STCG point out that the Commission has previously granted ETC designation to two wireless carriers – Northwest Missouri Cellular Limited Partnership⁶⁹ and Missouri RSA No. 5 Partnership⁷⁰ – in portions of the service area for which U.S. Cellular seeks such designation. They contend that the Commission must now take the existence of these other wireless ETCs into consideration when it determines whether designating U.S. Cellular's as an ETC would be in the public interest.

The STCG argues that the existing wireless carriers have already brought the benefits of wireless service, including Lifeline wireless service, to the areas for which they have been designated as ETCs. Therefore, they contend that U.S. Cellular must show that it will bring incremental benefits to those areas for which there is already a wireless carrier with ETC status. Another side of that argument is presented by CenturyTel, which contends that designating multiple competitive ETCs could make it less likely that any carrier will be able to complete the construction of a network in the high-cost areas that are to be served under the USF plan.⁷¹

The Commission has previously found that consumers in rural areas will benefit from the increased availability of wireless telecommunications services. There is no reason to believe that those benefits would not be enhanced by the presence of more than one wireless carrier. Increased competition is generally a good thing. That is particularly true for wireless service because it is offered in a competitive market with only limited regulation by the FCC. If that market is to function properly to protect consumers from high prices and poor service, there must be more than

⁶⁹ In the Matter of Northwest Missouri Cellular Limited Partnership's Application for ETC Designation, Case No. TO-2005-0466, Report and Order issued September 21, 2006.

⁷⁰ In the Matter of Missouri RSA No. 5 Partnership's Application for ETC Designation, Case No. TO-2006-0172, Report and Order issued September 21, 2006.

⁷¹ Brown Rebuttal, Ex. 11, pages 46-47.

one service provider in the market. Designating more than one wireless carrier as an ETC in a market will enhance competition and therefore is in the public interest.

Redefinition of Rural Service Areas

U.S. Cellular's application asks the Commission to redefine portions of the study areas of several rural telephone companies that fall outside U.S. Cellular's FCC-licensed service area.⁷² The list of ILEC wire centers to be redefined is set forth in Exhibit F to U.S. Cellular's Application.

U.S. Cellular seeks redefinition of certain ILEC study areas because, under federal law, a competitive ETC must serve an entire rural ILEC service area, which is defined as its study area, in order to be eligible for support in any part of that area, unless the state and the FCC agree to redefine the ILEC service area.⁷³ Of course, the FCC is not a party to this case so it cannot agree to a redefinition in this case. However, this Commission can grant conditional ETC status for the areas to be redefined, to take effect automatically upon a grant of concurrence by the FCC.

A redefinition of certain ILEC study areas is necessary because wireless carriers and wireline ILECs are not licensed along identical boundary lines. The boundary lines of some ILEC study areas cut across the boundary of U.S. Cellular's licensed service territory as established by the FCC. As a result, U.S. Cellular cannot provide service in the entire ILEC study area. To get around this problem, U.S. Cellular proposes that the Commission redefine, as a separate service area, each of the ILEC wire centers that are part of a large study area that crosses outside the area served by U.S. Cellular.

The FCC has indicated that a state commission must consider three factors in deciding to redefine an ILEC service area: (1) whether the proposal would result in cream skimming; (2) whether the ILEC would incur an undue administrative burden; and (3) whether the ILEC's status as a rural carrier would be affected. Cream skimming could result if a competitive ETC chose to serve only the low-cost portions of an ILEC's study area, while collecting support based on the cost of serving the entire study area, including high-cost areas. U.S. Cellular demonstrated that cream skimming would not be a problem in its proposed service area. No party challenged that assertion. Similarly, U.S. Cellular demonstrated that its proposed redefinition of the ILEC study areas would not cause any undue administrative burden on an ILEC, and that no ILEC's status as a rural carrier would be affected. No party challenged either assertion.

U.S. Cellular has justified the redefinition of ILEC study areas as proposed in its application. The Commission will grant conditional ETC status for the areas to be redefined, to take effect automatically upon a grant of concurrence by the FCC.

⁷² The Application lists the affected ILECs as: ALLTEL Missouri, Inc.; BPS Telephone Company; Chariton Valley Telephone Company; Craw-Kan Telephone Cooperative, Inc.; Le-Ru Telephone Company; Mid-Missouri Telephone Company; Spectra Communications Group, LLC; and United Telephone Company of Missouri d/b/a Sprint (now known as Embarq).

⁷³ 47 U.S.C. §214(e)(5) and 47 C.F.R. §54.207.

CONCLUSIONS OF LAW

The Missouri Public Service Commission has reached the following conclusions of law:

1. In establishing the principles that are to govern the provision of universal service support, the United States Congress, in the Telecommunications Act of 1996, set out the following principle regarding access in rural and high cost areas:

Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.⁷⁴

2. To help support that principle, Congress required that "only an eligible telecommunications carrier designated under section 214(e) of this title shall be eligible to receive specific Federal universal service support."⁷⁵ Congress also required that "[a] carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which support is intended."⁷⁶

3. Section 214(e)(2) of the Telecommunications Act gives authority to State commissions to designate a common carrier as an eligible telecommunications carrier for a service area designated by the State commission. More than one common carrier can be designated as an eligible carrier to serve a service area. Specifically, that section provides:

Upon request and consistent with the public interest, convenience, and necessity, the State commission may, in the case of an area served by a rural telephone company, and shall, in the case of all other areas, designate more than one common carrier as an eligible telecommunications carrier for a service area designated by the State commission, so long as each additional requesting carrier meets the requirements of paragraph (1). Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission shall find that the designation is in the public interest.

4. Section 214(e)(1) of the Telecommunications Act requires that a designated eligible telecommunications carrier must, throughout the designated service area:

(A) offer the services that are supported by Federal universal service support mechanisms..., either using its own facilities or a combination of its own facilities and resale of another carrier's

⁷⁴ 47 U.S.C. §254(b)(3).

⁷⁵ 47 U.S.C. §254(e).

⁷⁶ *Id.*

services (including the services offered by another eligible telecommunications carrier); and

(B) advertise the availability of such services and the charges therefore using media of general distribution.

5. By regulation, the Federal Communications Commission has required that an eligible telecommunications carrier must offer each of nine designated services in order to receive federal universal service support.⁷⁷ The following are the nine services that must be offered:

- (1) Voice grade access to the public switched network;
- (2) Local usage;
- (3) Dual tone multi-frequency signaling or its functional equivalent;
- (4) Single-party service or its functional equivalent;
- (5) Access to emergency services;
- (6) Access to operator services;
- (7) Access to interexchange service;
- (8) Access to directory assistance;
- (9) Toll limitation for qualifying low-income consumers.⁷⁸

6. A regulation of the Federal Communications Commission, 47 CFR §54.201(i) states:

A state commission shall not designate as an eligible telecommunications carrier a telecommunications carrier that offers the services supported by federal universal service support mechanisms exclusively through the resale of another carrier's services.

7. Section 253(b) of the Telecommunications Act provides as follows:

Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.

8. In recognition of its obligation under the Telecommunications Act to determine whether a telecommunications provider should be designated as an eligible telecommunications carrier, the Commission has promulgated a regulation, 4 CSR 240-3.570, to guide and govern that determination.

9. Commission Rule 4 CSR 240-3.570(2) provides as follows:

(A) Each request for ETC designation shall include:

1. Intended use of the high-cost support, including detailed descriptions of any construction plans with start and end dates, populations affected by construction plans, existing tower site locations for CMRS [commercial mobile radio service] cell towers, and estimated budget amounts;

⁷⁷ 47 CFR 54.101(b).

⁷⁸ 47 CFR 54.101(a)(1)-(9).

2. A two (2)-year plan demonstrating, with specificity, that high-cost universal service support shall only be used for the provision, maintenance and upgrading of facilities and services for which the support is intended in the Missouri service area in which ETC designation was granted. ...

10. Commission Rule 4 CSR 240-3.570(2)(A) further provides as follows:

3. The two (2)-year plan shall include a demonstration that universal service support shall be used to improve coverage, service quality or capacity on a wire center-by-wire center basis throughout the Missouri service area for which the requesting carrier seeks ETC designation including;

A. A detailed map of coverage area before and after improvements and in the case of CMRS providers, a map identifying existing tower site locations for CMRS cell towers;

B. The specific geographic areas where improvements will be made;

C. The projected start date and completion date for each improvement;

D. The estimated amount of investment for each project that is funded by high-cost support;

E. The estimated population that will be served as a result of the improvements;

F. If an applicant believes that service improvements in a particular wire center are not needed, it must explain its basis for this determination and demonstrate how funding would otherwise be used to further the provision of supported services in that area; and

G. A statement as to how the proposed plans would not otherwise occur absent the receipt of high-cost support and that such support will be used in addition to any expenses the ETC would normally incur;

4. A demonstration of the carrier's ability to remain functional in emergency situations, including a demonstration that the carrier has a reasonable amount of back-up power to ensure functionality without an external power source, is able to reroute traffic around damaged facilities and is capable of managing traffic spikes resulting from emergency situations;

5. A demonstration that the commission's grant of the applicant's request for ETC designation would be consistent with the public interest, convenience and necessity;

6. A commitment to advertise the availability of services and charges therefore using media of general distribution throughout the ETC service area;

7. A commitment to provide Lifeline and Link Up discounts consistent with 47 CFR 54.401 and 47 CFR 54.411. Each request for ETC designation shall include a commitment to publicize the availability of Lifeline service in a manner reasonably designed to

reach those likely to qualify for the service consistent with 47 CFR 54.405;

8. A statement that the carrier will satisfy consumer privacy protection standards as provided in 47 CFR 64 Subpart U and service quality standards as applicable;

9. A statement that the requesting carrier acknowledges it shall provide equal access pursuant to 4 CSR 240-32.100(3) and (4) if all other ETCs in that service area relinquish their designation pursuant to section 214(e) of the Telecommunications Act of 1996; and

10. A commitment to offer a local usage plan comparable to those offered by the incumbent local exchange carrier in the areas for which the carrier seeks designation. Such commitment shall include a commitment to provide Lifeline and Link Up discounts and Missouri Universal Service Fund (MoUSF) discounts pursuant to 4 CSR 240-31, if applicable, at rates, terms and conditions comparable to the Lifeline and Link Up offerings and MoUSF offerings of the incumbent local exchange carrier providing service in the ETC service area.

11. U.S. Cellular is a commercial mobile radio service (CMRS) provider as that term is used in 4 CSR 240-3.570.

DECISION

After applying the facts as it has found them to the applicable law, the Commission has reached the following decisions.

U.S. Cellular has met all requirements of federal and state law and may be designated as an eligible telecommunications carrier throughout its Missouri service area.

IT IS ORDERED THAT:

1. USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular, is designated as an Eligible Telecommunications Carrier for the wire centers listed in Exhibits C and D attached to its Application, and is designated as eligible to receive all available support from the federal Universal Service Fund, including support for rural, insular, and high-cost areas, and low-income customers. Exhibits C and D are attached to and incorporated in this order.

2. USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular, is designated as an Eligible Telecommunications Carrier for the wire centers listed in Exhibit F attached to its Application, and is designated as eligible to receive all available support from the federal Universal Service Fund, including support for rural, insular, and high-cost areas, and low income customers. Exhibit F is attached to and incorporated in this order.

3. USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular's designation as an Eligible Telecommunications Carrier for the wire centers listed in Exhibit F attached to its Application is conditional upon the redefinition of those wire centers as

permitted by 47 U.S.C. §214(e)(5) and 47 C.F.R. §54.207, with the designation to take effect automatically upon a grant of concurrence by the FCC.

4. USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular's designation as an Eligible Telecommunications Carrier for the wire centers listed in Exhibits C, D and F attached to its Application is conditioned upon it meeting a base line investment requirement of a two-year average of \$15 million per year in capital expenditures for construction of cell sites in its Missouri market, excluding St. Louis and the Joplin area, in addition to any funding it receives from the federal Universal Service Fund. In addition, USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular's designation as an Eligible Telecommunications Carrier is conditioned upon it spending all funds received from the federal Universal Service Fund in rural areas of Missouri in a manner consistent with all requirements of federal and state law.

5. The wire centers listed in Exhibit F attached to USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular's Application are redefined as separate service areas as requested.

6. USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular, shall file with the Commission a copy of its petition to the Federal Communications Commission seeking concurrence in the redefinition of its service areas.

7. The Commission finds that USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular, has met the high-cost certification requirement and is entitled to begin receiving high-cost support as of the effective date of this order.

8. The Commission certifies to the Federal Communications Commission that USCOC of Greater Missouri, LLC, d/b/a U.S. Cellular, will use such high-cost support for its intended purpose.

9. A copy of this Report and Order shall be served upon the Federal Communications Commission and the Universal Service Administration Company.

10. This Report and Order shall become effective on May 13, 2007.

Davis, Chm., and Gaw, C., concur;
Murray, C., concurs with concurring opinion attached;
Clayton, C., dissents with dissenting opinion to follow;
Appling, C., dissents;
and certify compliance with the provisions
of Section 536.080, RSMo 2000.

CONCURRING OPINION OF COMMISSIONER CONNIE MURRAY

I write separately to indicate my concern with the establishment of a base line spending level for U.S. Cellular.

In deciding to promulgate its rule in its existing form, the Commission decided that it would not require a detailed demonstration of how high-cost support would be used to provide services that would not be provided in the absence of that support

as part of the application for ETC status. There is no reason to treat U.S. Cellular's application any differently. The requirement that U.S. Cellular file annual reports providing detail of how it has spent those funds will provide the Commission with sufficient assurance that the USF funding is being well spent. If the Commission is not satisfied with the answers U.S. Cellular provides, it can turn off the flow of money by refusing to recertify the company.

The establishment of a reliable base line is not practical because a wireless carrier's capital budget can vary greatly from year to year, as U.S. Cellular's has done. Imposing a rigid base line requirement could limit the Commission's ability to fairly evaluate the company's actual spending decisions and could lead to incorrect conclusions about the company's spending.

For example, the Commission has set an investment base line level at \$15 million per year and if the company received \$10 million per year in USF funding, the Commission would expect the company to spend \$25 million per year on capital expenditures. However, in a particular year, for various reasons, perhaps interest rates spike, or a recession decreases demand for services, a company might decide that it can only justify \$10 million in capital spending. Adding the \$10 million it receives from USF funding, the company then spends \$20 million for the year and falsely appears to be mispending the USF funding. Further, to avoid not being recertified and being subject to penalties, the company would have to spend an additional \$5 million the following year in addition to the \$15 million base line and \$10 million USF funding. On the other hand, in a particular year, the company might decide to spend \$20 million of its own funds for capital improvements. In that circumstance the company could be tempted to spend only \$5 million of the \$10 million it receives from USF funding, pocket the other \$5 million, and appear to be handling the USF funds appropriately. Under these real life circumstances, the imposition of an investment base line might obscure rather than illuminate U.S. Cellular's actual spending practices. As a result, the Commission would be better able to evaluate U.S. Cellular's compliance without establishing an investment base line.

As I pointed out, the Commission's rules regarding designation of a competitive ETC do not require the establishment of an investment base line to assure that a company's spending of USF funding is incremental to what it would otherwise spend. Instead, 4 CSR 240.3 .570(2)(A)3 .G. simply requires the applicant to offer "a statement as to how the proposed plans would not otherwise occur absent the receipt of high-cost support and that such support will be used in addition to any expenses the ETC would normally incur." The Commission's rule requires the company to make a detailed demonstration of its compliance with that requirement only as part of its annual report of how it spent USF funding.

Although I have great concern with the establishment of a baseline spending level for a single company, I acquiesce on this issue in order to obtain a majority for this Report and Order.

*Note: At the time of publication, no other dissents have been issued.

In the Matter of the Application of the United Way of Greater St. Louis, Inc., for an Order of the Commission Granting It Authority as an Information and Referral Provider for Purposes of Obtaining 211 Service.

Case No. TO-2007-0312

Telecommunications §1. The Commission granted the United Way of Greater St. Louis, Inc.'s application for authorization to serve as a 211 Information and Referral Service Provider for a period of three years.

**ORDER GRANTING AUTHORITY TO SERVE AS AN
INFORMATION AND REFERRAL SERVICE PROVIDER**

Issue Date: May 11, 2007

Effective Date: May 21, 2007

Background

On February 23, 2007, the United Way of Greater St. Louis, Inc. filed an application with the Missouri Public Service Commission seeking authority to act as an Information and Referral Provider under Commission rule 4 CSR 240-32.200. As described in the rule, the purpose of 211 service is:

[I]ntended to enhance the ability of the public to access services that provide free information and referral to community resources in situation that are not immediately life-endangering, but still represent a serious but less urgent threat to basic human needs and individuals' health and welfare.

As required by the rule, the Commission issued an order directing that notice be sent. Specifically, the Commission directed that its Data Center notify all incumbent local and facilities based alternative local exchange telecommunications companies, all county seats for the requested exchanges and all city government in cities with the requested exchanges that have a population of 5,000 or more persons. Included

in the application is a list of counties proposed to be served. Later, the United Way filed an amended "Proposed List of *Exchanges* to be Served by 2-1-1."

The rule also requires service upon all human and social services organizations listed in the yellow pages for the exchanges to be served. Rather than require the Commission's Data Center to undertake this task, the Commission directed the United Way to notify all of those agencies it funds. Upon such notice, the Missouri Independent Telephone Company Group¹, AT&T Missouri, Windstream Missouri, Inc., and CenturyTel of Missouri, LLC, and Spectra Communications Group, LLC, d/b/a CenturyTel, requested and was granted intervention.

On April 25, 2007, the Staff of the Commission filed its memorandum recommending that the Commission grant the requested relief. All parties have responded to Staff's recommendation and do not oppose the United Way's applications.

The Application

Under Commission rules 4 CSR 240-32.200(3)(A)(2)-(17), and (3)(B)(1)-(3) an applicant seeking authority to serve as a provider of 211 services must make a number of affirmations in the application. The United Way has satisfied the Commission's requirements in this regard. With regard to the exchanges to be served, through the amended list of exchanges, it is the United Way's intention to serve all those portions of Missouri that the Heart of America United Way does not intend to serve. The Heart of America United Way has a pending application before the Commission to provide 211 services.²

Staff Memorandum

Staff states that the application meets the requirements of the Commission's 211 rule and should be granted. Staff goes on to explain that the "rule requires an entity applying for 211 accreditation to adhere to standards set forth by the Alliance of Information and Referral Systems (AIRS) and to either already be accredited by AIRS or to seek AIRS accreditation." Staff notes that the United Way states that it is seeking such accreditation and expects to be accredited by October 2008. In this regard, Staff recommends that the Commission direct the United Way to state the status of AIRS accreditation in its annual reports, which are already required to be filed subsection (16) of the rule.

Discussion

The Commission has reviewed the United Way's application and Staff's memorandum, which are hereby entered into evidence, and will grant the requested relief. As recommended by Staff, the Commission will also require the United Way

¹ Alma Communications Company, d/b/a Alma Telephone Company, Chariton Valley Telephone Corporation, Choctaw Telephone Company, Mid-Missouri Telephone Company (Otelco), and Northeast Missouri Rural Telephone Company.

² Case No. TO-2007-0338.

UNITED WAY OF GREATER ST. LOUIS, INC.

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to include in its annual report the status of its AIRS accreditation. Consistent with the Commission's 211 rule, the United Way shall also include in its annual report the geographical areas served, call volume, number of abandoned calls, average speed of answering, average call length, information on inquirer needs and barriers to service. The annual report shall cover the period from July 1 through June 30 of the previous year and shall be filed no later than August 1 of each year.

Also consistent with its rule, the Commission points out that the United Way will be responsible for all costs of provisioning service, including nonrecurring and recurring charges incurred by the use of the 211 dialing code. Further, the United Way shall not charge end users a separate charge specifically for 211 service nor shall the 211 code be used for commercial advertisements or solicitation.

Finally, the Commission notifies the United Way that if the Commission receives a formal complaint that the United Way is in violation of the AIRS criteria, or of a statute, rule, order or tariff applications to the provision of 211 service, or that its continued authorization is not in the public interest, the Commission shall investigate the complaint and take appropriate action, which may include revocation of the United Way's authorization.

IT IS ORDERED THAT:

1. The United Way of Greater St. Louis, Inc.'s application for authorization to serve as a 211 Information and Referral Service Provider is granted.
2. The United Way of Greater St. Louis, Inc. shall comply with the statements set forth in the application.
3. The United Way of Greater St. Louis, Inc. is granted authorization as a 211 Information and Referral Service Provider for a period of three years.
4. If the United Way of Greater St. Louis, Inc. wishes to continue as a provider after the three year period, it shall reapply as required under Commission rule 4 CSR 240-32.200.
5. If after having becoming accredited, the United Way of Greater St. Louis, Inc. loses AIRS accreditation, within 45 days of such loss, it shall submit to the Commission for approval a plan to secure such accreditation.
6. The United Way of Greater St. Louis, Inc. shall submit to the Commission an annual report documenting information and referral services as described in the body of this order and consistent with Commission rule 4 CSR 240-32.200.
7. This order shall become effective on May 21, 2007.
8. This case may be closed on May 22, 2007.

Kennard L. Jones, Senior Regulatory
Law Judge, by delegation of authority
pursuant to Section 386.240, RSMo 2000.

In the Matter of the Tariffs of Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P Increasing Electric Rates for the Services Provided to Customers in the Aquila Networks – MPS and Aquila Networks – L&P Service Areas*

Case No. ER-2007-0004

ACCOUNTING § 41. The Commission granted a fuel adjustment mechanism to Aquila. The Commission concluded that Aquila met the requirements of section 386.266, and it is reasonable and in the public interest to permit Aquila to use a fuel adjustment mechanism.

ELECTRIC § 22. Based on its analysis of the expert testimony offered by the parties, and on its balancing of the interest of the company's ratepayers and shareholders the Commission found that 10.25% was a fair and reasonable return on equity for Aquila. Based upon a 10.25% return on equity, Aquila's revenue requirement increase will be approximately \$13.6 million and \$45.1 million for it L&P and MPS Operating Divisions, respectively.

ELECTRIC § 23. Based on its analysis of the expert testimony offered by the parties, and on its balancing of the interest of the company's ratepayers and shareholders the Commission found that 10.25% was a fair and reasonable return on equity for Aquila. Based upon a 10.25% return on equity, Aquila's revenue requirement increase will be approximately \$13.6 million and \$45.1 million for it L&P and MPS Operating Divisions, respectively.

ELECTRIC § 39. The Commission granted a fuel adjustment mechanism to Aquila. The Commission concluded that Aquila met the requirements of section 386.266, and it is reasonable and in the public interest to permit Aquila to use a fuel adjustment mechanism.

APPEARANCES

James C. Swearingen, Paul A. Boudreau, and L. Russell Mitten, Attorneys at Law, Brydon, Swearingen & England, P.C., 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri 65102-0456, for Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P.

Shelley A. Woods, Assistant Attorney General, Supreme Court Building, Post Office Box 899, Jefferson City, Missouri 65102, for the Missouri Department of Natural Resources.

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*This case was appealed to the Missouri Court of Appeals and affirmed. See 326 S.W.3d 20 (Mo. App. W.D. 2010).

Lewis R. Mills, Jr., Public Counsel, and Michael F. Dandino, Deputy Public Counsel, Office of the Public Counsel, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public. Kevin A. Thompson, General Counsel, Nathan Williams, Deputy General Counsel, Dennis L. Frey, Senior Associate General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Cherlyn D. Voss

REPORT AND ORDER

Issue Date: May 17, 2007

Effective Date: May 27, 2007

I. Background

A. Procedural History

On July 3, 2006, Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P (“Aquila”) filed proposed tariff sheets, Tariff File No. YE-2007-0001, designed to implement a general rate increase for retail electric service. The matter was opened and denominated ER-2007-0004. The new rates contained therein were designed to produce additional gross annual electric revenues of \$94,500,000 in Aquila’s MPS operating division, and \$24,400,000 in Aquila’s L&P operating division, excluding gross receipts, sales, franchise, and occupational taxes. The proposed increase would result in a 22% and 22.1% increase, respectively, over existing revenues. The tariff sheets proposed an effective date of August 2, 2006.

The Commission issued its Suspension Order and Notice on July 5, 2006, suspending the proposed tariff sheets for 180 days plus six months from the original proposed effective date, that is, until May 31, 2007. In the same order, the Commission directed notice of Aquila’s tariff filing be provided to interested parties and the public. The Commission also established July 31 as the deadline for submission of applications to intervene.

The Sedalia Industrial Energy Users Association (“SIEUA”), AG Processing, Inc. (“AG Processing”), the City of St. Joseph, Missouri, the City of Kansas City, Missouri, Union Electric Company, d/b/a AmerenUE (“AmerenUE”), the Missouri Department of Natural Resources (“DNR”), AARP, and the Federal Executive Agencies (“FEA”), submitted timely applications and were allowed to intervene. Subsequently, The Commercial Group and the County of Jackson, Missouri filed late applications to intervene and were also allowed to intervene.

On August 2, 2006, the Commission established the test year for this case as the 12-month period ending December 31, 2005, adjusted and updated for any known and measurable changes through June 30, 2006. The Commission deferred making a decision as to whether to order any further true-up in this case until the parties were prepared to offer further recommendations. The parties subsequently agreed that no further true-up was needed, and no further true-up was ordered. On August 22, 2006, the Commission established a procedural schedule that included dates for the filing of prepared testimony and set an evidentiary hearing to begin on April 4.

The Commission conducted five local public hearings within Aquila's service territory at which the Commission heard comments from Aquila's customers and the public regarding Aquila's request for a rate increase. Public hearings were held in Lee's Summit on January 22, 2007, in Nevada and Sedalia on January 23, and in St. Joseph on January 24.

The parties prefiled direct, rebuttal and surrebuttal testimony. The evidentiary hearing began on April 4, 2007, and continued through April 12, at the Commission's offices in Jefferson City, Missouri. The Commission heard the testimony of 21 witnesses; 112 exhibits were offered during the hearing, including the pre-filed testimony of the witnesses. Most of those exhibits were admitted, some over objection preserved for appeal, and some of which were admitted after a portion was stricken. The Commission took administrative notice of some of the exhibits not admitted.

II. Discussion

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.¹

¹ In making its Findings of Fact and Conclusions of Law, the Commission is mindful that it is required, after a hearing, to "make a report in writing in respect thereto, which shall state the conclusion of the commission, together with its decision, order or requirement in the premises." Section 386.420.2, RSMo 2000. Because Section 386.420 does not explain what constitutes adequate findings of fact, Missouri courts have turned to Section 536.090, which applies to "every decision and order in a contested case," to fill in the gaps of Section 386.420. *St. ex rel. Laclede Gas Co. v. Pub. Serv. Comm'n of Mo.*, 103 S.W.3d 813, 816 (Mo. App., W.D. 2003); *St. ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n*, 24 S.W.3d 243, 245 (Mo. App., W.D. 2000). Section 536.090 provides, in pertinent part:

Every decision and order in a contested case shall be in writing, and . . . the decision . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order.

Missouri courts have not adopted a bright-line standard for determining the adequacy of findings of fact. *Glasnapp v. State Banking Bd.*, 545 S.W.2d 382, 387 (Mo. App. 1976). Nonetheless, the following formulation is often cited:

The most reasonable and practical standard is to require that the findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence. *Id.* (quoting 2 Am.Jur.2d Administrative Law § 455, at 268).

Findings of fact are inadequate when they "leave the reviewing court to speculate as to what part of the evidence the [Commission] believed and found to be true and what part it rejected." *St. ex rel. Int'l. Telecharge, Inc. v. Mo. Pub. Serv. Comm'n*, 806 S.W.2d 680, 684 (Mo. App., W.D. 1991) (quoting *St. ex rel. Am. Tel. & Tel. Co. v. Pub. Serv. Comm'n*, 701 S.W.2d 745, 754 (Mo. App., W.D. 1985)). Findings of fact are also inadequate that "provide no insight into how controlling issues were resolved" or that are "completely conclusory." *St. ex rel. Monsanto*

A. Jurisdiction

The record shows that Aquila operates generation plants for the purpose of generating electricity for sale at retail. The Commission concludes that Aquila is thus an electrical corporation within the intendments of Section 386.020(15) and a public utility pursuant to Section 386.020(42), RSMo Supp. 2004.² The Commission thus has jurisdiction over Aquila's services, activities, and rates pursuant to Sections 386.020(42), 386.250 and Chapter 393.

B. Burden of Proof

Section 393.150.2 provides in part, "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation . . . and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

C. Ratemaking Standards and Practices

The Commission is vested with the state's police power to set "just and reasonable" rates for public utility services,³ subject to judicial review of the question of reasonableness.⁴ A "just and reasonable" rate is one that is fair to both the utility and its customers;⁵ it is no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."⁶ In 1925, the Missouri Supreme Court stated:⁷

The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police

Co. v. Pub. Serv. Comm'n, 716 S.W.2d 791, 795 (Mo. banc 1986) (relying on *St. ex rel. Rice v. Pub. Serv. Comm'n*, 359 Mo. 109, 220 S.W.2d 61 (1949)).

² Unless otherwise specified, all statutory references are to the Revised Statutes of Missouri (RSMo), revision of 2000.

³ Section 393.130, in pertinent part, requires a utility's charges to be "just and reasonable" and not in excess of charges allowed by law or by order of the commission. Section 393.140 authorizes the Commission to determine "just and reasonable" rates.

⁴ *St. ex rel. City of Harrisonville v. Pub. Serv. Comm'n of Missouri*, 291 Mo. 432, 236 S.W. 852 (1922); *City of Fulton v. Pub. Serv. Comm'n*, 275 Mo. 67, 204 S.W. 386 (1918), error dis'd, 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; *City of St. Louis v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 509, 207 S.W. 799 (1919); *Kansas City v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 539, 210 S.W. 381 (1919), error dis'd, 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348 (1951).

⁵ *St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n*, 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

⁶ *St. ex rel. Washington University et al. v. Pub. Serv. Comm'n*, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (Mo. banc 1925).

⁷ *Id.*

power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. * * * These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

The Commission's guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.⁸ "[T]he dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental."⁹ However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.¹⁰ "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."¹¹

The Commission has exclusive jurisdiction to establish public utility rates,¹² and the rates it sets have the force and effect of law.¹³ A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission;¹⁴ neither can a public utility change its rates without first seeking authority from the Commission.¹⁵ A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's.¹⁶ Thus, "[r]atemaking is a balancing process."¹⁷

Ratemaking involves two successive processes.¹⁸ First, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.¹⁹ The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers. Revenue

⁸ May Dep't Stores Co. v. Union Elec. Light & Power Co., 107 S.W.2d 41, 48 (Mo. App. 1937).

⁹ St. ex rel. Crown Coach Co. v. Pub. Serv. Comm'n, 179 S.W.2d 123, 126 (Mo. App. 1944).

¹⁰ St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n, 585 S.W.2d 41, 49 (Mo. banc 1979).

¹¹ St. ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

¹² May Dep't Stores, supra, 107 S.W.2d at 57.

¹³ Utility Consumers Council, supra, 585 S.W.2d at 49.

¹⁴ Id.

¹⁵ Deaconess Manor Ass'n v. Pub. Serv. Comm'n, 994 S.W.2d 602, 610 (Mo. App., W.D. 1999).

¹⁶ May Dep't Stores, supra, 107 S.W.2d at 50.

¹⁷ St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988).

¹⁸ Missouri recognizes two distinct ratemaking methods: the "file-and-suspend" method and the complaint method. The former is initiated when a utility files a tariff implementing a general rate increase and the second by the filing of a complaint alleging that the subject utility's rates are not just and reasonable. See *Utility Consumers Council, supra*, 585 S.W.2d at 48-49; *St. ex rel. Jackson County v. Pub. Serv. Comm'n*, 532 S.W.2d 20, 28-29 (Mo. banc 1975), *cert. denied*, 429 U.S. 822, 50 L.Ed.2d 84, 97 S.Ct. 73 (1976).

¹⁹ St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n, 850 S.W.2d 903, 916 n. 1 (Mo. App., W.D. 1993).

requirement is usually established based upon a historical test year that focuses on four factors:²⁰ (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.²¹ The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D) R$$

where: RR = Revenue Requirement;
 C = Prudent Operating Costs, including
 Depreciation Expense and Taxes;
 V = Gross Value of Utility Plant in Service;
 D = Accumulated Depreciation; and
 R = Overall Rate of Return or Weighted Cost
 of Capital.

The return on the rate base is calculated by applying a rate of return, that is, the Weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.²²

The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. Section 393.140(4) authorizes the Commission to prescribe uniform methods of accounting for utilities and Section 393.140(8) authorizes the Commission to examine a utility's books and records and, after hearing, to determine the accounting treatment of any particular transaction. In this way, the Commission can determine the utility's prudent operating costs. Section 393.230 authorizes the Commission to value the property of electric utilities operating in Missouri, that is, to determine the rate base.²³ Section 393.240 authorizes the Commission to set depreciation rates and to adjust a utility's depreciation reserve from time-to-time as may be necessary.

The Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a Rate of Return. For any utility, its fair Rate of Return is simply its composite cost of capital. The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the

²⁰ In the present case, the test year was established as the twelve months ending December 31, 2005, updated and adjusted for known and measurable changes through June 30, 2006. *In the Matter of the Tariff of Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P Increasing Rates for Service Provided to Customers in the Aquila Networks – MPS and Aquila Networks L&P Service Areas*, Case No. ER-2007-0004 (*Order Establishing Test Year and Deferring Decision on a True-up at 2.*)

²¹ *Id.*, citing Colton, "Excess Capacity: Who Gets the Charge From the Power Plant?," 34 *Hastings L.J.* 1133, 1134 & 1149-50 (1983).

²² See *St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n*, 765 SW2d at 622.

²³ Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."

cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

D. Section 386.266 Authorizations and Standard Pertaining to Fuel and Purchased Power Cost Recovery Mechanisms

Section 386.266.1, the statute that allows the Commission to establish a fuel adjustment clause, provides as follows:

Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation. The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.

Section 386.266.4, sets out some of the provisions that must be included in a fuel adjustment clause, and subsection 4(1) establishes the standard to be used in evaluating a fuel adjustment clause. Subsection 4 reads as follows:

The commission shall have the power to approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section only after providing the opportunity for a full hearing in a general rate proceeding, including a general rate proceeding initiated by complaint. **The commission may approve** such rate schedule after considering all relevant factors which may affect the cost or overall rates and charges of the corporation, **provided that it finds that the adjustment mechanism** set forth in the schedules:

(1) Is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity;

(2) Includes provisions for an annual true-up which shall accurately and appropriately remedy any over- or under-collections, including interest at the utility's short-term borrowing rate, through subsequent rate adjustments or refunds;

(3) In the case of an adjustment mechanism submitted under subsections 1 and 2 of this section, includes provisions requiring that the utility file a general rate case with the effective date of new rates to be no later than four years after the effective date of the commission order implementing the adjustment mechanism...case;

(4) In the case of an adjustment mechanism submitted under subsections 1 or 2 of this section, includes provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals, and shall require refund of any imprudently incurred costs plus

interest at the utility's short-term borrowing rate. (emphasis added).

As set out above, Section 386.266.4(1), states that to be approved by the Commission, any mechanism must be reasonably designed to help the company earn its allowed return on equity. The statute expressly allows the Commission to accept, reject or modify the mechanism; however, it does not allow the Commission to impose a different standard of review.

Further, Section, 386.226.7, provides the Commission may:

take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed rate of return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

Additionally, Subsection 9 of that statute requires the Commission to promulgate rules to "govern the structure, content and operation of such rate adjustments, and the procedure for the submission, frequency, examination, hearing and approval of such rate adjustments." In compliance with the requirements of the statute, the Commission promulgated Commission Rules 4 CSR 240-3.161 and 4 CSR 240-20.090, which establish in great detail the procedures for submission, approval, and implementation of a fuel adjustment clause. Finally, Subsection 9 specifically authorizes a utility to apply for a cost recovery mechanism under that section before the Commission had adopted those rules.

Commission Rule 4 CSR 240-20.090(4)(A) requires an electric utility with a fuel adjustment clause "to file one (1) mandatory adjustment to its FAC²⁴ in each true-up year coinciding with the true-up of its FAC." That section authorizes an electric utility with a fuel adjustment clause "to also file up to three (3) additional adjustments to its FAC within a true-up year. With the timing and number of such additional filings to be determined in the general rate proceeding establishing the FAC and in general rate proceedings thereafter."

Commission Rule 4 CSR 240-20.090(9) requires the rate design of any rate adjustment mechanism ("RAM") requested under 4 CSR 240-20.090 to "reflect differences in losses incurred in the delivery of electricity at different voltage levels for the electric utility's different rate classes." That section also requires an electric utility requesting a RAM to have "conducted a Missouri jurisdictional system loss study within twenty-four (24) months prior to the general rate proceeding in which it request its initial RAM." The Commission has authority to grant a waiver of any requirement contained in Commission Rule 4 CSR 240-20.090 pursuant to 4 CSR 240-20.090(15) which states: "Provisions of this rule may be waived by the commission for good cause shown after an opportunity for a hearing."

Commission Rule 4 CSR 240 3.161(2)(P) requires an electric utility requesting to establish a RAM as described in 4 CSR 240-20.090(2) to file, "a proposed schedule and testing plan with written procedures for heat rate tests . . . to determine the base level of efficiency for each of the units." The Commission has authority to grant a waiver of any requirement contained in Commission Rule 4 CSR

²⁴ As used in this Commission Rule, "FAC" is an acronym for fuel adjustment clause.

240-3.161 pursuant to 4 CSR 240-3.161(16) which states: "Provisions of this rule may be waived by the commission for good cause shown."

Although the term "good cause" is frequently used in the law,²⁵ the rule does not define it. Therefore, it is appropriate to resort to the dictionary to determine its ordinary meaning.²⁶ Good cause "generally means a substantial reason amounting in law to a legal excuse for failing to perform an act required by law," or to put it more concisely, a "[l]egally sufficient ground or reason."²⁷ Similarly, "good cause" has also been judicially defined as a "substantial reason or cause which would cause or justify the ordinary person to neglect one of his [legal] duties."²⁸ Of course, not just any cause or excuse will do. To constitute *good cause*, the reason or legal excuse given "must be real not imaginary, substantial not trifling, and reasonable not whimsical."²⁹ And some legitimate factual showing is required, not just the mere conclusion of a party or his attorney.³⁰ Moreover, a finding of good cause "lies largely in the discretion of the officer or court to which the decision is committed" and "depends upon the circumstances of the individual."³¹

E. Authority to Issue an Accounting Authority Order

The Court of Appeals has held that the Commission has the regulatory authority to grant a form of relief to a utility in the form of an accounting technique, an AAO.³² An AAO allows a utility to defer and capitalize certain expenses until the time it files its next rate case, and it protects the utility from earnings shortfalls and softens the blow which results from extraordinary construction programs.³³

F. Overview

1. Aquila's Proposed General Rate Increase

As filed, Aquila's proposed tariffs sought additional gross annual Missouri jurisdictional revenue of approximately \$94.5 million annually in Aquila's MPS

²⁵ *State v. Davis*, 469 S.W.2d 1, 5 (Mo. 1971).

²⁶ See *State ex rel. Hall v. Wolf*, 710 S.W.2d 302, 303 (Mo. App. E.D. 1986) (in absence of legislative definition, court used dictionary to ascertain the ordinary meaning of the term "good cause" as used in a Missouri statute); *Davis*, 469 S.W.2d at 4-5 (same).

²⁷ Black's Law Dictionary 692 (6th ed. 1990).

²⁸ *Graham v. State*, 134 N.W. 249, 250 (Neb. 1912). Missouri appellate courts have also recognized and applied an objective "ordinary person" standard. See, e.g., *Cent. Mo. Paving Co. v. Labor & Indus. Relations Comm'n*, 575 S.W.2d 889, 892 (Mo. App. W.D. 1978) ("[T]he standard by which good cause is measured is one of reasonableness as applied to the average man or woman.") *Id.*

²⁹ *Belle State Bank v. Indus. Comm'n*, 547 S.W.2d 841, 846 (Mo. App. S.D. 1977). See also *Barclay White Co. v. Unemployment Compensation Bd.*, 50 A.2d 336, 339 (Pa. 1947) (to show good cause, reason given must be real, substantial, and reasonable). *Id.*

³⁰ See generally *Haynes v. Williams*, 522 S.W.2d 623, 627 (Mo. App. E.D. 1975); *Havrisko v. U.S.*, 68 F.Supp. 771, 772 (E.D.N.Y. 1946); *The Kegums*, 73 F.Supp. 831, 832 (S.D.N.Y. 1947).

³¹ *Wilson v. Morris*, 369 S.W.2d 402, 407 (Mo. 1963); *Matter of Seiser*, 604 S.W.2d 644, 646 (Mo. App. E.D. 1980).

³² *Missouri Gas Energy v. Public Service Commission State of Missouri*, 978 S.W.2d 434 (Mo. App. 1998).

³³ *Id.*

operating division and \$24.4 million annually in Aquila's L&P operating division, or a 22% and 22.1% increase respectively. Aquila currently serves approximately 235,763 customers in its MPS service territory and approximately 65,313 customers in its L&P service territory.

2. Aquila's Operations

Based in Kansas City, Missouri, Aquila is an investor-owned utility providing retail electric service to 1 million customers in Missouri, Kansas, Colorado, Iowa and Nebraska. Aquila provides retail electric service to customers in Missouri in and about Kansas City and St. Joseph, Missouri under the names Aquila Networks-MPS and Aquila Networks-L&P, respectively. As of December 31, 2005, Aquila had 204,506 residential electric customers, 28,431 small general service customers, 1,199 large general service customers, 155 large power service customers, and 1,472 lights customers in 235 communities in 34 counties.

3. The Other Parties

Intervenor SIEUA is an unincorporated voluntary association consisting of large commercial and industrial users of natural gas and electricity in and around Sedalia, Missouri.

Intervenor AG Processing, Inc., operates a processing facility in St. Joseph, Missouri, and is a large industrial customer of Aquila.

Intervenor St. Joseph, Missouri, is a municipality of the State of Missouri and its residents and commercial interests are customers of Aquila. St. Joseph is also a large consumer of energy supplied by Aquila.

Intervenor Kansas City, Missouri, is a municipality of the State of Missouri and its residents and commercial interests are customers of Aquila. Kansas City is also a large consumer of energy supplied by Aquila.

Intervenor AmerenUE is a regulated electric and gas utility that operates in Missouri and elsewhere.

Intervenor AARP is a nonprofit, nonpartisan membership organization that advocates for people who are 50 years of age or older. AARP has members in Missouri who receive electric service from Aquila and will be affected by the outcome of this case.

Intervenor the Federal Executive Agencies' members include the United States Department of Defense, the United States Department of Energy, and other Federal Executive Agencies, which have offices, facilities or installations in the service territory of Aquila and which purchase utility service from Aquila.

Intervenor the Commercial Group's members are JCPenney Corporation, Inc., Lowe's Home Centers, Inc., and Wal-Mart Stores East, LP.

Intervenor Jackson County, Missouri is a political subdivision of the State of Missouri and its residents and commercial interests are customers of Aquila. Jackson County is also a large consumer of energy supplied by Aquila.

The Missouri Department of Natural Resources ("DNR") is an executive branch department authorized and established by Chapter 640, RSMo. Sections 640.150

through 640.185 charge the Department with certain responsibilities with respect to energy.

The Public Counsel (“OPC”) is appointed by the Director of the Missouri Department of Economic Development and is authorized to “represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]”³⁴

The Staff of the Commission traditionally appears as a party in Commission proceedings and is represented by the Commission’s General Counsel, an employee of the Commission authorized by statute to “represent and appear for the Commission in all actions and proceedings involving this or any other law [involving the Commission.]”³⁵

G. The Issues

As required by the procedural schedule, the parties jointly filed a list of issues to be determined by the Commission. The parties also filed prehearing briefs setting out their positions and arguments with respect to each issue. In setting out the issues developed by the parties and the parties’ stated positions on those issues, the Commission seeks only to inform the reader of these items. The parties’ framing of the issues may not accurately reflect the material issues under the applicable statutes and rules. Those issues, as formulated by the parties, are fully recited at the beginning of the discussion of each issue, and are set forth below.³⁶

1. Proposed Fuel Adjustment Clause:

- A. Should the Commission authorize Aquila to use a fuel and purchased power recovery mechanism allowed by 4 CSR 240.20.090?
 - i. What standard should the Commission use in determining whether to allow Aquila to use a fuel and purchased power adjustment mechanism?
 - ii. What portion of fuel and purchased power costs should be recovered by a recovery mechanism rather than by base rates?
 - iii. Should a fuel and purchased power adjustment mechanism include recovery of any demand charges?
 - iv. Should a fuel and purchased power adjustment mechanism require definitive production standards for recovery of fuel and purchased power costs via the mechanism?
 - a. Proposed Adjustment Clause: If the Commission authorized Aquila to use a fuel adjustment clause, how should it be structured?
 - i. What recovery period should be used in the fuel adjustment clause?

³⁴ Sections 386.700 and 386.710.

³⁵ Section 386.071.

³⁶ Only the issues and sub-issues not resolved by the two unanimous stipulations are shown. The numbering of the issues is unchanged from the original list. The parties’ positions on the issues are discussed, to the extent necessary, elsewhere in this order.

- ii. What line losses adjustment should be included in determining the fuel cost adjustment?
 - iii. How often should the fuel adjustment clause be adjusted?
 - iv. Should the fuel adjustment require a phase-in (cap) for sharp changes in fuel or purchased power costs?
 - v. What heat rate testing of generation plants should be conducted?
- b. Interim Energy Charge: If the Commission authorizes Aquila to use an interim energy charge, how should it be structured?
- i. What natural gas costs/prices should be included in the charge?
 - ii. What coal costs/prices should be included in the charge?
 - iii. What purchased power costs/prices should be included in the charge?
 - iv. Should the interim energy charge be established and true-up on a divisional basis (for MPE and for L&P separately) or on a unified basis (MPS and L&P combined)?
 - v. Additional items to consider include treatment of off-system sales and hedging program cost/benefits.

As outlined by the parties, this issue appears very complicated. However, there are actually only three primary questions for the Commission to decide:

- a. Should the Commission authorize Aquila to use a fuel adjustment mechanism to address its fuel and purchased power costs as provided for under Section 386.266 RSMo?
- b. If a fuel adjustment mechanism is appropriate, should the Commission authorize Aquila to implement an interim energy charge or a fuel adjustment clause?
- c. How should any authorized interim energy charge or fuel adjustment clause be constructed?

Therefore, this Order will address these three issues, together with their attendant sub-issues that also must be decided, as restated. All of the issues and subissues pertaining to the establishment of a fuel adjustment clause are contained within these three restated issues.

As noted earlier in this Report and Order, the rates Aquila will be allowed to charge its customers are based on a determination of the company's revenue requirement. Aquila's revenue requirement is the sum of operating and maintenance expenses, depreciation expenses, taxes, and a reasonable return on the net value of property used and useful in serving its customers.³⁷ A revenue requirement is based on the costs and income the company experienced during a historical test year. For this case, the test year was established as 12-month period ending December 31, 2005, adjusted and updated for any known and measurable

³⁷ Parcell Direct, Ex. 221, Page 5, lines 10-14.

changes through June 30, 2006. The Commission will use the expenses and revenues measured during the test year to predict the expenses the company will be allowed to recover in future rates. Expenses that may be incurred in the future generally are not included in the rate calculations.

Under traditional rate-making procedures, at the end of the rate case the Commission establishes the rates an electric utility can charge. Once rates are established, the utility cannot change those rates without filing a new rate case and restarting the review process. However, in 2005, the Missouri legislature passed a law allowing the Commission to establish a mechanism for an electric utility to make periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs.³⁸ The sort of mechanism envisioned by the statute is generally known as a fuel adjustment clause.

Section 386.266.7 provides that the Commission may:

take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed rate of return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

Subsection (9) required the Commission to promulgate rules to "govern the structure, content and operation of such rate adjustments, and the procedure for the submission, frequency, examination, hearing and approval of such rate adjustments." In compliance with the requirements of the statute, the Commission promulgated Commission Rule 4 CSR 240-3.161, which establishes in great detail the procedures for submission, approval, and implementation of a fuel adjustment clause.

a. Should the Commission authorize Aquila to use a fuel adjustment mechanism to address its fuel and purchased power costs as provided for under Section 386.266 RSMo?

i. Sufficiency of Aquila's Filed Request. In his prefiled direct testimony, Public Counsel witness Ryan Kind indicated he could not locate information required by several sections of 4 CSR 240-3.161(2) in Aquila's fuel adjustment clause filing.³⁹ Mr. Kind did not identify what specific information he believed was missing from the filing, or what additional information Aquila needed to file to comply with that rule. Instead, Mr. Kind criticized Aquila for failing to include with its fuel adjustment clause filing a guide to the information that was responsive to each of the pertinent filing requirements.⁴⁰

In response to a Public Counsel data request, Aquila provided to all parties a guide identifying the location in Aquila's direct testimony where the information required by each section of the Commission rules is located.⁴¹ Following receipt of

³⁸ Section 386.266, RSMo (2006 Cum. Supp.).

³⁹ Kind Direct, Ex. 401, pages 15 – 16.

⁴⁰ *Id.*

⁴¹ Williams Rebuttal, Ex. 33, page 8, line 21 to page 9, line 4.

that guide, Mr. Kind filed his rebuttal testimony in which he did not indicate that he continued to find Aquila's fuel adjustment clause filing was deficient for failure to comply with any statutory requirement or Commission Rule.⁴² Under cross-examination, Mr. Kind again alleged that Aquila's initial fuel adjustment clause filing was deficient in that it failed to comply with 4 CSR 240-3.161(2)(O), (Q) and (R).⁴³ However, Public Counsel does not argue in either its Prehearing or Posthearing brief that Aquila's fuel adjustment clause filing was, or continues to be, deficient as to any Commission Rule.

In their Post Hearing Brief, SIEUA and AG-P allege Aquila failed to comply with 4 CSR 240-3.161(H) in that its fuel adjustment clause filing lacked a "complete explanation of all costs that shall be considered for recovery" under the proposed fuel adjustment clause.⁴⁴

Findings of Fact: The Commission finds the testimony of Aquila witnesses Dennis Williams and H. Davis Rooney contains all the information required by each of the three provisions challenged by Public Counsel.⁴⁵ Further, no witness, aside from Mr. Kind, suggested Aquila's fuel adjustment clause filing failed to comply with any of these three provisions. The Commission finds Aquila's fuel adjustment clause filing complies with 4 CSR 240-3.161(2)(O), (Q) and (R).

While the Commission may not agree that all items Aquila seeks to flow through its proposed fuel adjustment clause are appropriate, the Commission finds Aquila's proposed fuel adjustment clause tariff contains a very thorough explanation of all costs Aquila seeks authority to flow through its proposed fuel adjustment clause. Consequently, Aquila also meets the filing requirements of 4 CSR 240-3.161(H).⁴⁶

Conclusions of Law: Based upon its review of Aquila's fuel adjustment clause filing and the evidence presented in this case, the Commission concludes that Aquila's fuel adjustment clause filing complies with all applicable statutory requirements and Commission Rules, except: 1) 4 CSR 240-20.090(9), which requires line loss factors to be included in any fuel adjustment clause filing and requires a utility to have conducted a line loss study within twenty-four months of making a fuel adjustment clause filing; and 2) 4 CSR 240-3.161(2)(P), which requires an electric utility filing to establish a RAM as described in 4 CSR 240-20.090(2) to file "a proposed schedule and testing plan with written procedures for heat rate tests."

ii. Appropriateness of a Waiver of 4 CSR 240-20.090(9). Section 386.266(9) specifically authorizes an electric utility to apply for a cost recovery mechanism under that section before the Commission had promulgated its rules pertaining to fuel and purchased power cost recovery mechanism. The draft rules under consideration at the time of Aquila's filing made recognition of line losses in

⁴² Kind Direct, Ex. 401, pages 15-16.

⁴³ Tr. pages 901- 902, and pages 927- 928.

⁴⁴ Post Hearing Brief of Sedalia Industrial Energy Users Association and AG Processing, Inc., pages 55 – 56.

⁴⁵ Rooney Direct, Ex. 23, page 27, line 1 to page 29, line 14; Williams Direct, Ex. 32, page 3, line 10 to page 11, line 5 and Sch. DRW-1; Williams Rebuttal, Ex. 33, page 8, line 19 to page 9, line 4. See also: 4 CSR 240-3.161(2)(O), (Q) and (R).

⁴⁶ Aquila's Proposed electric tariffs, P.S.C. MO. No. 1 Original Sheet Nos. 124 and 125, part of the original tariff filing on July 3, 2006, that resulted in the establishment of this case.

the fuel adjustment clause optional;⁴⁷ however, the rules as finally adopted made recognition of the line losses mandatory.⁴⁸

The issue of Aquila's failure to include appropriate line loss factors, and what line loss factors Aquila should have included in its fuel adjustment clause filing, were raised and addressed by the parties in prefiled testimony,⁴⁹ during the evidentiary hearing,⁵⁰ and in prehearing and posthearing briefs. In his direct testimony, SIEUA, AG-P, and FEA witness Maurice Brubaker noted Aquila's failure to include line loss factors in its fuel adjustment clause filing and testified as to what factors should have been used.⁵¹ After reviewing Mr. Brubaker's testimony, Aquila witness Dennis Williams agreed that based upon the language contained in 4 CSR 240-20.090(9), as ultimately adopted by the Commission, the line loss factors proposed by Mr. Brubaker should be included in Aquila's fuel adjustment clause filing.⁵²

The line loss factors proposed by Mr. Brubaker and agreed to by Aquila are based upon Aquila's most recent line loss study, which was completed in 2002. Two parties have objected to using the 2002 line loss factors because they are based upon a line loss study conducted more than twenty-four months before Aquila's fuel adjustment clause filing. However, those two parties, SIEUA and AG-P, are also the very parties whose witness recommended the using the line loss factors from the 2002 study.

In the Stipulation and Agreement as to Certain Issues, Aquila's fuel and purchased power cost was set at approximately \$200,000,000 for a test year ending December 2005, updated for known and measurable changes through June 30, 2006. Aquila has experienced an increase in its fuel and purchased power cost of between 13 and 20% annually for each of the last 3 years.⁵³ Based upon evidence presented to the Commission in this case, there is strong reason to believe this trend will continue.⁵⁴ If fuel and purchased power costs increase by 15% annually, absent some type of cost adjustment mechanism, Aquila would under recover its prudently incurred fuel and purchased power costs by approximately \$30,000,000 in the 12 months following the conclusion of this case, and as much as \$90,000,000 over the next 24 months.⁵⁵ This likely scenario would result in Aquila losing an unconscionable amount of money where no party was prejudiced by Aquila's failure to comply with a technicality of a Commission rule.

Accordingly, good cause exists to grant Aquila a waiver, as provided for under 4 CSR 240-20.090(15), from the following requirements contained in 4 CSR 240-20.090(9): 1) the requirement to include line loss factors in its original fuel adjustment clause filing, and 2) the requirement to include line loss factors in its fuel

⁴⁷ July 17, 2006 Missouri Register, Vol. 31, No. 14, page 1078.

⁴⁸ Final Order of Rulemaking in Case No. EX-2006-0472 (4 CSR 240-20.090) pages 6-7.

⁴⁹ Brubaker Direct (Rate Design), Ex. 501, pages 3-6; Williams Surrebuttal, Ex. 34, page 7.

⁵⁰ Tr. pages 623 and 647.

⁵¹ Brubaker Direct (Rate Design), Ex. 501, pages 3-6.

⁵² Williams Surrebuttal, Ex. 34, page 7.

⁵³ Tr. page 782

⁵⁴ Featherstone Direct, Ex. 206, pages 8-9; Tr. pages 920-922 and 941, Aquila Net, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P 2005 Form 10-K Report.

⁵⁵ *Id.*

adjustment clause that are based upon a line loss study completed within twenty-four months of that fuel adjustment clause filing.

The question then becomes what line loss factors should be included in any fuel adjustment clause mechanism approved by the Commission. No party offered testimony suggesting the line loss factors proposed by Mr. Brubaker and taken from Aquila's 2002 line loss study were inappropriate. The line loss factors recommended by Mr. Brubaker are reasonable and should be included in any cost adjustment mechanism authorized for Aquila.

Findings of Fact: Aquila's failure to include sufficient and appropriate line loss factors was sufficiently addressed in the record, as noted above. The Commission finds Aquila's failure to have conducted a line loss study within twenty-four months of filing a request for a fuel adjustment clause, and its failure to include line loss factors in its original filing were reasonable, given that the draft rule in place when Aquila made that filing did not require line loss factors. Further, the Commission finds no party was prejudiced by Aquila's failure to have conducted a line loss study within twenty-four months of filing a request for a fuel adjustment clause, and its failure to include line loss factors in its original filing. Further, the Commission finds rejecting Aquila's fuel adjustment clause request based upon a marginal filing oversight unconscionable, because, as addressed above, it would likely cause Aquila to lose a significant amount of money. Accordingly, the Commission finds good cause exists to grant Aquila a waiver, as provided for under 4 CSR 240-20.090(15), from the following requirements contained in 4 CSR 240-20.090(9): 1) the requirement to include line loss factors in its original fuel adjustment clause filing, and 2) the requirement to include line loss factors in its fuel adjustment clause that are based upon a line loss study completed within twenty-four months of that fuel adjustment clause filing.

Having reviewed Mr. Brubaker's proposal, the Commission finds the line loss factors recommended by Mr. Brubaker are reasonable and should be included in any cost adjustment mechanism authorized for Aquila.

Conclusions of Law: Although the Commission had not yet adopted final rules governing fuel adjustment clauses when Aquila filed its rate case in July of 2006, Aquila's inclusion of a fuel adjustment clause request under Section 386.266 RSMo (Cum. Supp. 2006)⁵⁶ was appropriate. As noted above, Section 386.266(9) specifically permitted such an application prior to the promulgation of final rules. The Commission concludes Aquila's waiver request meets the standards under 4 CSR 240-20.090(15) for good cause and permits it to waive both the requirement to include line loss factors in its original fuel adjustment clause filing, and the requirement to include line loss factors based upon a line loss study completed within twenty-four months of that fuel adjustment clause filing.

The Commission concludes the line loss factors recommended by Mr. Brubaker may lawfully be used in any cost adjustment mechanism authorized for Aquila. Aquila is still subject to all other requirements contained in 4 CSR 240-20.090(9).

iii. Appropriateness of a Waiver of 4 CSR 240-3.161(2)(P). Commission Rule 4 CSR 240 3.161(2)(P) requires an electric utility seeking to establish a RAM as described in 4 CSR 240-20.090(2) to file "a proposed schedule and testing plan with

⁵⁶ All references to Section 386.266 are to the 2006 Cumulative Supplement unless otherwise noted.

written procedures for heat rate tests . . . to determine the base level of efficiency for each of the units.” As part of its fuel adjustment clause filing, Aquila included a schedule for heat rate and/or efficiency testing that identified, but did not set out in written detail, testing procedures. Under Aquila’s proposal, testing would be conducted in accordance with Southwest Power Pool (SPP) criteria – specifically, Section 12.1 – Electrical Facility Ratings.⁵⁷

Staff witness Michael Taylor testified that Aquila provided Staff with additional details concerning the SPP rating testing procedures in response to a data request.⁵⁸ Mr. Taylor further testified that he did not believe the SPP procedures identified by Aquila would satisfy the requirements of the applicable rule, in that they would not yield meaningful conclusions regarding the heat rates and/or efficiency of Aquila’s generating plants.⁵⁹ Mr. Taylor then suggested several alternate sources for testing procedures.⁶⁰ No witnesses aside from Aquila witness Mr. Rooney and Staff witness Mr. Taylor provided testimony on this issue.

During the evidentiary hearing Staff and Aquila offered Exhibit 242, which was admitted into evidence. Exhibit 242 set out a proposed resolution to Staff’s heat rate and/or efficiency testing concerns that was agreeable to Staff and Aquila (242 Proposal). Under the 242 Proposal, if the Commission authorizes a RAM, Aquila must complete a proposed heat rate and/or efficiency schedule and a proposed testing plan with written procedures as described in 4 CSR 240-3.161(2)(P) that are agreeable to all parties to this case. The 242 Proposal would also require Aquila to have that plan completed no less than sixty days before the effective date of a tariff filing seeking a rate adjustment under a fuel adjustment clause or the filing of its initial application for a true-up an interim energy charge.⁶¹

SIEUA and AG-P also argue that Aquila’s fuel adjustment clause filing should be rejected for failure to comply with 4 CSR 240-3.161(2)(P).⁶² Their argument is based solely upon Staff witness Mr. Taylor’s analysis of Aquila’s filing. In their Post Hearing Brief SIEUA and AG-P decline to address or even acknowledge the 242 Proposal, which alleviated Mr. Taylor’s concerns.

Findings of Fact: Having reviewed the arguments and evidence presented by each witness, the Commission finds Aquila made a good faith effort to comply with the requirements of 4 CSR 240-3.161(2)(P). Further, as set out above, the Commission finds Aquila would likely experience significant financial hardship if the Commission rejected its fuel adjustment clause based upon a filing oversight. Accordingly, the Commission finds good cause exists to grant Aquila a waiver of that provision, as provided for under 4 CSR 240-3.161(16).

The Commission further finds the 242 Proposal to be reasonable with one exception. The Commission does not believe it is appropriate to require the written procedures to be agreed to by all non-Aquila parties to ER-2007-0004, given that parties who believe a RAM is never appropriate could block adjustments under an approved RAM by opposing even reasonable procedures.

⁵⁷ Rooney Direct, Ex. 24, page 27, lines 3-11.

⁵⁸ Taylor Rebuttal, Ex. 227, page 3, line 4 to page 4, line 2.

⁵⁹ *Id.* at pages 5-6.

⁶⁰ *Id.*

⁶¹ Ex. 242.

⁶² Post Hearing Brief of Sedalia Industrial Energy Users Association and AG Processing, Inc., pages 54 - 55.

Conclusions of Law: Commission Rule 4 CSR 240 3.161(2)(P) requires an electric utility seeking to establish a RAM as described in 4 CSR 240-20.090(2) to file "a proposed schedule and testing plan with written procedures for heat rate tests . . . to determine the base level of efficiency for each of the units." Accordingly, the Commission finds good cause exists to grant Aquila a waiver of that provision, as provided for under 4 CSR 240-3.161(16).

In light of the concerns noted above, the Commission concludes it is reasonably necessary to require, in connection with the establishment of a rate adjustment mechanism, that Aquila develop a heat rate and/or efficiency testing schedule and plan under the terms set out in Exhibit 242, with the following conditions. First, in the event any party to ER-2007-0004 opposes the written heat rate and/or efficiency testing procedures ultimately proposed by Aquila, Aquila may file a motion with the Commission seeking approval of those procedures. Second, Aquila must have finalized procedures that are either agreed to by the parties, or approved by the Commission, in place no less than sixty days before the effective date listed on the tariff for Aquila's initial fuel adjustment clause adjustment filing.

iv. Determining Whether a Fuel Cost Adjustment Mechanism is Appropriate. Aquila has requested a fuel adjustment clause in this rate case and has modified the details of its proposed fuel adjustment clause several times during the course of this proceeding in response to concerns expressed by various parties. The details of the fuel adjustment clause Aquila asks the Commission to approve are found in the surrebuttal testimony of Dennis R. Williams,⁶³ as modified by further concessions set out in Aquila's Post Hearing Brief at pages 43 to 47. The fuel adjustment clause Aquila proposes would net 100% of off-system sales revenue against fuel and purchased power costs. In other words, offsystem sales revenue increases would offset rising fuel and purchased power costs. The proposed fuel adjustment clause would spread recovery or return of over or undercollections over a subsequent 12-month period, and no more than two to four fuel adjustment clause rate adjustments would be allowed per true-up year. Only fluctuations in actual fuel costs, fuel transportation costs, and purchase power costs would be flowed through the proposed fuel adjustment clause. The fuel adjustment clause would also contain provisions for heat rate testing and line loss factors.

While Section 386.266 allows the Commission to approve a fuel adjustment clause,⁶⁴ the statute does not **require** the Commission approve a fuel adjustment clause. Instead, it specifically gives the Commission authority to **accept, reject or modify** a proposed fuel adjustment clause after giving an opportunity for a full hearing in a general rate case.⁶⁵ The statute does not, however, provide specific guidance on when a fuel adjustment clause should be approved, other than requiring them to be reasonably designed to allow the utility a reasonable opportunity to earn its allowed return on equity.

While Missouri has not allowed electric utilities to use a fuel adjustment clause since 1979, fuel adjustment clauses are common in other states. In fact, other than

⁶³ D. Williams Surrebuttal, Ex. 34, page 6, line 10 to page 9 line 22, and Sch. DRW-1.

⁶⁴ Section 386.266, in effect overturns a 1979 Missouri Supreme Court decision finding the Missouri Commission did not have statutory authority to authorize a fuel adjustment clause for residential customers. *State ex rel. Utility Consumers Council of Mo., Inc.*, 585 S.W.2d, at 49.

⁶⁵ Section 386.266.4, RSMo (Cum. Supp. 2006).

Missouri, all but two of the 29 non-restructured states without retail competition allow their electric utilities to apply to recover fuel and purchased power costs through some type of fuel adjustment clause.⁶⁶ Therefore, other states' experiences with fuel adjustment clauses can be instructive for this Commission in making its decision whether to grant Aquila's request for a fuel adjustment clause.

Several parties proposed financial standards that a company should have to meet before any cost recovery mechanism would be authorized. Aquila argues that if its fuel adjustment clause filing meets the mechanical filing requirements of Section 386.266 RSMo and Commission Rules 4 CSR 240-20.090 and 4 CSR 240-3.161(2)(A) through (S), it should be approved. As addressed above, the Commission found Aquila's fuel adjustment clause filing complies with all applicable statutory requirements and Commission Rules, except specific provisions of: 1) 4 CSR 240-20.090(9) and 2) 4 CSR 240-3.161(2)(P) from which the Commission herein grants Aquila waivers. However, in making a determination as to the appropriateness of authorizing a cost recovery mechanism, the Commission must weigh many factors, including the standard for review contained in Section 386.266.

As addressed above, in addition to setting out basic requirements for inclusion in any authorized cost adjustment mechanism, Section 386.266.4 sets out the following standard for the Commission to use when evaluating a cost recovery mechanism:

4. The commission shall have the power to approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section . . . The commission may approve such rate schedules after considering all relevant factors which may affect the costs or overall rates and charges of the corporation, **provided that it find that the adjustment mechanism set forth in the schedules:**

(1) Is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity.
(emphasis added)

Public Counsel Witness Ryan Kind argued a cost recovery mechanism should not be approved absent a showing the company faces a "substantial threat to its financial viability if it did not have a fuel adjustment clause in effect that would recover some or all of the increased costs of fuel and purchased power in between rate cases."⁶⁷ Mr. Kind gives no indication what would constitute a sufficient threat. As set out in detail above, the evidence in this case supports a conclusion Aquila will likely under recover tens of millions of dollars without a RAM. The Commission is not sure if that would qualify as a "substantial threat to financial viability" under Mr. Kind's analysis, but it illustrates that Mr. Kind's analysis is unduly burdensome, vague and should be rejected.

Further, the Commission considered and dismissed similar arguments for an earnings threshold for eligibility to use a cost recovery mechanism in the formal rulemaking docket for 4 CSR 240-20.090. Specifically, the Commission found "an earnings threshold for eligibility to use a RAM is contrary to the intent of the legislature, as articulated in SB 179."⁶⁸ Therefore, no such eligibility criteria will be

⁶⁶ Tr. p. 818, lines 16 – 23.

⁶⁷ Kind Direct, Ex. 401, page 3, line 17 to page 15, line 3.

⁶⁸ SB 179 has been codified at Section 386.266 RSMo (Cum. Supp. 2006).

included in the rule.”⁶⁹ Mr. Kind’s proposed standard is contrary to the standard for approval contained in Section 386.266.4(1), which requires that for the Commission to approve an adjustment mechanism it must be “reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity.”

SIEUA, AG-P and FEA witness Donald Johnstone argued the Commission should not authorize a fuel adjustment clause for a utility absent a showing of “acute need,” which he defined as requiring “a substantial financial need must be shown by the utility.”⁷⁰ Mr. Johnstone further stated that for any fuel adjustment clause “to be approved, there ought to be more than a mere convenience to the utility.”⁷¹ Mr. Johnstone further suggested the negative effects on customers must be weighed against the benefit to the company.

The Commission agrees a fuel adjustment clause should not be authorized for the mere “convenience” of a utility. However, Mr. Johnstone’s “acute need” standard is too vague to be useful in evaluating a fuel adjustment clause request. Like Public Counsel’s “substantial threat to its financial viability” standard, Mr. Johnstone’s “acute need” standard is contrary to both the intent of the legislature in passing Section 386.266 RSMo, and the approval standard contained in Subsection 386.266.4(1).

Nancy Brockway, an independent consultant who appeared as a witness for AARP, testified that she served as a Commissioner on the New Hampshire Public Utilities Commission from 1998 to 2003, as a senior staff member of the Maine Public Utilities Commission from 1983 to 1986, and as a hearing officer and General Counsel for the then-Massachusetts Department of Public Utilities from 1986 to 1991. Since leaving the New Hampshire Commission in 2003, Ms. Brockway has provided consulting services to many different groups and testified before a wide variety of state, federal and international agencies and groups on a wide variety of issues. Ms. Brockway further testified that as a staff advocate, hearing officer and Commissioner, she participated in numerous fuel adjustment clause proceedings, and has provided testimony on the potential problems associated with a fuel adjustment clause.⁷²

Ms. Brockway testified a cost adjustment mechanism should only be used for utility costs that meet the following three qualifications:

1. They represent a significant portion of a utility’s costs;
2. they fluctuate significantly; and
3. the costs are outside the utility’s control.⁷³

Ms. Brockway supported the use of these criteria based upon her experience with fuel adjustment clauses as a former Commissioner, hearing officer and staff advocate.

The qualifications, or criteria, proposed by Ms. Brockway appear to be well accepted in the regulatory community, and are similar to the criteria presented to the Commission in Union Electric Company, d/b/a AmerenUE’s pending rate case.⁷⁴

⁶⁹ Final Order of Rulemaking, Case No. EX-2006-0472 (September 21, 2006).

⁷⁰ Johnstone Rebuttal, Ex. 505, p. 9, lines 12 – 15.

⁷¹ *Id.*

⁷² Brockway Surrebuttal, Ex. 601, page 3, line 28 to page 4, line 9.

⁷³ Brockway Surrebuttal, Ex. 601, page 4, lines 13 through 27, adopting the Direct Testimony of Ronald Binz, Binz Direct, Ex. 600, page 6, lines 21-25.

⁷⁴ See: Case No. ER-2007-0002, Ex. 502, Direct Testimony of Michael L. Brosch, p. 16, lines 3-16.

Further, while Aquila's witnesses challenged the standards and requirements for fuel adjustment clause approval suggested by other witnesses, they did not challenge the validity of the criteria presented by Ms. Brockway. Rather, Aquila contends its proposed fuel adjustment clause meets those criteria.

Brockway's first criterion is whether fuel and purchased power represent a significant portion of a utility's costs. Fuel and purchased power expense is the largest item of expense Aquila incurs, comprising approximately 46% of the company's total operation and maintenance expense.⁷⁵ No party disputed these figures. Clearly, Aquila's fuel and purchased power expenses are substantial and meet the first criterion.

The second criterion described by Brockway is that the costs to be tracked must fluctuate significantly, in other words, they must be volatile. Aquila was able to demonstrate its fuel costs will likely be increasing in coming years. No party challenged Aquila's contention that its fuel costs have increased between 13% and 20% annually for each of the past three years, or that its fuel costs are likely to continue to increase into the future.⁷⁶ Further, unlike many companies, Aquila does not have contracts in place to cover the bulk of its future fuel and purchased power needs.⁷⁷

Staff witness Cary Featherstone, who has been a Staff utility auditor for twenty-seven years and has testified in dozens of Commission cases,⁷⁸ testified high volatility has characterized the purchased power and natural gas markets in recent years, combined with Aquila's heavy reliance on both purchased power and gas-fired generation, make it very difficult to predict with a reasonable degree of certainty fuel costs for Aquila using either historical or forecasted levels.⁷⁹ Aquila's fuel and purchased power expenses have been and are likely to continue to be volatile and meet the second criterion.

The third criterion is whether the costs are outside the utility's control. The cost items that would be tracked in a fuel adjustment clause are coal, coal transportation, natural gas, oil, nuclear fuel, and purchased power. Aquila generates its electricity from natural gas and coal-fired power plants,⁸⁰ and also utilizes a large amount of purchased power.⁸¹ The price of natural gas, coal, and railroad freight rates to transport that coal are established by national, and in some cases, international markets. Aquila does not have control over those prices. Similarly, Aquila does not have control over the prices it must pay for purchased power.

When a utility's fuel and purchased power costs are oscillating in that way, the time consuming rate-making process cannot possibly keep up with the swings. Further, rate cases are difficult and expensive endeavors for the Commission and intervening parties, as well as for the utility. As a result, in those circumstances a fuel adjustment clause may be needed to protect both the utility and its ratepayers from inappropriately low or high rates.

⁷⁵ D. Williams Surrebuttal, Ex. 34, page 5, lines 3 – 7.

⁷⁶ *Id.* at page 6, lines 3-8.

⁷⁷ Tr. p. 656 lines 13-17, Tr. p. 659 lines 13-18, and Ex. 415.

⁷⁸ Featherstone Direct, Ex. 206, Schedule CGF 1.

⁷⁹ Featherstone Direct, Ex. 206, p. 20, lines 1 – 13.

⁸⁰ Neff Direct, Ex. 14, Page 3, Lines 14-15.

⁸¹ Stipulation and Agreement as to Certain Issues, Schedule 3.

Findings of Fact: The Commission finds Public Counsel's criteria of showing a "substantial threat to its financial viability if it did not have a fuel adjustment clause in effect that would recover some or all of the increased costs of fuel and purchased power in between rate cases," unreasonable, unduly burdensome and overly vague.

The Commission finds that a fuel adjustment clause should not be authorized for the mere "convenience" of a utility, but finds that the higher standard of "acute need" is unreasonable and overly vague.

The Commission finds the criteria proposed by Ms. Brockway to be reasonable. The Commission finds Aquila's proposed fuel adjustment mechanism meets all three criteria, as more fully discussed above.

After carefully considering the evidence and arguments of the parties, balancing the interests of ratepayers and shareholders, based on the evidence presented at this hearing and on the Commission's evaluation of Aquila's situation as it currently exists, the Commission finds a RAM is appropriate to address Aquila's fuel and purchased power costs in this proceeding. The Commission cannot, however, guarantee that Aquila's circumstances will justify its continued appropriateness in any future rate proceeding.

Conclusions of Law: The new statute (section 386.266) allows the Commission to approve a fuel adjustment clause. The statute does not require that the Commission approve a fuel adjustment clause. Instead, it specifically gives the Commission authority to accept, reject or modify a proposed fuel adjustment clause after giving an opportunity for a full hearing in a general rate case. Having considered Aquila's request after hearing, the Commission concludes "that an earnings threshold for eligibility to use a RAM is contrary to the intent of the legislature, as articulated in SB 179."⁸² As such, the Commission concludes Aquila has met the requirements of section 386.266, and it would be reasonable and in the public interest to permit Aquila to use an adjustment mechanism.

The Commission concludes Public Counsel's proposed standard is vague, unduly burdensome and contrary to the standard for approval contained in Section 386.266.4(1), which requires that for the Commission to approve an adjustment mechanism it must be "reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity." Likewise, the Commission concludes Mr. Johnstone's "acute need" standard to be too vague to be useful and contrary to both the intent of the legislature in passing Section 386.266, and the approval standard contained in Subsection 386.266.4(1).

After carefully considering the evidence and arguments of the parties, and balancing the interests of ratepayers and shareholders, the Commission agrees with Aquila and Staff and concludes that a RAM method is appropriate to address Aquila's fuel and purchased power costs in this proceeding.

b. Should the Commission authorize Aquila to implement an interim energy charge or a fuel adjustment clause?

The Commission must now determine what fuel adjustment mechanism is the proper means by which Aquila should recover its volatile fuel costs. To do so, the Commission must balance the need to afford Aquila relief from extreme volatility in fuel and purchased power costs against the need to preserve a financial incentive for Aquila to control its fuel cost.

⁸² SB 179 has been codified at Section 386.266 RSMo (Cum. Supp. 2006).

Staff argues that an interim energy charge is the most appropriate mechanism for addressing the issue of variable fuel and purchased power costs given the recent and continuing fuel and purchased power price volatility. Staff first argues that, unlike a fuel adjustment clause, an interim energy charge affords customers a period of stability regarding electricity prices during its effective period.⁸³ Staff witness Cary Featherstone proposed the implementation of an interim energy charge similar to that previously implemented for Aquila following a stipulation and agreement in ER-2004-0034.⁸⁴

To implement such an interim energy charge, the Commission would first establish a base level (or floor) for estimated fuel and purchased power costs that would be included in permanent rates. Then, the Commission would authorize the collection of an additional portion of strictly variable costs up to a forecasted level (the ceiling) via an interim energy charge surcharge based on the kWh usage of Aquila's customers. Mr. Featherstone recommended a floor amount reflect a price of \$6.00 per MMBtu for natural gas, \$55.00 per MWh for variable purchased power, and \$21 per ton for high Btu blend coal.⁸⁵ Mr. Featherstone next recommended prices reflected in the ceiling amount be \$9.00 per MMBtu of natural gas, \$90.00 per MWh of purchased energy, and \$40 per ton for high Btu blend coal.⁸⁶

Mr. Featherstone further recommended the effective period for the interim energy charge be two years, with a true-up audit to be conducted at the termination of the interim energy charge.⁸⁷ If, upon completion of the true-up audit, Aquila's prudently incurred variable fuel and purchased power costs were within the range defined by the ceiling and floor amounts of the interim energy charge, customers would receive a refund equal to the amount collected minus the prudently incurred actual costs. Any refund amounts due to customers would be returned with interest.⁸⁸

The Commission agrees with Staff that an interim energy charge would afford customers with a period of rate stability. However, on the date an interim energy charge goes into effect the utility's customers are forced to pay the difference between the floor and ceiling rates as an upfront charge. If the ceiling is set too high the customer will be overpaying for up to two years. If the interim energy charge ceiling is set too low, especially if it is set significantly below actual purchased power costs, a utility will not recover its prudently incurred fuel costs.

The Commission has used the interim energy charge in two recent cases, both with equally poor results. In The Empire District Electric Company's (Empire's) recent rate case, the Commission found Empire's interim energy charge had resulted in an annual under-recovery of prudently-incurred fuel and purchased power costs totaling \$26.8 million.⁸⁹ Similarly, under Aquila's most recently implemented, and subsequently terminated, interim energy charge, Aquila under-recovered its fuel and purchased power costs by approximately \$34 million within approximately 20 months.⁹⁰

⁸³ Tr. page 714, lines 20-23.

⁸⁴ Featherstone Direct, Ex. 206, page 11, line 13 to page 33, line 21.

⁸⁵ Featherstone Rebuttal, Ex. 207, page 6; and Tr. page 755, line 15 to page 756, line 12.

⁸⁶ *Id.*

⁸⁷ Tr. page 706, lines 15-17.

⁸⁸ Featherstone Direct, Ex. 206, page 11, line 16 to page 12, line 10; and page 14 lines 30-32.

⁸⁹ Report and Order, Case No. ER-2006-0315 (December 21, 2006) pages 44-45.

⁹⁰ Tr. page 596, lines 4 through 8.

Staff next argues an interim energy charge is preferable to a fuel adjustment clause because it provides incentives for a utility to run its plants effectively, and to minimize the cost of its fuel and purchased power, both to avoid incurring costs above the forecast level and to take advantage of the opportunities to drive costs below the base level.⁹¹ The Commission finds Staff's argument unpersuasive in these circumstances. The Commission finds a fuel adjustment clause better addresses Aquila's current situation, and prudence reviews, including some type of incentive mechanism to encourage Aquila to behave prudently, best allow this Commission to set rates that are both just and reasonable for consumers.

While the Commission agrees with Staff that an interim energy charge can be a useful tool to ease the effect of volatility in the price of purchased power, the Commission does not believe it is a superior method to the fuel adjustment clause given the facts in this case.

Findings of Fact: The Commission finds, although an interim energy charge may afford customers a period of rate stability, the possibility of over or under-recovery of prudently incurred fuel costs, as discussed above, outweighs any rate stability benefit. Accordingly, the Commission finds a fuel adjustment clause is preferable to an interim energy charge, because a fuel adjustment clause allows the utility a greater opportunity to recover its actual, prudently incurred fuel costs.

The Commission finds Staff's argument unpersuasive in these circumstances. The Commission finds a fuel adjustment clause better addresses Aquila's current situation, and prudence reviews, including some type of incentive mechanism to encourage Aquila to behave prudently, best allow this Commission to set rates that are both just and reasonable for consumers.

Conclusions of Law: In this instance, the Commission believes a fuel adjustment clause is preferable to an interim energy charge, because a fuel adjustment clause allows the utility a greater opportunity to recover its actual, prudently incurred fuel costs. While the Commission agrees with Staff that an interim energy charge can be a useful tool to ease the effect of volatility in the price of purchased power, the Commission does not believe it is a superior method to the fuel adjustment clause given the facts in this case. Further, given the significant under-recovery that resulted from the two most recently approved interim energy charges, the Commission is not certain an interim energy charge would satisfy the approval standard contained in Section 386.266.4(1), in that, an interim energy charge arguably is not reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity. The Commission concludes Aquila should be authorized to implement a fuel adjustment clause in this case.

c. How should the fuel adjustment clause be structured?

The Commission must now consider what form that fuel adjustment clause should take.

i. What costs should be recoverable through the fuel adjustment clause?

Aquila originally proposed to recover through its fuel adjustment clause all costs recorded in Federal Energy Regulatory Commission ("FERC") Accounts 501, 509, 547, and 555. In addition to the actual costs of fuel and purchased power, these accounts also included related costs, such as unit train lease, depreciation, and

⁹¹ Tr. page 714, lines 20 through 23.

maintenance costs; freeze/dust suppression costs; fuel handling costs; costs associated with fly-ash removal; gas reservation charges; and demand charges for purchased power contracts with terms in excess of one year. After considering objections of various parties, Aquila has agreed these costs will be recovered exclusively through base rates.⁹² Aquila continues to believe, however, that hedging costs and demand charges related to purchased power contracts with terms of one year or less should be recovered through the fuel adjustment clause.⁹³

Staff witness Cary Featherstone argues only variable fuel and purchased power costs, including variable transportation costs, should be included in a fuel adjustment clause.⁹⁴ Specifically, Mr. Featherstone contends it is inappropriate to include demand charges for any capacity contracts, regardless of their duration, for two reasons. First, Mr. Featherstone points to the fact that demand charges are fixed costs to reserve capacity, and as such are more like plant investment cost than fuel or purchased power cost. Second, Staff opposes Aquila's use of short-term contracts to meet its growing capacity needs. Staff argues that allowing Aquila to pass on this type of cost would allow Aquila to meet its growing load requirements through short-term capacity, thus creating another disincentive for it to build generating units and placing all the risk of future fuel and purchased power cost increases on its customers.⁹⁵ Mr. Featherstone's analysis is persuasive.

Findings of Fact: The Commission finds a reasonable fuel adjustment clause should be straightforward and simple to administer, retain some incentive for company efficiency, and be readily auditable and verifiable through expedited regulatory review. The Commission can find no probative evidence in the record to support a finding that hedging costs or demand charges related to purchased power contracts with terms of one year or less should be recovered in a different manner than purchased power contracts with longer terms. The Commission agrees with Staff, and finds that demand charges are fixed costs to reserve capacity, and as such are more like plant investment cost than fuel or purchased power cost. This is the case irrespective of the length of the purchased power contract. Further, if demand charges on short term contracts are allowed to flow through the fuel adjustment clause, Aquila would be encouraged to forgo entering long term contracts in favor of short term contracts.

Conclusions of Law: The Commission concludes it would be improper to allow Aquila to flow hedging costs or demand costs associated with any purchased power contract through its fuel adjustment clause. The Commission concludes Aquila will only be allowed to flow variable fuel and purchased power costs, including variable transportation costs, through its fuel adjustment clause.

ii. What recovery period should be used? Aquila witness Dennis Williams originally proposed four, quarterly recovery periods. However, faced with opposition from all parties, Mr. Williams changed his position on this issue and stated that the company would agree to the single, annual recovery period proposed by Industrials' witness Mr. Johnstone.⁹⁶ No party opposed the use of a single recovery period.

⁹² Post-Hearing Brief of Aquila, Inc., pages 43 through 44.

⁹³ *Id.* at page 44.

⁹⁴ Featherstone Rebuttal, Ex. 207, page 8, lines 10 through 20.

⁹⁵ Tr. page 707, line 25 to page 708, line 17.

⁹⁶ D. Williams Direct, Ex. 32, pages 3-5; D. William Surrebuttal, Ex. 34, pages 6-7; and Aquila's Post Hearing Brief, page. 43.

Findings of Fact: The Commission finds a single recovery period is appropriate in that it would benefit Aquila's rate payers by mitigating the effect of seasonal variations in fuel and purchased power costs.⁹⁷

Conclusions of Law: The Commission concludes a single annual recovery period is reasonable and lawful under section 386.266.

iii. What line loss adjustments should be included? Although the draft rules under consideration at the time of the company's filing made recognition of line losses in a fuel adjustment clause optional, 4 CSR 240-20.090 (the Commission's Fuel Adjustment Clause Rule), as finally adopted, makes recognition of line losses mandatory. Aquila's original proposed fuel adjustment clause assumed every customer class had the same line losses and charged every customer on the system the same average loss factor.⁹⁸ It is inappropriate to use a single loss factor for all customers, because line losses vary depending upon the facilities used to supply customer needs.⁹⁹ To conform to the Commission's Fuel Adjustment Clause Rule and appropriately account for variances in line losses, these differences in line loss factors must be recognized in the fuel adjustment clause.¹⁰⁰

SIEUA, AG-P and FEA expert witness Maurice Brubaker included a table of "Losses and Loss Multipliers," detailing the line loss factors he recommended be included in any fuel adjustment clause ordered in this case.¹⁰¹ After considering his recommendation and proposed factors, Aquila recommended his proposal be adopted by the Commission as part of any fuel adjustment clause it approves.¹⁰² No other party took a position on this issue.

Findings of Fact: The Commission finds the line loss factors proposed by Mr. Brubaker and supported by Aquila are appropriate and should be included in the fuel adjustment clause.

Conclusions of Law: The Commission concludes line loss factors must be recognized in the fuel adjustment clause. The Commission further concludes line loss factors proposed by Mr. Brubaker conform to the requirements of the rule.

iv. What heat rate testing of generation plants should be conducted? As addressed in detail above at pages 27 to 29 under the heading, "Appropriateness of a Waiver of 4 CSR 240-3.161(2)(P)," the Commission finds Aquila should be: 1) granted a waiver of Commission Rule 4 CSR 240-3.161(2)(P), and 2) required to have finalized procedures for heat rate and/or efficiency testing that are either agreed to by the parties, or approved by the Commission, in place no less than sixty days before the effective date listed on the tariff for Aquila's initial fuel adjustment clause adjustment filing.

Findings of Fact: The Commission finds the 242 Proposal to be reasonable with one exception. The Commission does not believe it is appropriate to require the written procedures to be agreed to by all non-Aquila parties to ER-2007-0004, given

⁹⁷ Johnstone Rebuttal, Ex. 505, page 22.

⁹⁸ Brubaker Direct, Ex. 501, page 3, lines 11-17.

⁹⁹ *Id.*, page 3, line 18 to page 4, line 2.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at page 4

¹⁰² Aquila's Post Hearing Brief, page 44.

that parties who believe a RAM is never appropriate could block adjustments under an approved RAM by opposing even reasonable procedures.

Conclusions of Law: As addressed in detail above at pages 27 to 29 under the heading, "Appropriateness of a Waiver of 4 CSR 240-3.161(2)(P)", the Commission concludes it is reasonably necessary to require, in connection with the establishment of a rate adjustment mechanism, that Aquila develop a heat rate and/or efficiency testing schedule and plan under the terms set out in Exhibit 242, with the following conditions. First, in the event any party to ER-2007-0004 opposes the written heat rate and/or efficiency testing procedures ultimately proposed by Aquila, Aquila may file a motion with the Commission seeking approval of those procedures. Second, Aquila must have finalized procedures that are either agreed to by the parties, or approved by the Commission, in place no less than sixty days before the effective date listed on the tariff for Aquila's initial fuel adjustment clause adjustment filing.

v. How often should the fuel rate be adjusted? Originally Aquila proposed quarterly adjustments. However, in its Post Hearing Brief, Aquila advised the Commission that it did not oppose semi-annual adjustments.¹⁰³ Aquila's revised position is in agreement with SIEUA, AG-P and FEA witness Donald Johnstone, who proposed that any fuel adjustment clause authorized for Aquila should include two adjustment periods per year to decrease the impact of seasonal variations in both customer usage patterns and fuel and purchased power costs.¹⁰⁴

Only Public Counsel witness Russell Trippensee suggested Aquila should only be allowed to adjust its fuel adjustment clause once per year.¹⁰⁵ Mr. Trippensee argued annual adjustments would decrease the impact of seasonal variations in both customer usage patterns and fuel and purchased power costs.¹⁰⁶ However, no party, including Public Counsel, recommended the inclusion of a single adjustment period in either its prehearing or posthearing brief.

Aquila witness Dennis Williams testified that a single adjustment period would not be reasonable for three reasons. First, annual adjustments could result in rate shock to customers given the recent trends toward large annual increases in fuel and purchased power costs. Second, there would be carrying charges associated with delayed recovery. Third, annual adjustments are inconsistent with the objective of Section 386.266 RSMo to allow full and timely recovery of prudently-incurred fuel and purchased power costs.¹⁰⁷

Findings of Fact: The Commission finds Mr. Williams' testimony on the issue more persuasive, and further finds two adjustments per year will adequately decrease the impact of seasonal variations in both customer usage patterns and fuel and purchased power costs. Accordingly, the Commission finds Aquila's fuel adjustment clause should provide for two adjustments per year.

Conclusions of Law: An electric utility with a fuel adjustment clause must file at least one adjustment to its fuel adjustment clause in each true-up year coinciding with the true-up of its fuel adjustment clause.¹⁰⁸ The Commission has discretion to

¹⁰³ Post-Hearing Brief of Aquila, Inc., page 44-45.

¹⁰⁴ Johnstone Rebuttal, Ex. 505, page 22.

¹⁰⁵ Trippensee Rebuttal, Ex. 402, pages 4-8.

¹⁰⁶ *Id.*

¹⁰⁷ Williams Surrebuttal, Ex. 34, pages 10-12.

¹⁰⁸ 4 CSR 240-20.090(4)(A).

authorize any utility with a fuel adjustment clause to file up to three additional adjustments to its fuel adjustment clause within a true-up year.¹⁰⁹ The Commission concludes it may lawfully limit the adjustments to twice each year.

vi. Should the fuel adjustment clause require a phase-in for sharp changes in fuel or purchased power costs, contain a “soft cap”? SIEUA, AG-P and FEA witness Donald Johnstone proposed that any rate increase resulting from increased fuel and purchased power cost flowing through the fuel adjustment clause be limited to a “soft cap” of 3% annually.¹¹⁰ Any amount in excess of the “soft cap” would be recovered with interest in the 12-month period immediately following the standard 12-month recovery period.¹¹¹ Further, although Aquila’s fuel adjustment clause proposal does not include a “soft cap,” Aquila does not oppose such a cap provided it is set at a reasonable level of at least 6% annually.¹¹²

While a “soft cap” might prevent customers’ bills from rising significantly during the first year of the fuel adjustment clause, the Commission is concerned that any “soft cap” could result in those same customers facing greater price increases in the future, especially if current upward trends in fuel and purchased power costs continue.¹¹³ AARP witness Nancy Brockway argues convincingly that it is not appropriate to include a “soft cap” in the approved fuel adjustment clause, because it would simply defer certain increases to future periods with interest, and likely result in even greater rate shock.¹¹⁴

Findings of Fact: The Commission finds, as recommended by witness Nancy Brockway, a “soft cap” to be inappropriate, due to the potential for rate shock.

Conclusions of Law: The Commission concludes it has the discretion in the application of a “soft cap,” which is not warranted in this instance.

vii. Should the fuel adjustment clause include performance standards? As part of their “alternative” fuel adjustment clause, SIEUA, AG-P and FEA asked the Commission to adopt specific performance standards that would apply to the coal-fired generating plants that Aquila uses to satisfy its base load power requirements.¹¹⁵ SIEUA, AG-P and FEA witness Donald Johnstone argued the standards are necessary to protect consumers from the expense of higher-cost replacement power Aquila might have to acquire if there is an outage in one of its lower-cost base load units.¹¹⁶ However, unless Aquila imprudently shuts down a base load facility, it should be allowed to recover reasonable costs for purchasing replacement power while such a facility is non-operational. Accordingly, for Mr. Johnstone’s proposal to be reasonable, the Commission would have to assume Aquila would imprudently shut down one of its base load generating facilities. The Commission has no reason to believe Aquila would do this. In any event, the prudence of any replacement power cost purchased due to Aquila’s shutting down

¹⁰⁹ *Id.*

¹¹⁰ Johnstone Rebuttal, Ex. 505, page 24, line 10 to page 25, line 9.

¹¹¹ *Id.*

¹¹² Williams Surrebuttal, Ex. 34, pages 24-25.

¹¹³ As discussed *infra*, Aquila has experienced a 13-20% annual increases in fuel and purchased power costs over the last three years.

¹¹⁴ Tr. page 863.

¹¹⁵ Johnstone Rebuttal, Ex. 505, page 16, line 17 through page 18, line 2.

¹¹⁶ *Id.*

of a base load unit should be addressed in the annual prudence reviews included in Aquila's proposed fuel adjustment clause.

Findings of Fact: The Commission finds it unreasonable to assume Aquila might imprudently shut down one of its base load generating facilities. The Commission further finds the prudence of any replacement power cost purchased due to Aquila's shutting down of a base load unit should be addressed in the annual prudence reviews included in Aquila's proposed fuel adjustment clause.

Conclusions of Law: The Commission concludes it has sufficient remedies available to deter imprudent action by Aquila and regular performance reviews are required under the law to detect imprudent action. The Commission finds no performance standards shall be included in the fuel adjustment clause.

viii. At what level, or under what formula, should over or under collection of fuel and purchased power costs be passed through the fuel adjustment clause? Aquila's proposed fuel adjustment clause provides for a complete pass-through of 100% of prudently incurred fuel and purchased power costs above or below the amount included in base rates.¹¹⁷ Aquila argues this assures customers will only bear the actual cost of fuel and energy that the Company prudently incurs in order to provide service.

AARP witness Nancy Brockway and SIEUA, AG-P and FEA witness Donald Johnstone each recommended the Commission only authorize Aquila to flow 50% of its prudently incurred fuel and purchased power costs above those in base rates through the fuel adjustment clause (50% flow-through).¹¹⁸ They contend this type of sharing mechanism must be incorporated into any fuel adjustment clause to ensure Aquila will act prudently in procuring the fuel and purchased power necessary to provide service to its customers.¹¹⁹ They further argue prudence reviews are ineffectual, in that they are an imperfect tool for catching inefficiency and eliminating its effects from rates.¹²⁰

Aquila witness Dennis Williams objects to the proposed 50% flow-through because it would: 1) prohibit Aquila from collecting from customers a portion of its fuel and purchased power costs, even if those costs were determined to have been prudently incurred, and 2) prohibit customers from receiving the full benefit of any decreases in fuel and energy costs.¹²¹

As discussed above, in the Stipulation as to Certain Issues, Aquila's fuel and purchase cost was set at approximately \$ 200,000,000. Aquila has experienced an increase of between 13% and 20% annually for each of the last 3 years. Under a 50% pass-through scenario, if Aquila's fuel and purchased power costs continued to increase by 15% annually, Aquila would under recover approximately \$15,000,000 in prudently incurred fuel and purchased power expense in the 12 months following the conclusion of this case, and possibly \$45,000,000 within 24 months.¹²²

¹¹⁷ Williams Rebuttal, Ex. 33, pages 11-12; and Williams Surrebuttal, Ex. 34, pages 17-23.

¹¹⁸ Brockway Surrebuttal, Ex. 601, pages 6-7; Tr. page 881, lines 17-23; Johnstone Rebuttal, Ex. 505, page

13, line 10 to page 15, line 10.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ Williams Rebuttal, Ex. 33, pages 11 - 12; and Williams Surrebuttal, Ex. 34, pages 17 -23.

¹²² Tr. page 782

When asked how Aquila would recover the millions in prudently incurred costs that would not be recovered by a 50% pass-through fuel adjustment clause, SIEUA, AG-P and FEA witness Donald Johnstone stated “when costs go up you’ve got manage your business in a way to - - to have earnings. And so you have to control all of your costs to be equal to your revenues.” Mr. Johnstone declined to offer any theories on where or how Aquila might be able to reduce other costs to compensate for the \$15 to \$45 million in prudently incurred fuel and purchased power cost it would not be allowed to recover under his proposal.

While the Commission believes Aquila should be given the opportunity to recover its prudently incurred fuel costs, it also agrees with Mr. Johnstone and Ms. Brockway that: 1) after-the-fact prudence reviews alone are insufficient to assure Aquila will continue to take reasonable steps to keep its fuel and purchased power costs down; and 2) the easiest way to ensure a utility retains the incentive to keep fuel and purchased power costs down is to allow less than 100% pass through of those costs.¹²³ Accordingly, it is not appropriate to allow Aquila to pass 100% of its fuel and purchased power costs, above those included in its base rates, through its fuel adjustment clause.

As set out above, without a fuel cost adjustment mechanism, if Aquila’s fuel and purchased power costs increase by 15% in each of the next two years, Aquila will under recover \$30 million in prudently incurred costs in the first year and \$60 million in the second year. Under the 50% pass-through proposal, Aquila would still under-recover \$15 million and \$30 million in the first and second year respectively. Clearly, any adjustment mechanism that would authorize such under-recovery would be a violation of Section 386.266.4(1), in that, it would not afford Aquila a sufficient opportunity to earn a fair return on equity. In contrast, under a 95% pass-through, again assuming a 15% increase in Aquila’s fuel and purchased power costs, Aquila would under recover its prudently incurred costs by only \$1.5 million and \$3.0 million the first and second year respectively.

Findings of Fact: The Commission finds Mr. Williams’ testimony on the issue is more persuasive, and further finds a 50% flow-through would not allow sufficient recovery of prudent fuel and purchased power costs.

The Commission also finds after-the-fact prudence reviews alone are insufficient to assure Aquila will continue to take reasonable steps to keep its fuel and purchased power costs down, and the easiest way to ensure a utility retains the incentive to keep fuel and purchased power costs down is to not allow a 100% pass through of those costs.

The Commission finds allowing Aquila to pass 95% of its prudently incurred fuel and purchased power costs, above those included in its base rates, through its fuel adjustment clause is appropriate. With a 95% pass-through, the Commission finds Aquila will be protected from extreme fluctuations in fuel and purchased power cost, yet retain a significant incentive to take all reasonable actions to keep its fuel and purchased power costs as low as possible, and still have an opportunity to earn a fair return on its investment.

Conclusions of Law: The Commission concludes allowing Aquila to only pass 50% of its prudently incurred fuel and purchased power costs through its fuel adjustment clause is not in keeping with the legislative intent of Section 386.266.4(1), which requires any RAM approved by the Commission be “reasonably

¹²³ Brockway Surrebuttal, Ex. 601, pages 6–7; Tr. pages 847-849 and 878-885; Johnstone Rebuttal, Ex. 505, page 13, line 10 through page 15, line 10.

designed to provide the utility with a sufficient opportunity to earn a fair return on equity.”

As set out above, without a fuel cost adjustment mechanism, if Aquila’s fuel and purchased power costs increase by 15% in each of the next two years, Aquila will under recover \$30 million in prudently incurred costs in the first year and \$60 million in the second year, totally \$90 million over the two-year-period. Under the 50% pass-through proposal, Aquila would still under-recover \$15 million and \$30 million in the first and second year respectively. Any adjustment mechanism authorizing such under-recovery would be a violation of Section 386.266.4(1).

The Commission concludes that a 95% pass-through would not violate Section 386.266.4(1), in that it would still afford Aquila a sufficient opportunity to earn a fair return on equity.

2. Return on Common Equity: What return on common equity should be used for determining Aquila’s rate of return?

Four financial analysts offered recommendations regarding an appropriate return on equity in this case. Testifying on behalf of Aquila, Samuel C. Hadaway, a consultant from Austin, Texas who holds an economics degree for Southern Methodist University, as well as, a Masters in Business Administration and a Ph.D. from the University of Texas at Austin,¹²⁴ recommends Aquila be allowed a return on equity of 11.25%¹²⁵ Testifying on behalf of SIEUA, AG-P and FEA, Michael Gorman, a consultant from St. Louis, Missouri who holds a Masters in Business Administration with a concentration in finance from the University of Illinois at Springfield, recommends Aquila be allowed a return on equity of 10.0 %.¹²⁶ David C. Parcell, a consultant from Virginia who holds a Masters in Business Administration from Virginia Commonwealth University, testified on behalf of Staff. He recommends Aquila be allowed a return on equity between 9.0% and 10.25%, with the mid-point of his recommendation being 9.625%.¹²⁷ In addition, Russell Trippensee, the Chief Utility Accountant for the Public Counsel, who holds an accounting degree from the University of Missouri at Columbia, testified on behalf of Public Counsel. Mr. Trippensee offered analysis of the recommendations made by the other experts, but did not recommend a specific rate of return on equity.¹²⁸

There is one more source the Commission can use as a guidepost in establishing an appropriate return on equity. In a survey of regulatory decisions from around the country, as reported by Regulatory Research Associates, the average allowed return in the electric utility industry for 2006 was 10.36%, with a median return of 10.25%.¹²⁹

The Commission does not believe it would be appropriate for its return on equity finding to unthinkingly mirror the national average. Obviously, if all commissions took that approach returns on equity would never change, despite changing economic conditions, leading to unreasonable results. However, the

¹²⁴ Hadaway Direct, Ex. 13, page 1, lines 3-11.

¹²⁵ Hadaway Rebuttal, Ex. 14, page 19, lines 13-14.

¹²⁶ Gorman Direct, Ex. 507, page 17, and Appendix A.

¹²⁷ Parcell Direct, Ex. 221, page 1, lines 14-27, and page 31 line 5-6.

¹²⁸ Trippensee Direct, Ex. 403, pages 1-2.

¹²⁹ Ex. 241.

national average is a good indicator of the capital market in which Aquila will have to compete for the equity needed to finance its operations. The Commission has an obligation under the law, as well as a matter of practical necessity, to allow Aquila an opportunity to earn a return that will allow it to compete in the capital market. No one, including ratepayers, benefit if Aquila is starved for capital.

In recent rate cases, the Commission has used what has been described as a zone of reasonableness to assist it in evaluating the recommendations offered by return on equity experts. The zone of reasonableness has been described as a range 100 basis points above and 100 basis points below the national average allowed return on equity. If the national average is taken to be 10.36%, then the zone of reasonableness runs from 9.36% to 11.36%.¹³⁰

Aquila, Staff, SIEUA, AG-P, and FEA sponsored financial analysts who recommended a return on equity in this case. Their recommended ROEs are: Aquila – 10.25%, plus a 50 basis point adder; Staff – 9.0-10.25%; SIEUA, AG-P and FEA – 10%, with a 30 basis point reduction if a fuel adjustment clause is authorized. All proposed ROE recommendations fall within of the “zone of reasonableness.” The Commission will next analyze the various ROE recommendations proposed by the parties.

The zone of reasonableness is simply a tool to help the Commission to evaluate the recommendations offered by various rate of return experts. It should not be taken as an absolute rule that would preclude consideration of recommendations that fall outside that zone. However, a recommendation that greatly varies from the national norm will be viewed with skepticism.

Each expert witness performed multiple calculations using various methods to justify their recommendations for the return on equity the Commission should use in calculating the rates Aquila will be allowed to charge its customers. Collectively, they devoted hundreds of pages of testimony to discrediting each others' opinions. In the end, despite their best efforts to educate, the experts have managed to create a thicket of conflicting opinions. If the Commission were to attempt to force its way through the tangle it could easily lose its way or even become ensnared.

To avoid becoming tangled in that thicket, the Commission must study the issue from a greater distance. Rather than attempt to untangle each of the narrow, technical disputes between the parties, the Commission will attempt to step back and examine the problem from a broader perspective.

When the Commission steps back, the first pattern that emerges is the realization that the rate of return advocated by the expert who testified for Aquila is too high. It appears as though Dr. Hadaway designed a methodology to achieve the same return the Commission approved for Kansas City Power & Light Company in Case No. ER-2006-0314.¹³¹

In large part, the overly high return on equity recommendation put forward by Dr. Hadaway results from his inclusion of a 50 basis point construction risk add-on premium, based on Aquila's allegedly greater construction risk.¹³² Dr. Hadaway testified Aquila's six-year construction expenditures as a percentage of net plant is 118.2%, compared to an average of 60.9% for the comparable group.¹³³ Despite his

¹³⁰ Ex. 240, page 7.

¹³¹ *Report and Order*, issued December 21, 2006, Case No. ER-2006-0314.

¹³² Hadaway Rebuttal, Ex. 14, page 19, lines 6-13.

¹³³ *Id.*

advocacy of an adjustment to account for Aquila's alleged increased construction risk, Dr. Hadaway admits his entire construction risk adjustment is based upon Aquila's "**projected, estimated**" construction expenditures over the next six years.¹³⁴ Further, Dr. Hadaway admitted that in comparing construction risk, he compared more recent Aquila estimates to older estimates for the comparable utilities.¹³⁵

In addition to the obvious incongruity of a large construction risk adjustment for a company based on projected and estimated construction expenditures, the opposing experts convincingly explained that Dr. Hadaway's return on equity recommendation and proposed construction adjustment are inappropriately inflated for more technical reasons as well. In particular, the Commission accepts as credible the testimony of SIEUA, AG-P, and FEA's witness, Michael Gorman, who explains that Dr. Hadaway's failure to acknowledge offsetting financial risks results in an improper evaluation of the construction and financial risk differential between the proxy groups and Aquila.¹³⁶ Dr. Hadaway's proposed adjustment for construction risk is an incomplete assessment of Aquila's overall risk because it ignores other aspects of risk that make Aquila less risky than many of the comparable companies, including: nuclear operations, operations in deregulated states, non-regulated affiliates, and hurricane risk.¹³⁷ In sum, the construction risk upward adjustment proposed by Dr. Hadaway appears to be a transparent effort to inflate the company's proposed return on equity.

On the other side of the thicket, the Commission finds the return on equity proposed by Staff Witness Parcell is too low. If the Commission were to adopt the return on equity he advocates, Aquila would have one of the lowest allowed returns on equity in the country. Parcell's group of comparable proxy companies includes several companies owning no generation and are therefore exposed to significantly lower risk.¹³⁸ Only Parcell's high point of 10.25% seems reasonable under these circumstances.

In setting rates the Commission's obligation is to reasonably balance shareholder and ratepayer interests. This is not an intellectual game designed to fatten or drive down the company's bottom line. Economic theories must be tempered by a realistic appraisal of the effect the numbers derived from those theories will have on the company and on ratepayers. For once, the Commission would like to see a rate case in which the witnesses presented by the parties present a balanced analysis rather than racing to the extremes.

Of the witnesses who testified in this case Michael Gorman, the witness for SIEUA, AG-P and FEA, did the best job of presenting the balanced analysis the Commission seeks, but even his analysis was lacking in certain aspects. His overall recommendation was for a return on equity of 10.0%. Mr. Gorman performed three different analyses to arrive at his overall recommendation. His Constant Growth

¹³⁴ Tr. pages 322-323.

¹³⁵ Tr. pages 416-417.

¹³⁶ Gorman Rebuttal, Ex. 508, pages 5-6.

¹³⁷ Tr. pages 334-364.

¹³⁸ Parcell Direct, Ex. 221, pages 20-31, and Tr. pages 496-497.

Discounted Cash Flow (DCF)¹³⁹ analysis resulted in a recommended return on equity of 9.4 percent using his comparable group and 9.5% using Dr. Hadaway's comparable group,¹⁴⁰ his Bond Yield Plus Risk Premium Model analysis results in a recommended return on equity of 10.0% for both his proxy group and Dr. Hadaway's proxy group,¹⁴¹ and his Capital Asset Pricing Model (CAPM)¹⁴² results in a recommended return on equity of 10.2% using his proxy group and 10.6% using Dr. Hadaway's proxy group.¹⁴³ Mr. Gorman's overall recommendation of 10.0% is then a blending of these three analyses.

On cross-examination, Mr. Gorman indicated his 10.0% recommendation presumed Aquila would not be granted a fuel adjustment clause, and if the Commission awards Aquila a fuel adjustment clause, his recommendation would drop by thirty basis points to 9.7%.¹⁴⁴ Public Counsel witness Russell Trippensee also stated that any ROE recommendation should be reduced if Aquila is authorized to establish a fuel adjustment clause.¹⁴⁵

All the experts agree having a cost recovery mechanism, such as a fuel adjustment clause, results in less risk for a company and a company's return on equity should be decreased to compensate. The question then becomes whether that decrease in business risk is already reflected in Mr. Gorman's return on equity recommendation.

Mr. Gorman's testimony is lacking in this area in that there is insufficient evidence in the record to determine whether the companies in Mr. Gorman's proxy group have cost recovery mechanisms. However, 18 of the 24 companies in Dr. Hadaway's proxy group have fuel cost recovery mechanisms.¹⁴⁶ Mr. Gorman performed his three analyses using his proxy group and then again utilizing Dr. Hadaway's proxy group.¹⁴⁷ He obtained very similar results irrespective of which group was used.¹⁴⁸ Accordingly, the Commission finds the decreased risk associated with having a cost recovery mechanism is already accounted for in Mr. Gorman's return on equity calculation and no additional adjustment is necessary.

Findings of Fact: The Commission finds that none of the experts' final results appear to be reasonable. The 11.25% rate of return advocated by the expert who testified for Aquila, Dr. Hadaway, is too high. Dr. Hadaway's failure to acknowledge or account for financial risks faced by the comparable companies, that are either not faced by Aquila, or faced to a lesser degree, resulted in an improper inflation of his rate of return recommendation.

¹³⁹ Gorman explains that "[t]he DCF model posits that a stock price is valued by summing the present value of expected future cash flows discounted at the investor's required rate of return (ROR) or cost of capital." Gorman Direct, Ex. 507, page 20, lines 15-17.

¹⁴⁰ *Id.* at page 23, lines 9-11, and page 34, TABLE 4.

¹⁴¹ *Id.* at page 19, lines 5-6, and page 34, TABLE 4.

¹⁴² Gorman explains that "[t]he CAPM method of analysis is based upon the theory that the market required ROR for a security is equal to the risk-free ROR, plus a risk premium associated with the specific security." *Id.* at page 29, lines 9-11.

¹⁴³ *Id.* at Page 19, Lines 15-16, and page 34, TABLE 4.

¹⁴⁴ Tr. pages 532-533.

¹⁴⁵ Trippensee Direct, Ex. 403, pages 7-8.

¹⁴⁶ Hadaway Rebuttal, Ex. 14, page 18, lines 4-16.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

Dr. Hadaway's 50 basis point construction risk adjustment based upon "projected" and "estimated" construction expenditures as a percentage of existing plant over the next six years is inappropriately high, especially given that he compared current Aquila estimates to older estimates for the comparable companies. A more modest adjustment of 10 to 15 basis points is appropriate.

Michael Gorman, the witness for SIEUA, AG-P and FEA, did the best job of presenting the balanced analysis the Commission seeks. In examining Mr. Gorman's three analyses, the results of his DCF analysis are somewhat inconsistent with the results of the other two analyses and should be excluded. Utilizing the results of Mr. Gorman's Risk Premium and CAPM, Aquila's return on equity should be in the low 10% area. Next, Aquila's return on equity should be adjusted upwards by 10 to 15 basis points to reflect its increased construction risk compared to the comparable companies, as well as the fact the company is not recovering 100% of its prudently incurred fuel and purchased power costs.

A cost recovery mechanism, such as a fuel adjustment clause, results in a bit less risk for a company and a company's return on equity should be decreased to compensate. However, the Commission finds the decreased risk associated with having a cost recovery mechanism is already accounted for in Mr. Gorman's return on equity calculation and no additional adjustment is necessary.

Based on its analysis of the expert testimony offered by the parties, and on its balancing of the interest of the company's ratepayers and shareholders the Commission finds 10.25% is a fair and reasonable return on equity for Aquila that will allow it to compete in the capital market for the funds needed to maintain its financial health. Based upon a 10.25% return on equity, Aquila's revenue requirement increase will be approximately \$13.6 million and \$45.1 million for its L&P and MPS Operating Divisions, respectively.

Conclusions of Law: The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's *Hope* and *Bluefield* decisions.¹⁴⁹ Pursuant to those decisions, returns for Aquila's investors must be commensurate with returns in other enterprises with corresponding risks.¹⁵⁰ Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of *Hope* and *Bluefield* unmistakably requires a *comparative method*, based on a quantification of risk.¹⁵¹

Investor expectations of Aquila are not the sole determiners of ROE under *Hope* and *Bluefield*, we must then compare it to the performance of other companies that are similar to Aquila in terms of risk. *Hope* and *Bluefield* also expressly refer to objective measures.¹⁵² The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk.

¹⁴⁹ Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603, 64 S.Ct. 281, 288, 88 L.Ed. 33, 345 (1943); and Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 690, 43 S.Ct. 675, 678, 67 L. Ed. 1176, 1181 (1923).

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.*

In its decision in *Missouri Gas Energy*, the Commission stated that it does not believe its return on equity finding should "unthinkingly mirror the national average."¹⁵³ However, the national average is an indicator of the capital market in which Aquila will have to compete for necessary capital. One requirement imposed by *Hope* and *Bluefield* is that Aquila's rates be sufficient to permit it to obtain necessary capital.¹⁵⁴

Based on its analysis of the expert testimony offered by the parties, and on its balancing of the interest of the company's ratepayers and shareholders the Commission finds a ROE of 10.25% satisfies the *Hope* and *Bluefield* standards and is a fair and reasonable return on equity for Aquila.

3. Accounting Authority Order – Sibley Generating Facility: Should the unamortized balances of the Sibley AAOs be included in Aquila's rate base in this case?

The Commission has the regulatory authority to grant a form of relief to a utility in the form of an accounting technique, an accounting authority order (AAO).¹⁵⁵ An AAO allows a utility to defer and capitalize certain expenses until the time it files its next rate case, and it protects the utility from earnings shortfalls and softens the blow which results from extraordinary construction programs.¹⁵⁶

The Commission granted Aquila two AAOs associated with expenditures involving its Sibley Rebuild and Western Coal Conversion product.¹⁵⁷ These projects were undertaken to extend the useful life of the Sibley Generating Station by 20 years and to comply with the 1990 Federal Clean Air Act.¹⁵⁸ This project avoided building a new generation plant at substantially higher costs and allowed the Sibley unit to burn low sulfur western coal to meet environmental requirements.¹⁵⁹

To avoid the need to purchase other power resources to meet the peak season demand, work on these projects was only conducted in off-peak periods.¹⁶⁰ This approach provided for a substantial savings for Aquila's customers, but caused recovery problems for the company because it took several years to complete.¹⁶¹ If the Commission had not granted Aquila an AAO, Aquila would have been unable to recover the cost of system upgrades without filing annual rate cases.

In its December 27, 1989 *Order Concerning Application for Approval of Accounting Procedure and Consolidating Dockets*, Case No. EO-90-114 and *Report and Order* in Case Nos. EO-91-358 and EO-91-360, the Commission concluded these expenses were extraordinary in nature and justified the special accounting

¹⁵³ *In the Matter of Missouri Gas Energy*, Case No. GR-2004-0209 (*Report & Order*, issued Sept. 21, 2004).

¹⁵⁴ *Hope*, 320 U.S. at 603; *Bluefield*, 262 U.S. at 690.

¹⁵⁵ *Missouri Gas Energy v. Public Service Commission State of Missouri*, 978 S.W.2d 434 (Mo. App. 1998).

¹⁵⁶ *Id.*

¹⁵⁷ Kolte Surrebuttal, Ex.19, page 4, lines 6-13.

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at lines 16-22.

¹⁶¹ *Id.* at page. 4, line 22 to page 5, line 2.

treatment.¹⁶² By allowing the deferral of these costs, the Commission allowed Aquila to stage the Sibley projects, thereby saving its customers the expense of purchasing alternate power resources during peak-demand periods, and also avoiding a series of rate cases to capture the staged elements of those projects.¹⁶³ In each case, the Commission allowed the amortization of the expense over a 20-year period, plus the inclusion of the unamortized amount in rate base.¹⁶⁴

Aquila witness Ron Kolte and Staff witness Philip Williams each contend that the unamortized balances of the Sibley AAOs should be included in rate base in this case.¹⁶⁵ In support of that position, Mr. Williams and Mr. Kolte testify the public policy analysis upon which the Commission based its decision to initially authorize the Sibley AAOs is still sound.¹⁶⁶ Mr. Williams further testified that allowing a continuation of construction accounting of major capital projects by an AAO and including those construction costs in rate base provides an incentive for the utility to commit significant capital investment on a timely basis.¹⁶⁷ Both Mr. Kolte and Mr. Williams state that the Commission has already granted the AAOs and incorporated them in prior rate cases and should do so again here.¹⁶⁸

Public Counsel contends the Commission should deny rate base treatment for the unamortized deferred cost balance allowed by the AAOs.¹⁶⁹ Public Counsel argues inclusion of these balances in the rate base would be inconsistent with the purpose of the AAO mechanism as a remedy to mitigate the impact of regulatory lag. Public Counsel appears to object to the AAOs on the basis that their balances include property taxes, carrying costs and depreciation expense related to the originally deferred amounts.¹⁷⁰ Public Counsel claims these items are book entries rather than actual capital outlays of real dollars and that Aquila should not be allowed to earn a return on these amounts.¹⁷¹

The Commission agrees with Public Counsel that AAOs are to be considered on a case-by-case basis, and that the Commission can revisit the issue and is not bound by its prior determinations. However, the Commission agrees with Mr. Williams and Mr. Kolte that the public policy analysis upon which the Commission based its decision to initially authorize the Sibley AAOs is still sound.¹⁷² The deferred costs included in the Sibley AAOs represent major capital additions to plant in service and should be treated the same way as other capital costs for these projects, and afforded rate base treatment. Further, absent AAO treatment, these amounts would have been lost as a result of booking these costs directly to expense following completion of the projects.¹⁷³ The Commission finds the unamortized balances of the Sibley AAOs should be included in Aquila's rate base in this case.

¹⁶² 1 Mo. P.S.C. 3rd 200 (1991).

¹⁶³ *Id.*

¹⁶⁴ Tr. page 94, lines 21-23.

¹⁶⁵ P. Williams Rebuttal, Ex 236, pages 3-4; and Kolte Surrebuttal, Ex. 18, pages 2-9.

¹⁶⁶ *Id.*

¹⁶⁷ P. Williams Rebuttal, Ex. 236, page 6, line 19 to page 7, line 5.

¹⁶⁸ P. Williams Rebuttal, Ex. 236, pages 3-4; and Kolte Surrebuttal, Ex. 18, pages 2-9.

¹⁶⁹ Robertson Rebuttal, Ex. 406, pages 9-17.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² P. Williams Rebuttal, Ex. 236, pages 3-4; and Kolte Surrebuttal, Ex. 18, pages 2-9.

¹⁷³ Tr. page 96, lines 15-24.

Findings of Fact: The Commission agrees with Staff and Aquila that the public policy analysis upon which the Commission based its decision to initially authorize the Sibley AAOs is still sound. The deferred costs included in the Sibley AAOs represent major capital additions to plant in service and should be treated the same way as other capital costs for these projects, and afforded rate base treatment.

Conclusions of Law: The Commission has the regulatory authority to grant a form of relief to a utility in the form of an accounting technique, an accounting authority order (AAO). An AAO allows a utility to defer and capitalize certain expenses until the time it files its next rate case, and it protects the utility from earnings shortfalls and softens the blow which results from extraordinary construction programs. While AAOs are to be considered on a case-by-case basis, and the Commission can revisit the issue and is not bound by its prior determinations, the deferred costs included in the unamortized balances of the Sibley AAOs, represent major capital additions to plant in service, and should be included in Aquila's rate base in this case.

4. Depreciation: What depreciation rates should be used to determine rates in this case?

Staff and Aquila maintain that Aquila's currently approved depreciation rates should be used to set rates in this case. Initially, SIEUA, AG-P and FEA opposed Aquila's use of those depreciation rates. No other party took a position on this issue.

During the evidentiary hearing, counsel for SIEUA, AG-P and FEA advised the Commission they were dropping the depreciation issue and were now agreeing that Aquila's current depreciation rates should be used in this case.¹⁷⁴

Findings of Fact: The Commission finds Aquila's currently approved depreciation rates are appropriate to use to determine rates in this case. The Commission further finds no party objects to the use of those depreciation rates.

Conclusions of Law: The Commission finds Aquila's currently approved depreciation rates are appropriate and will be used to determine appropriate rates in this case.

G. The Settled Issues

Many issues were resolved by the agreement of the parties. On April 4, 2007, a Stipulation and Agreement as to Certain Issues was filed and served on the parties. Each party that did not sign the stipulation filed an official statement indicating it did not oppose the stipulation. As permitted by its regulations, the Commission treated the unopposed stipulation and agreement as a unanimous partial stipulation and agreement.¹⁷⁵ After considering the stipulation and agreement, the Commission approved it as a resolution of the issues addressed in that agreement.¹⁷⁶ The issues that were resolved by the approved stipulation and agreement will not be further addressed in this report and order.

¹⁷⁴ Tr. page 464, lines 4 - 8.

¹⁷⁵ 4 CSR 240-2.115(2).

¹⁷⁶ An Order Approving Stipulation and Agreement as to Certain Issues was issued on April 12, 2007.

IT IS ORDERED THAT:

1. Subject to the conditions set out in the body of this order, Aquila is granted a waiver from the following requirements contained in Commission Rule 4 CSR 240-20.090(9): the requirement to include line loss factors in its original fuel adjustment clause filing, and the requirement to include line loss factors in its fuel adjustment clause that are based upon a line loss study completed within twenty-four months of that fuel

adjustment clause filing.

2. Aquila is granted a waiver of Commission Rule 4 CSR 240-3.161(2)(P), subject to the conditions set out in the body of this order.

3. The proposed electric service tariff sheets submitted under Tariff File No. YE-2007-0001 on July 3, 2007, by Aquila, Inc., d/b/a Aquila Networks MPS and Aquila Networks L&P for the purpose of increasing rates for retail electric service to customers are hereby rejected. The specific sheets rejected are:

P.S.C. Mo. No. 1

3rd Revised Sheet No. 2, Canceling 2nd Revised Sheet No. 2
2nd Revised Sheet No. 18, Canceling 1st Revised Sheet No. 18
2nd Revised Sheet No. 19, Canceling 1st Revised Sheet No. 19
2nd Revised Sheet No. 21, Canceling 1st Revised Sheet No. 21
2nd Revised Sheet No. 22, Canceling 1st Revised Sheet No. 22
2nd Revised Sheet No. 23, Canceling 1st Revised Sheet No. 23
2nd Revised Sheet No. 24, Canceling 1st Revised Sheet No. 24
2nd Revised Sheet No. 25, Canceling 1st Revised Sheet No. 25
2nd Revised Sheet No. 28, Canceling 1st Revised Sheet No. 28
2nd Revised Sheet No. 29, Canceling 1st Revised Sheet No. 29
2nd Revised Sheet No. 30, Canceling 1st Revised Sheet No. 30
2nd Revised Sheet No. 31, Canceling 1st Revised Sheet No. 31
2nd Revised Sheet No. 33, Canceling 1st Revised Sheet No. 33
2nd Revised Sheet No. 34, Canceling 1st Revised Sheet No. 34
2nd Revised Sheet No. 35, Canceling 1st Revised Sheet No. 35
1st Revised Sheet No. 36, Canceling Original Sheet No. 36
2nd Revised Sheet No. 41, Canceling 1st Revised Sheet No. 41
2nd Revised Sheet No. 42, Canceling 1st Revised Sheet No. 42
2nd Revised Sheet No. 43, Canceling 1st Revised Sheet No. 43
2nd Revised Sheet No. 44, Canceling 1st Revised Sheet No. 44
1st Revised Sheet No. 46, Canceling Original Sheet No. 46
2nd Revised Sheet No. 47, Canceling 1st Revised Sheet No. 47
2nd Revised Sheet No. 48, Canceling 1st Revised Sheet No. 48
1st Revised Sheet No. 49, Canceling Original Sheet No. 49
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2nd Revised Sheet No. 79, Canceling 1st Revised Sheet No. 79
2nd Revised Sheet No. 80, Canceling 1st Revised Sheet No. 80
1st Revised Sheet No. 82, Canceling Original Sheet No. 82
2nd Revised Sheet No. 88, Canceling 1st Revised Sheet No. 88
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2nd Revised Sheet No. 92, Canceling 1st Revised Sheet No. 92
1st Revised Sheet No. 94, Canceling Original Sheet No. 94
2nd Revised Sheet No. 95, Canceling 1st Revised Sheet No. 95
2nd Revised Sheet No. 97, Canceling 1st Revised Sheet No. 97
2nd Revised Sheet No. 99, Canceling 1st Revised Sheet No. 99
2nd Revised Sheet No. 100, Canceling 1st Revised Sheet No. 100
2nd Revised Sheet No. 103 Canceling 1st Revised Sheet No. 103
2nd Revised Sheet No. 104, Canceling 1st Revised Sheet No. 104
Original Sheet No. 124
Original Sheet No. 125
Original Sheet No. 126

4. Aquila Inc., d/b/a Aquila Networks MPS and Aquila Networks L&P shall file proposed electric service tariff sheets in compliance with this Report and Order no later than midnight on May 20, 2007.

5. Aquila, Inc., shall complete the proposed heat rate and/or efficiency schedule and testing plan with written procedures, as described in 4 CSR 240-3.161(2)(P) that is either agreed to by all parties to this case or has been approved by the Commission no less than sixty (60) days before the effective date listed on the tariff for its initial fuel adjustment clause filing for the purpose of adjusting a fuel adjustment clause rate pursuant to 4 CSR 240-3.161(7) and 4 CSR 240-20.090(4).

6. All pending motions, not otherwise disposed of herein, are hereby denied.

7. This Report and Order shall become effective on May 27, 2007.

Davis, Chm., concurs, with separate concurring opinion attached;
Murray, C., concurs;
Appling, C., concurs, with separate concurring opinion attached;
Gaw, C., dissents, with separate dissenting opinion to follow;
Clayton, C., dissents;
certify compliance with the provisions of Section 536.080, RSMo.

CONCURRING OPINION OF CHAIRMAN JEFF DAVIS

This commissioner respectfully concurs with the majority decision in all parts ; however, there are at least three points raised in this case worthy of further commentary: (1) Skyrocketing fuel prices are driving large rate increases for Aquila customers and, absent some change of circumstances, it is likely Aquila customers will see significant rate increases over the next few years ; (2) This report and order marks the first time the Missouri Public Service Commission has implemented a fuel adjustment mechanism pursuant to Section 386.266 enacted in 2005 by the Missouri General Assembly with the passage of Senate Bill 179 ; and (3) The ex-parte communication from Pirate Capital in this case illustrates that the source of capital can be as important as the attraction of capital itself when determining what's in the public interest.

This opinion, like all other opinions, is based on the facts and circumstances of this particular case as well as preceding cases this body may recognize. Nothing in this opinion should be construed as to any position this commissioner might take in any case, currently pending or in the future.

1. Rising fuel prices dictated the majority of this rate increase and, absent some change in circumstances, this trend will likely continue.

Subject to the adjustments set out in paragraphs 5, 10 and 13 of the stipulation, all of the parties agreed to an increase of at least \$40.6 million for Aquila's MPS territory and at least \$12 .7 million for its St. Joseph Light & Power property for a total of roughly \$53 .3 million. The actual award in this case is approximately \$58 .7 million. Further, the company is receiving a fuel adjustment mechanism (FAC).

This increase follows a \$44.8 million rate increase awarded by this commission for both properties in February 2006. As stated in the majority opinion, fuel and purchased-power expenses make up approximately 46 percent of Aquila's total operating costs. These costs rose 13 percent to 20 percent annually over the three-year period ending June 30, 2006 . This pattern of increases is of great concern because subsequent increases in fuel costs will necessitate Aquila seeking additional rate increases of a similar magnitude.

The light at the end of the tunnel - the rate stability so many of Aquila's customers are desperately seeking - appears to be years away. Aquila's fuel and purchased-power expenditures have increased rapidly in recent years. This underscores the perils of being a vertically integrated utility with a significant reliance on natural-gas fired generation and purchased power. The general trend appears to be that both the price of natural gas and the demand for purchased power will continue to increase. Those increased costs will ultimately be reflected in increased rates for Aquila customers.

The goal can and must be rate stability for consumers, even though that goal is challenging and may take years to accomplish. Aquila's fuel and purchased-power costs may well remain upwardly volatile until the company acquires more generation to meet both baseload and peak capacity demand. Aquila is taking steps to add generation capacity by partnering with KCP&L to construct the Iatan II Coal Plant and to construct two new natural gas-fueled electricity-generating turbines in Sedalia, Missouri.

While increasing generation capacity is essential to meeting baseload and peak demands for electricity, it is no panacea for Aquila's customers in terms of rate stability. Assuming the latan II coal plant is constructed on schedule in 2010, Aquila will be back in front of this commission seeking another substantive rate increase because the costs of power plant construction cannot be put into rates until the plant is "used and useful ." (Chapter 393.135 RSMo, 2000) These costs could be compounded by compliance with future emissions requirements, particularly any federal action on carbon dioxide emissions (CO2).

2. This decision marks the first time this commission has implemented a fuel adjustment mechanism (FAC) pursuant to Section 386.266 approved by the General Assembly in Senate Bill 179 (2005 legislative session).

Lately, Aquila's rising fuel and purchased-power costs by themselves are enough to cause rate shock when those costs are eventually passed through to customers in the form of a rate case. Skyrocketing fuel and purchased power prices can compound rate risk for consumers because, when they necessitate a rate case, the company will also seek recovery of their rate case expenses as well as other expenses.

In 2005, the Missouri General Assembly enacted Senate Bill 179 to provide this commission with the option of using a fuel-adjustment mechanism as a tool to establish just and reasonable rates between rate case filings by incorporating market cost changes for prudent, necessary fuel and purchased-power costs.

More than 25 other states can use this method of utility rate regulation. It smoothes the impact of fuel-cost volatility spikes on consumers, minimizes rate shock resulting from the eventual pass-through of fuel and purchased power costs due to regulatory lag and spares both consumers and taxpayers the expense of a rate case when the principal cost driver is the cost of fuel and purchased power.

This commission recognizes the hardship rate volatility can place on all classes of consumers - residential, commercial and industrial. Further, we are all acutely aware of the need to institute safeguards to ensure fuel adjustment clauses do not allow utility service providers to incur fuel costs in an imprudent manner.

That being said, a line-item surcharge allowing a utility to recover its prudently incurred fuel and purchased-power costs is a necessary evil in the case of this particular company. In a time of rapidly rising fuel and purchased-power prices, there is no way a company like Aquila can earn its allowed return on equity by reducing its expenses by tens of millions of dollars in other areas to offset increased fuel and purchased-power costs. In short, fuel and purchased-power increases are dramatically outpacing the ability of the company to absorb these costs. When those expenses already amount to almost half of the company's total expenses, no amount of increased efficiency can offset tens of millions of dollars in new expenses.

The ability to earn an allowed return on equity is important. These earnings attract and sustain investment the company needs to expand generating capacity and maintain essential infrastructure. There is no disputing the Aquila system could use more investment.

Critics of Aquila will argue Aquila is responsible for its own difficulties. There is no doubt Aquila management shares some responsibility in creating this dilemma. Other than PSC staffs assertion that Aquila should have built and kept the Aries plat, no testimony has been offered in this proceeding or any other previous proceeding that said Aquila should have undertaken a plan to construct other electric generation

alternatives a decade ago. In fact, the conventional wisdom of the late 90's was that that the price of natural gas would remain relatively stable and no one ever anticipated the price of natural gas peaking at more than \$10 .00/mmbtu. If those assumptions were correct, natural gas fired generation would have proven to be more cost-competitive with coal-fired generation.

These facts, when combined with the costly and exhaustive permitting process required by the Missouri Department of Natural Resources (DNR) in granting emissions permits, make it highly unlikely Aquila would have ever been able to construct a coal plant under those conditions. Accordingly, it is very difficult to accurately and proportionately balance the culpability of Aquila's management for the challenges the company now faces in containing costs related to providing reliable and affordable utility services to its customers.

All of the proposed FAC mechanisms in this case had some facet that was unappealing. Aquila's proposal to recover 100 percent of its fuel increase costs was technically sound, but failed to ensure prudent and necessary pass-through because the company incurred no risk of financial loss if it failed to prudently manage its fuel costs. The 95 percent pass-through adopted by the majority in this case is reasonable in that it allows the company to recover all or most of its fuel and purchased power costs above \$200 million, while encouraging the company to be prudent. For instance, if fuel and purchased power costs increase by \$30 million in one year to a level of \$230 million total -- a likely scenario based on the testimony presented in this case -- the company will recover \$27 million of those costs and lose \$3 million.

A company like Aquila might be able to make up a \$3 million shortfall and, based on judgment and experience, such a shortfall is reasonable under the circumstances. Thus, in my opinion, this approach is most reasonable under the circumstances facing Aquila and the customers it serves.

The other proposals considered by the PSC would have excessively penalized the company for fuel and purchased power costs far beyond its control. This would make it extremely difficult for the company to reinvest in infrastructure and to attract the investment capital necessary to maintain infrastructure and expand generation capacity.

I found the other proposed cost-sharing mechanisms unreasonable for the following reasons:

- an interim energy charge or I.E.C. similar to the one proposed in this case cost Aquila more than \$20 million since their last rate case decision in February 2006. Accordingly, I did not feel comfortable adopting the methodology proposed by the PSC staff in this case.

- the 50-50 sharing proposal proposed by several parties of the parties is unfair for a company like Aquila . In scenarios such as that referenced above, Aquila has no means of possibly offsetting a loss of \$15 million or more on an annual basis.

- the Wyoming Plan sponsored by AARP has some attractive features similar to the IEC in that it contained a deadband, which would require the utility to absorb costs within a certain range, and encouraged proportionate sharing with no cap.

If the market for fuel and purchased power were less volatile, this proposal definitely would merit strong consideration ; however, in an era of upward cost volatility, the deadband prohibits the utility

from recovering a significant portion of its prudently incurred costs at the outset.

-Although intriguing, an accounting authority order (AAO) would be something this commissioner would gladly consider if this commission had no other alternative. The weakness of the AAO is that it will be thrown into the next rate case. Parties will make all sorts of arguments to disallow those expenses and the company will either agree to take less than they are otherwise entitled in settlement or run the risk of the commission arbitrarily making downward adjustments in other areas because the recovery of the AAO expenses has the potential of being such a large issue.

Absent certainty of fuel cost variances, some aspects of rate setting are like rate design in that they are more art than science. Although the parties are to be commended for coming to an agreement on how the process should work, their extreme positions left this commission in the position of having to try develop a FAC mechanism that would be just and reasonable to all parties.

Aquila should be very mindful that the majority of this commission took a bold step in awarding Aquila a fuel adjustment mechanism. This commission and the General Assembly will be watching. If Aquila fails to adopt a proper hedging strategy, fails to follow its hedging strategy or abuses the discretion given to it by this commission in any other way, this commissioner will not hesitate to modify or reject Aquila's FAC application in a future proceeding.

3. The ex-parte communication from Pirate Capital in this case illustrates the point that the source of capital is as important as the attraction of capital itself when determining what's in the public's best interest.

A. Concerns regarding the attraction of capital:

Attraction of capital is essential for all utilities, especially those who need to spend large sums of money to enhance reliability, improve infrastructure and add new generation. This is particularly true regarding baseload generation, which is more expensive and takes longer to construct.

Aquila is a vertically integrated utility needing to make significant investments in all three of these areas. This commission has to avoid the temptation of being punitive in rate proceedings to the extent it leaves a company vulnerable to problems caused by undercapitalization and inadequate earnings potential.

Missouri utilities, including Aquila, seem to have no problem attracting investment capital. However, recent events such as the collapse of the Amaranth hedge fund and its effect on the futures market for natural gas, the proposed acquisition of Texas Utilities (TXU) by private equity firms and Pirate Capital's rattling of the saber in the middle of this rate case begs the question of who's going to actually run the company and whether some investors require greater regulatory scrutiny.

Although the issue is not squarely in front of us in this case, the generally accepted principle that "cash is cash" may no longer be true when a group of new, more active investors pushes its way through the boardroom doors, and if the short-term interests of those investors collide with and ultimately prove detrimental to the long-term benefit of ratepayers - the public interest.

For instance, a five-year plan designed to reduce debt and improve Aquila's capital structure could ultimately increase the company's return in a rate case at the expense of delaying improvements necessary to enhance the reliability of the Aquila system. This type of action might be detrimental to the current generation of Aquila ratepayers in terms of reliability and risk further rate increases to the next generation of Aquila customers.

This Commission is likely to view a conscious decision by utility management to purchase power and pass it through a fuel adjustment mechanism, rather than construct appropriate generation resources as detrimental to ratepayers. Neither of these issues is before this commission today, but they are foreseeable, particularly where a company has demonstrated questionable decision-making ability in the past. This commission must be vigilant against conduct that is not in the long-term best interests of the state and its ratepayers.

B. Concerns regarding Aquila management decisions affecting the company's ability to attract capital:

The commission staff -- led by Bob Schallenberg, Director of the PSC's Utility Services Division -- and others here at the Commission have consistently taken a longrange view of utility planning - spanning 30 years or longer.¹⁷⁷ These views are most evident in cases where the prudence of constructing new generation assets is an issue. In those cases, the PSC staff has taken positions in favor of Missouri electric utilities owning their own electric generation because it is more reliable to have generation facilities located near the customers being served and cheaper once the costs are depreciated over a period of thirty years or longer. Companies that followed this strategy and built excess generation capacity, like KCP&L and Ameren UE, have used off-system sales of their excess electricity to subsidize costs to their regulated utility customers.

Both utilities and customers have benefited under this regulatory framework. Ameren UE and KCP&L generated earnings for their investors and avoided rate increases for almost two decades, while actually reducing the rates paid by their customers over that same period. This accomplishment is no small feat and provides strong support for the long-term approach espoused by Mr. Schallenberg and the rest of the PSC staff in this regard.

In contrast to Ameren UE and KCP&L, Aquila purchases a substantial portion of the electricity it needs to meet customer demands. Aquila even divested its interest in the Aries plant and then unsuccessfully tried to re-acquire the plant. The evidence in this case shows Aquila's fuel and purchased power expenses have risen rapidly and all relevant information at our disposal indicates that these costs will continue to rise -- the only question is how much?

Aquila needs more baseload generation and, according to the PSC staff, at least two more gas-fired turbines. Constructing power plants is expensive and these facilities constitute only a portion of Aquila's capital concerns. Based on the PSC staffs depreciation studies, Aquila's distribution system is one of the oldest in the state and likely in need of further investment. It could be argued that investments

¹⁷⁷ Equally important to note is that, to the best of this commissioner's knowledge, the PSC staff has always opposed acquisition premiums being passed through to utility ratepayers and the Missouri PSC has never approved such a premium.

should have already been made, but simply weren't made because Aquila did not have the cash flow to make them.

Last year, the Office of Public Counsel (OPC) filed a request seeking a management audit of Aquila in case number EO-2006-0356. The PSC Staff performed a limited audit and Mr. Mills filed a response raising some very valid points on behalf of OPC in response to those findings on October 31, 2006. This commission subsequently issued an order "accepting" the report and directing Aquila to comply with all of the recommendations contained therein on March 13, 2007. Although the order was silent as to the issue, it is noteworthy that KCP&L's proposed acquisition of Aquila was announced in January 2007.¹⁷⁸ Had the proposed acquisition not been announced, it is almost a certainty that Aquila's management would have faced more scrutiny of its management decisions and this commission would be entertaining further suggestions from Mr. Mills' office. Pending the outcome of that case, we still might be considering further steps regarding Aquila management.

Mr. Mills is correct in that there are ample grounds for questioning the prudence of Aquila's management, past and present. These include:

- Management decisions to pursue unregulated business ventures that eventually caused Aquila to hemorrhage money, lose its investment grade status and some would say neglect its customers for years;
- The decision of Aquila to sell its interest in the Aries plant to Calpine and the subsequent mishandling of the zoning, siting and construction of the South Harper generating facility which will be a source of controversy for this commission, the courts and the legislature for years to come .
- A subsequently corrected "accounting error" discovered in a previous rate case that under-funded employee pension benefits;
- Aquila's decisions that led the company to pay \$25 million to settle claims with the Commodities Futures Trading Commission (CFTC) and the PSC's subsequent lawsuit against Aquila Inc., Aquila Merchant Services, Inc., and other energy marketers seeking monetary damages for allegations of natural gas price manipulation.

C. How should this commission resolve lingering allegations of imprudence by Aquila management?

In fairness to Aquila's current management, I am not sure if different management would have been able to perform better given the same circumstances. Although I might agree with the PSC staff, OPC and other interested parties on a philosophical level, the commission employs a "reasonable person standard" to determine whether the company's decision was reasonable under the circumstances. Imprudence on the part of a utility is difficult to prove under this standard for two reasons: First, the company is usually able to put forth some evidence its managers were acting prudently under the circumstances; and second, damages are often difficult, if not impossible, to quantify. That being said, when one considers the totality of the circumstances, Mr. Mills is justified in his desire that this commission keep a tight leash on Aquila.

¹⁷⁸ See Case No. EM-2007-0374

There is no question Aquila's decisions have been detrimental to its ratepayers. That detriment is difficult, if not impossible, to quantify; nor is it feasible to calculate whether or not those decisions should have been dealt with by this commission in previous rate proceedings subsequent to the alleged imprudent behavior actually occurring. There is no clear answer to this question and these issues will continue to haunt Aquila management for years to come regardless of who's in charge.

CONCURRENCE OF COMMISSIONER LINWARD APPLING

I write separately to emphasize two items that underlie this Report and Order.

First, parties should keep in mind that pointing the Commission to the results of other cases, even recent cases, is not particularly helpful. The Commission must exercise its judgment based on the evidence about this utility in this record. The circumstances of one utility are different from others; the circumstances of the same utility change over time from one case to the next; and, most importantly, the evidentiary record varies greatly from case to case, even on the same issue. Thus, different results from case to case are to be expected. It is not that the Commission forgets the results of recent rate cases, it is that those results are not controlling.

Second, the need to provide customers and utilities with specific rates tends to make us forget that ratemaking is not an exact science; that rate-setting consists of application of good judgment and common sense; and that rates are not the result of the rote application of formulas. Thus, the use of a particular figure in calculating a revenue requirement does not imply that all other figures are unreasonable, nor that all other results are unreasonable.

The General Assembly adopted Section 386 .266 to provide the Commission with another tool to set just and reasonable rates for utilities and customers. The Commission does not believe, and no party has suggested, that in providing this additional tool the General Assembly intended to overturn the long-standing principle that utilities are not guaranteed a particular return on investment, but only have the opportunity to earn a fair and reasonable return. Thus, it cannot be maintained that the passage of S.B. 179 guarantees that a utility earn the particular return used by the Commission in setting rates.

These principles are particularly pertinent in this case. Based on the stipulated rate base and capital structure (Stipulation and Agreement, paragraph 13; Schedule 4), and a return on equity of 10.25%, Aquila's annual return on investment will be some \$54,557,000 per year. The Commission has authorized a fuel adjustment clause that will permit Aquila to recover 95% of its prudently incurred fuel costs above a base level. It appears from the evidence in the record that, if Aquila cannot contain its fuel costs to the base amount, that it may not recover between \$3,000,000 and \$6,000,000 of its annual fuel costs, thus reducing its return on investment by a similar amount. These are the figures to keep in mind when gauging the fairness of Aquila's fuel adjustment clause.

It is in light of all of the above considerations that a fuel adjustment clause permitting recovery of 95% of specified fuel costs above a base amount, together with the provisions for prudence reviews, strikes a reasonable balance of the interests of ratepayers in the lowest reasonable rates with Aquila's interest in full recovery of its reasonable costs.

*Note: At the time of publication, no other dissents have been issued.

In the Matter of Aquila, Inc., to Implement a General Rate Increase for Retail Electric Service Provided to Customers in Its Aquila Networks-MPS and Aquila Networks-L&P Missouri Service Areas

Case No. ER-2007-0004

Electric, § 1. On May 17, 2007, the Commission issued its Report and Order. In that order, at page 44, the Commission stated that “it would be improper to allow Aquila to flow hedging costs or demand costs associated with any purchased power contract through its fuel adjustment clause.” Hedging costs and demand costs are also referred to collectively on page 43. In each instance the phrase “hedging costs” was inadvertently included.

ORDER CLARIFYING REPORT AND ORDER

Issue Date: May 22, 2007

Effective Date: May 27, 2007

Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P, filed a motion on May 18, 2007, asking for clarification. This order addresses the motion.

On May 17, 2007, the Commission issued its Report and Order. In that order, at page 44, the Commission stated that “it would be improper to allow Aquila to flow hedging costs or demand costs associated with any purchased power contract through its fuel adjustment clause.” Hedging costs and demand costs are also referred to collectively on page 43. In each instance the phrase “hedging costs” was inadvertently included. The language in question was only intended to address appropriate treatment of demand costs.

The treatment of hedging costs was addressed by the parties in the Stipulation and Agreement as to Certain Issues (Stipulation and Agreement). On April 12, 2007, the Commission approved the Stipulation and Agreement. Under the Stipulation and Agreement, prudently incurred hedging costs will flow through the fuel adjustment clause, but Aquila’s 2006 hedge settlement losses of \$11.5 million were expressly excluded. The Stipulation and Agreement further provides that the ultimate settlement values of Aquila’s hedge contracts in place on March 27, 2007, will not be subject to prudence review. Any hedge position taken after March 27, 2007, however, is subject to a prudence review and potential disallowance.

IT IS ORDERED THAT:

1. Aquila’s Motion for Clarification filed on May 18, 2007, is granted, as addressed in the body of this order.
2. This order shall become effective on May 27, 2007.

Cherlyn D. Voss, Regulatory Law Judge,
by delegation of authority pursuant to
Section 386.240, RSMo 2000.

Metropolitan St. Louis Sewer District v. Missouri-American Water Company

Case No. WC-2007-0040

Sewer, § 10. The Commission ordered that the Metropolitan St. Louis Sewer District shall compensate Missouri –American Water Company, a private water company, for the data obtained by Missouri-American during meter readings under the authority of statute § 249.645.

APPEARANCES

Jacqueline Ulin Levey and J. Kent Lowry, Attorneys at Law, Armstrong Teasdale, LLC, One Metropolitan Square, Suite 2600 St. Louis MO 63102, for Metropolitan St. Louis Sewer District.

Kenneth C. Jones, Corporate Counsel, Missouri-American Water Company, 727 Craig Road, St. Louis, MO 63141, for Missouri-American Water Company.

Christina L. Baker, Assistant Public Counsel, Office of the Public Counsel, P.O. Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Keith R. Krueger, Deputy General Counsel, Missouri Public Service Commission, Governor Office Building, Suite 800, 200 Madison Street, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

JUDGE: Kennard L. Jones

REPORT AND ORDER

Issue Date: May 22, 2007

Effective Date: June 1, 2007

Summary

In this Report and Order the Missouri Public Service Commission concludes that Section 249.645 RSMo 2000 allows private water companies to charge sewer districts for meter-reading data.

FINDINGS OF FACT

The Commission notes that the parties have filed a Joint Statement of Facts. To facilitate reference to those facts, the Commission will hereunder recite a portion thereof.

Procedural History

Metropolitan St. Louis Sewer District filed a complaint against Missouri-American Water Company alleging that the meter-reading data gathered by Missouri-American should, under Missouri law, be provided to MSD at no charge. Missouri-American disagrees and asserts that MSD must continue to compensate Missouri-American for the information. The parties filed a Joint Statement of Facts and the Commission heard oral argument. Thereafter, the parties, including the

Office of the Public Counsel and the Staff of the Commission, filed post hearing briefs.

Joint Statement of Facts

1. MSD is a sewer district, as referenced in Section 249.645 RSMo 2000, and provides sewer service in the city and county of St. Louis, Missouri.

2. Missouri-American is a public utility, regulated by the Commission, which provides water service to customers in St. Louis County.

3. Missouri-American has approximately 348,000 quarterly-read meters and 1,000 monthly-read meters in St. Louis County, for a total of approximately 1,404,000 reads per year.

4. In order to read its meters, Missouri-American must physically read each meter.

5. Missouri-American's budgeted cost for meter reading in St. Louis County for 2007 is \$1,926,210 (which includes labor and labor-related expenses of \$1,792,506, vehicle expense of \$107,256, and meter-reading equipment expense of \$26,448).

6. In 1993, MSD and St. Louis Water Company (Missouri-American's predecessor) entered into an agreement whereby St. Louis Water Company agreed to provide to MSD certain water usage and customer identification data for a fee.

7. MSD sought the Water Usage Data to develop a new billing procedure for residential sewer service based on water usage rather than a flat rate, which had been used through the effective date of the 1993 Agreement.

8. The Water Usage Data provided to MSD under the terms of the 1993 Agreement was gathered through readings and estimates done by St. Louis County Water Company for its own billing purposes.

9. In the 1993 Agreement, the parties agreed that MSD would compensate approximately 50% of St. Louis Water Company's cost of obtaining the necessary data.

10. This amount of compensation was included in St. Louis Water Company's tariff which the parties agreed must be approved by the Commission.

11. The tariff rate proposed by the parties and subsequently approved by the Commission was \$1.24 per residential customer per year.

12. The term of the Agreement was from July 1993 to July 1995 and from year to year thereafter subject to termination by either party at any time on 30 days written notice.

13. Thereafter, the Commission approved an amendment to the agreement adjusting for winter usage data, to more accurately reflect just compensation.

14. The amount that MSD paid to St. Louis Water Company continued to increase through 1998.

15. In 2002, MSD and Missouri-American entered into a new agreement whereby MSD would compensate Missouri-American approximately 50% of Missouri-American's cost of obtaining the Data.

16. The term of the 2002 Agreement was until the end of 2003 and from year to year thereafter subject to termination by either party at any time upon 30 days notice.

17. By way of correspondence between the parties in September of 2003, the parties terminated the 2002 Agreement effective on December 31, 2003.

18. To date the parties have been unable to finalize a new agreement regarding the provision of Water Usage Data.

19. Pending the parties' dispute, Missouri-American has continued to provide MSD with the data and MSD has continued to compensate Missouri-American according to their 2002 Agreement.

20. Missouri-American represents, and MSD has no reason to dispute, that since 1999, MSD has paid Missouri-American the following amounts for Water Usage Data: \$444,059.921 (1999); \$445,415.75 (2000); \$447,830.09 (2001); \$701,860.68 (2002); \$759,823.74 (2003); \$756,194.40 (2004); \$764,900.56 (2005); and \$766,930.14 (2006).

21. If MSD does not pay the fee required by Missouri-American, it has no way of calculating its charges for sewer service, other than conducting its own water meter readings or estimates.

23. In its last rate proceeding¹, Missouri-American submitted a revised tariff to the Commission seeking approval for a flat annual rate of \$760,000 for the provision of Water Usage Data to MSD based on MSD's payment of \$759,823.74 for such Data in 2003.

24. Because MSD and Missouri-American were still negotiating a new agreement, the parties agreed that Missouri-American would withdraw those sheets pertaining to the charge to MSD.

DISCUSSION

The parties do not dispute that Section 249.645 RSMo 2000 controls. The relevant portion of that statute, from subsection 1, is as follows:

Any private water company, public water supply district, or municipality supplying water to the premises located within a sewer district shall, upon reasonable request, make available to such sewer district its records and books so that such sewer district may obtain therefrom such data as may be necessary to calculate the charges for sewer service.

The question is whether Missouri-American can charge MSD for meter-reading data. As is apparent, the statute does not explicitly address compensation for the information supplied by water suppliers to sewer districts.

MSD argues that under proper statutory construction, the Commission must conclude that the legislature's intention is that Missouri-American supply its water usage information to MSD free of charge. MSD reasons that the legislature, while enacting a similar statute² and during other sessions, had the opportunity to add language explicitly permitting Missouri-American to charge for the information. MSD concludes that because the legislature is presumed to know the state of the law when it passes legislation,³ and chose not to add language explicitly allowing a charge, then the information must be provided free of charge.

As pointed out by Missouri-American, the Commission has "a duty to read statutes in their plain, ordinary, and usual sense. Where there is no ambiguity, we cannot look to any other rule of construction."⁴ Hence, before looking to other statutes to determine the meaning of Section 249.645.1, the Commission must find

¹ Commission Case No. WR-2003-0500.

² Section 250.233 RSMo 2000.

³ During oral argument, Tr. Page 36, lines 2-7, MSD refers to *Nicholi v. City of St. Louis*, 762 S.W. 2d 423 in support of this argument.

⁴ *Bosworth v. Sewell*, 918 S.W. 2d 773, 777 (Mo. 1996).

that it is ambiguous. As noted above, Section 249.645 does not contain explicit language regarding charges for the relevant information. Missouri-American contends that the language is not ambiguous and that the phrase “upon reasonable request”, assumes a reasonable charge.⁵ Further, Missouri-American contends that the parties’ and the Commission’s past behavior should be given great consideration in interpreting the statute.

This point is well taken. The parties have historically agreed to, and the Commission has approved, a charge for the water usage information. Thus, read in its “usual” sense, as is evidenced by the parties’ past practice, the Commission must find that the statute contemplates a reasonable charge for the information. However, MSD urges the Commission to look outside of §249.645 to find the statute ambiguous. The ambiguity is therefore created by breaking the rule first rule of construction set out in *Bosworth*.

As part of its argument concerning statutory construction, MSD compares the relevant statute to Section 250.233. Section 249.645 concerns sewer districts while Section 250.233 concerns cities, towns and villages. The relevant language is the same in both, except that Section 250.233 contains language concerning a charge for the information. As pointed out by Staff, MSD has cited no reason why the legislature would treat municipal sewer systems differently than sewer districts.⁶ Although MSD argues that the burden to show this different treatment lies with Staff and Missouri-American,⁷ it is MSD that proposes that there be different treatment. The burden to show this distinction therefore lies with MSD.

If the legislature was specifically aware that Section 249.645 did not have language regarding a charge for the information, the Commission must ask why, when enacting this legislation, didn’t the legislature add language stating that the information should be provided *free of charge*? This is the converse of MSD’s argument. Just as MSD argues that the legislature’s inaction with regard to the disputed statutory language should be interpreted to mean the legislature intended the information to be free, the Commission can reason that the same inaction means the information should not be free. Hence, the Commission can not gather any legislative intent from the legislature’s inaction with regard to adding language, in Section 249.645, having to do with compensation.

Without the benefit of specific legislative intent, the Commission must broadly “seek to ascertain the intention of the lawmakers by giving the words used their ordinary meaning, by considering the entire act and its purposes, and by seeking to avoid unjust, absurd, unreasonable, confiscatory or oppressive results.”⁸ To adopt MSD’s interpretation of Section 249.645 would be to ensure, not avoid an unjust, unreasonable, absurd and confiscatory result.

MSD argues that it would be more unjust, unreasonable, absurd, confiscatory or oppressive to interpret the statute in such a way as to force a public entity to share a private entity’s total data collection costs.⁹ MSD’s argument bares absolutely no weight in this regard. First, MSD is not being forced to subsidize or share in Missouri-American’s costs. MSD can send its own workers out to gather the

⁵ Missouri-American’s Post-Hearing Brief, Page 3, full paragraph 2.

⁶ Staff’s Post-Hearing Brief, Page 6, paragraph 3.

⁷ MSD’s Post-Hearing Reply Brief, Page 4.

⁸ *State ex rel. Killingsworth*, 168 S.W.3d 621 (Mo. App. E.D. 2005).

⁹ MSD’s Post-Hearing brief, Page 7, paragraph 3.

information it needs in order to bill its customers. The Constitutions of the United States and of Missouri, as pointed out by Staff, clearly state that "private property shall not be taken for public use without just compensation and that no person shall be deprived of . . . property without due process of law."¹⁰ The meters and the water-usage information Missouri-American gathers from those meters is unquestionably Missouri-American's property. Also, Missouri-American is a private entity. The data Missouri-American gathers is therefore private property. MSD is a public agency. The Commission finds that in order for a request under Section 249.645 to be reasonable, it must include a charge for the information. MSD must therefore give "just compensation" for the "private property" it receives from Missouri-American.

CONCLUSIONS OF LAW

Although the Commission entertains MSD's argument of statutory construction, the Commission concludes that it need not look outside the relevant statute to determine its plain, ordinary and usual meaning.

The Commission also concludes that MSD, not Staff or Missouri-American, bears the burden of proof to show why the legislature chose to explicitly state in §250.233 that certain entities must pay a reasonable charge to water companies but did not explicitly include such language in Section 249.645.

DECISION

Within the context of Section 249.645, the Commission finds that a reasonable request for information includes a reasonable charge. Further, even going outside of the relevant statute and comparing it to Section 250.233 the Commission is unable to find that the legislature intended that there be no charge under Section 249.645. The words in Section 250.233 concerning a charge are not superfluous. Those words mean that there shall be a charge under that section. They do not, however, mean that there shall be no charge under Section 249.645. This result would be unreasonable, confiscatory and, not intending an unreasonable interpretation of its statutes, could be the reason the legislature did not see the necessity to add explicit language in Section 249.645 concerning a charge for water-usage information.

The Commission is aware that Missouri-American has a pending rate case.¹¹ MSD must compensate Missouri-American for its water-usage information. The amount of that compensation will be considered in the pending rate case.

IT IS ORDERED THAT:

1. Metropolitan St. Louis Sewer District shall compensate Missouri-American Water Company for Missouri-American meter-reading data.
2. This order shall become effective on June 1, 2007.
3. This case may be closed on June 2, 2007.

Davis, Chm., Murray, Clayton,

¹⁰ Amendment V to the U.S. Constitution and Article I, Section 10 of the Missouri Constitution.

¹¹ Commission Case No. WR-2007-0216.

and Appling, CC., concur;
Gaw, C., dissents, with separate
dissenting opinion to follow;
and certify compliance with the
provisions of Section 536.080, RSMo.

Dissenting Opinion of Commissioner Steve Gaw

I dissent in this case primarily because I disagree with the statutory construction analysis of the Majority. The Majority decision ignores a significant rule of interpretation. Words in a statute should be assumed to have some intended meaning. In this case the relevant statute, Section 244.645 RSMo states in pertinent part: *...Any private water company, public water supply district, or municipality supplying water to the premises located within a sewer district shall, **upon reasonable request**, make available to such sewer districts its records and books so that such sewer district may obtain therefrom such data as may be necessary to calculate the charges for sewer service...*

The question as to the meaning of this language as it applies to the question before us is not clear. On its surface the statute does not appear to suggest that there should be a charge for the access by Metropolitan St. Louis Sewer District (MSD) of information collected by Missouri American as a result of its normal and necessary actions in collecting customer billing information. This interpretation is bolstered by language used in another section on the same subject but regarding different political subdivisions. Section 250.233 RSMo, in pertinent part states: *...Any private water company or public water supply district supplying water to the premises located within said city, town or village shall, **at reasonable charge upon reasonable request**, make available to such city, town or village its records and books so that such city, town or village may obtain therefrom such data as may be necessary to calculate the charges for sewer service...* The additional language in this section as highlighted under rules of statutory construction must be given some meaning. The statutory history in this case makes it clear that the legislature opened §249.645 at the time it enacted §250.233. Yet the difference in the language is clear. By not acknowledging a difference, the Majority renders the additional language in §250.233 meaningless. The legislature appears to have intended that MSD have open access to the billing books of Missouri American in order to avoid unnecessary duplication of meters and meter reading. Providing MSD access to this information in and of itself, arguably does not cause cost to Missouri American. Moreover access is not the same as a request by MSD for manipulation or delivery of the data by Missouri American which would be subject to appropriate

charges. The statute does not require anything of Missouri American other than granting access to its records upon reasonable request.¹

There may be a question as to whether the state unconstitutionally requires Missouri American to provide access to its records by another entity other than a regulatory authority. However, this Commission does not have the authority to declare statutes unconstitutional. Absent such a finding, the legislature's decision to add language in §250.233 allowing for a reasonable charge would seem to express an intent that there be no charge for access to information when the language is absent in §249.645.

For these reasons, I must dissent.

In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area*

Case No. ER-2007-0002

Electric §20. This order denies AmerenUE's request for a fuel adjustment clause. It allows AmerenUE to increase the revenue it may collect from its Missouri customers by approximately \$43 million. As a result, the average residential customer's monthly bill will increase by \$2.33, or approximately 3.26 percent.

APPEARANCES

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Lewis Mills and Christina Baker, Attorneys at Law, P.O. Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the Public.

¹ The Majority opinion's legal analysis suggesting that MSD must find some logical explanation for why the legislature might have decided to have a different policy for MSD than for sewer districts in other areas is not supported by cited legal authority. The Missouri statutes are filled with provisions that vary from one class of political subdivision to another. To expect a party to explain why the legislature might have enacted different policy for one class of political subdivisions than another before the difference would be given meaning, appears to be a novel concept in statutory interpretation.

*This case was appealed to the Missouri Court of Appeals (WD69259) and affirmed. See 274 S.W.3d 569 (Mo. App. W.D. 2009).

UNION ELECTRIC COMPANY D/B/A AMERENUE

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DEPUTY CHIEF REGULATORY LAW JUDGE: Morris L. Woodruff

REPORT AND ORDER

Issue Date: May 22, 2007

Effective Date: June 1, 2007

Summary

This order denies AmerenUE's request for a fuel adjustment clause. It allows AmerenUE to increase the revenue it may collect from its Missouri customers by approximately \$43 million. As a result, the average residential customer's monthly bill will increase by \$2.33, or approximately 3.26 percent.

Procedural History

On July 7, 2006, Union Electric Company d/b/a AmerenUE filed tariff sheets designed to implement an annual general rate increase for electric service in the amount of \$360,709,000. The tariff revisions carried an effective date of August 6, 2006.

On July 11, the Commission suspended AmerenUE's tariff until June 4, 2007, the maximum amount of time allowed by the controlling statute.¹ In the same order, the Commission directed that notice of AmerenUE's tariff filing be provided to interested parties and the public. The Commission also established July 31 as the deadline for submission of applications to intervene.

The State of Missouri; the Missouri Energy Group (MEG);² Noranda Aluminum, Inc.; the Missouri Department of Natural Resources; Aquila, Inc.; the Missouri Industrial Energy Consumers (MIEC);³ Laclede Gas Company; AARP; the Consumers Council of Missouri; and MOKAN CCAC submitted timely applications and were allowed to intervene. Subsequently, the Missouri Association for Social Welfare; the Missouri Department of Economic Development; The Commercial Group;⁴ the Missouri Retailers Association and the UE Joint Bargaining Committee filed late applications and were also allowed to intervene.

On September 12, the Commission established the test year for this case as the 12-month period ending June 30, 2006, with a further true-up period through January 1, 2007. In the same order, the Commission established a procedural schedule leading to a hearing beginning on March 12.

The Commission conducted sixteen local public hearings at which the Commission heard comments from AmerenUE's customers and the public regarding AmerenUE's request for a rate increase. Public hearings were held in St. Louis County and in the City of St. Louis on January 2, in Columbia and Rolla on January 3, in Cape Girardeau and Dexter on January 4, again in St. Louis County and the City of St. Louis on January 8, in Wentzville on January 9, in Kirksville and Hayti on January 10, in Jefferson City and Excelsior Springs on January 11, in Mexico and Moberly on January 12, and in Hillsboro on January 17.

The parties prefiled direct, rebuttal, and surrebuttal testimony. The evidentiary hearing began on March 12, and continued through March 29. Further true-up direct testimony was prefiled on April 6, but the parties agreed that no true-up hearing was needed and the true-up hearing scheduled for April 19 and 20 was canceled.

Public Counsel's Motion to Dismiss

On January 12, 2007, the Office of the Public Counsel filed a motion asking the Commission to dismiss AmerenUE from this case, for its failure to have an attorney enter an appearance at three of the multiple local public hearings held in this case. As the basis for its motion, Public Counsel points to Commission Rule 4 CSR 240-2.116(3), which provides the Commission may dismiss a party from a case for failure

¹ Section 393.150, RSMo 2000.

² The members of MEG are Barnes-Jewish Hospital, Buzzi Unicem USA, Inc.; Holcim US, Inc.; and SSM HealthCare.

³ The members of MIEC are Anheuser-Busch Companies, Inc.; Bandwidth Exchange Buildings, L.L.C.; BioKyowa, Inc.; The Boeing Company; DaimlerChrysler; Enbridge, Inc.; Ford Motor Company; GKN; General Motors Corporation; Hussman Corporation; JW Aluminum; MEMC Electronic Materials, Inc.; Monsanto; Pfizer; Precoat Metals; Proctor & Gamble Company; Nestlé Purina PetCare; Solutia; and U.S. Silica Company.

⁴ The members of the Commercial Group are JCPenney Corporation, Inc.; Lowe's Home Centers, Inc., and Wal-Mart Stores East, LP.

to comply with any order issued by the Commission, including a failure to appear at a public hearing. AmerenUE filed a response to Public Counsel's motion on January 16. Public Counsel replied on January 18. No other party has responded.

The rule cited by Public Counsel gives the Commission discretion to dismiss a party from a case for failing to comply with a Commission order to appear at a local public hearing, or other scheduled proceeding. The Commission's order scheduling fifteen local public hearings regarding AmerenUE's request for a rate increase was issued on November 3, 2006. A sixteenth local public hearing was subsequently scheduled in an order issued on January 5. Neither order explicitly requires counsel representing any party to appear at any local public hearing. Therefore, Public Counsel cannot point to any Commission order AmerenUE has violated.

The Commission schedules local public hearings to allow the public an opportunity to be heard. The sworn testimony citizen witnesses offer at the local public hearing is made a part of the record and may be relied upon by the Commission when making its decision regarding AmerenUE's request for a rate increase. For that reason, attorneys for the various parties are given an opportunity to question witnesses if they desire to do so. A party deciding not to send an attorney to a local public hearing does so at its own risk. Nevertheless, the presence of legal counsel for the parties is not essential to the local public hearing process. Therefore, if a party decides to forego the opportunity to question citizen witnesses by not sending an attorney to a local public hearing, neither the public, nor the Commission's process is harmed. In fact, many parties to this, as well as other rate cases, choose not to send an attorney to local public hearings.

The Commission certainly expects that a utility requesting a rate increase will send representatives to each local public hearing to answer questions from the public, and more importantly, to listen to the concerns and complaints of its ratepayers. AmerenUE had employees present at all of the local public hearing to fulfill that role, even though it did not have an attorney available to enter a formal appearance at some of the hearings.

There is no basis for dismissing AmerenUE from this case, and the Commission will deny Public Counsel's motion.

The Partial Stipulations and Agreements

During the course of the evidentiary hearing, various parties filed three unanimous partial stipulations and agreements resolving several issues that would otherwise have been the subject of testimony at the hearing. No party opposed the partial stipulations and agreements. As permitted by its regulations, the Commission treated these unopposed partial stipulations and agreements as unanimous.⁵ After considering each of the stipulations and agreements, the Commission approved them as a resolution of the issues addressed in those agreements.⁶ The issues that were resolved therein will not be further addressed in this report and order.

⁵ 4 CSR 240-2.115(C).

⁶ An *Order Approving Partial Stipulation and Agreement Concerning Class Cost of Service and Certain Rate Design Issues Filed on March 22, 2007* was issued on April 5, 2007; An *Order Approving Tier I Partial Stipulation and Agreement Filed on March 15, 2007*, and an *Order Approving Tier II Partial Stipulation and Agreement filed on March 26, 2007*, were issued on April 11, 2007.

Overview

AmerenUE is an investor-owned utility providing retail electric service to large portions of eastern and central Missouri, including the St. Louis metropolitan area. It is the largest electric utility in Missouri, serving approximately two million customers. AmerenUE is a subsidiary of Ameren Corporation, which is a holding company that owns electric utilities in Illinois, as well as various other unregulated subsidiaries.

AmerenUE began the rate case process when it filed its tariff on July 7, 2006. In doing so, AmerenUE asserted it was entitled to increase its rates enough to generate an additional \$360,709,000 in gross electric revenues per year. AmerenUE set out its rationale for increasing its rates in the direct testimony it filed along with its tariff on July 7. In addition to its filed testimony, AmerenUE provided work papers and other detailed

information and records to the Staff of the Commission, Public Counsel, and to the intervening parties. Those parties then had the opportunity to review AmerenUE's testimony and records to determine whether the requested rate increase was justified.

Obviously, there are a multitude of matters about which the parties could disagree. Fortunately, there was no disagreement about many matters and, as a result, those potential issues were never brought before the Commission. Where the parties disagreed, they prefiled written testimony for the purpose of raising those issues to the attention of the Commission. All parties were given an opportunity to prefile three rounds of testimony – direct, rebuttal, and surrebuttal. The process of filing testimony and responding to the testimony filed by other parties revealed areas of agreement that resolved some issues and areas of disagreement that revealed new issues. On March 7, 2007, the parties filed a Joint Statement of Issues listing the issues they asked the Commission to resolve.

As previously indicated, a number of the identified issues were resolved by the approved partial stipulations and agreements and will not be further addressed in this report and order. The remaining issues will be addressed in turn. Factual matters will be addressed in the Findings of Fact section. If an issue also contains a legal aspect, that portion of the issue will be addressed in the Conclusions of Law section.

Taum Sauk

Before addressing the issues identified by the parties, there is one additional matter that needs to be mentioned because it has received a great deal of attention from the public and the press. On December 14, 2005, the upper reservoir at AmerenUE's Taum Sauk pumped storage facility in Reynolds County, Missouri ruptured, allowing 1.5 billion gallons of water to rush down the side of a mountain and through Johnson's Shut-Ins State Park. Fortunately, no one was killed in the flood, although several people were injured, but the raging waters caused extensive property and environmental damage.⁷

AmerenUE claims to accept full responsibility for the reservoir failure and the resulting damages. Consequently, its rate increase request does not include any money to pay for cleanup of the park, reimbursement of the expenses incurred by

⁷ Birk Direct, Ex. 025, Page 22, lines 15-19.

the State of Missouri, or for resolution of individual damage claims.⁸ Furthermore, AmerenUE has not asked to recover the cost of fines or penalties imposed by the federal or state governments as a result of the Taum Sauk disaster.

In a rate case such as this, the Commission establishes the rates a utility may charge based in part on the expenses the utility incurs to provide service to its customers. If an expense is not allowed into the utility's cost of service, its rates will be set at a level which does not allow the company to recover that cost from its customers. Since AmerenUE will not be allowed to include the Taum Sauk expenses in its cost of service as calculated for this case, those costs will not be recovered from ratepayers and will instead have to be paid with shareholder funds.

The exclusion of the direct expenses of cleaning up the Taum Sauk mess is not the end of the matter. AmerenUE used the Taum Sauk pumped hydro power plant to provide electricity to its customers, as well as to generate power to sell off-system in the wholesale electricity market. With the Taum Sauk plant unable to generate electricity because of the failure of the reservoir, AmerenUE will have to generate electricity for its own customers using other, more expensive, power plants. Furthermore, it will be unable to sell power from the Taum Sauk plant in the profitable wholesale market. Since profits from off-system sales are used to offset AmerenUE's cost of service, and thereby reduce the rates paid by AmerenUE's customers, the loss of revenue from the Taum Sauk plant could have adverse consequences for ratepayers, aside from the direct cost of cleanup.

To avoid harming ratepayers, AmerenUE agreed that the various studies and cost models that are used to determine the company's cost of service should be based on the assumption the Taum Sauk plant has remained in operation throughout the test year. By using these models that assume the Taum Sauk plant is still operating, the Commission will be able to establish rates that protect ratepayers from having to pick up the bill for either the cleanup costs or the lost revenues resulting from the Taum Sauk disaster. Very late in this case, Public Counsel proposed an additional adjustment to AmerenUE's revenue requirement based on an argument that AmerenUE should account for a possible loss of opportunities to sell the regulatory capacity of the Taum Sauk Plant. The Commission deals with that question later in this order.

The Rate Making Process

The rates AmerenUE will be allowed to charge its customers are based on a determination of the company's revenue requirement. AmerenUE's revenue requirement is calculated by adding the company's operating expenses, its depreciation on plant in rate base, taxes, and its rate of return multiplied by its rate base. The revenue requirement can be expressed as the following formula:

$$\text{Revenue Requirement} = E + D + T + R(V-AD+A)$$

Where: E = Operating expense requirement

D = Depreciation on plant in rate base

T = Taxes including income tax related to return

R = Return requirement

(V-AD+A) = Rate base

For the rate base calculation:

V = Gross Plant

⁸ Baxter Direct, Ex. 001, Page 34, Lines 14-17.

AD = Accumulated depreciation

A = Other rate base items

All parties accept the basic formula. Disagreements arise over the amounts that should be included in the formula.

Conclusions of Law Regarding Jurisdiction

AmerenUE is a public utility, and an electrical corporation, as those terms are defined in Section 386.020(42) and (15), RSMo Supp. 2006. As such, AmerenUE is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

Section 393.140(11), RSMo 2000, gives the Commission authority to regulate the rates AmerenUE may charge its customers for electricity. When AmerenUE filed a tariff designed to increase its rates, the Commission exercised its authority under Section 393.150, RSMo 2000, to suspend the effective date of that tariff for 120 days beyond the effective date of the tariff, plus an additional six months.

Conclusions of Law Regarding the Determination of Just and Reasonable Rates

In determining the rates AmerenUE may charge its customers, the Commission is required to determine the proposed rate is just and reasonable.⁹ AmerenUE has the burden of proving its proposed increase is just and reasonable.¹⁰

In determining whether the rates proposed by AmerenUE are just and reasonable, the Commission must balance the interests of the investor and the consumer.¹¹ In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.¹²

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on

⁹ Section 393.150.2, RSMo 2000.

¹⁰ *Id.*

¹¹ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, (1944).

¹² *Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 690 (1923).

investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.¹³

The Supreme Court has further indicated:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.¹⁴

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.¹⁵

Furthermore, in quoting the United States Supreme Court in *Hope Natural Gas*, the Missouri Court of Appeals said:

[T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' ... Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts.¹⁶

The Issues

¹³ Id. at 692-93.

¹⁴ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (citations omitted).

¹⁵ *Federal Power Commission v. Natural Gas Pipeline Co.* 315 U.S. 575, 586 (1942).

¹⁶ *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).

1. The Proposed Fuel Adjustment Clause

Discussion:

The rates AmerenUE will be allowed to charge its customers are based on a determination of the company's revenue requirement. A revenue requirement is based on the costs and income the company experienced during a historical test year. For this case, the test year was established as the 12-month period ending on June 30, 2006, with a trueup period running through January 1, 2007. That means the Commission will use the expenses and revenues measured during the test year to predict the expenses the company will be allowed to recover in future rates. Expenses possibly incurred in the future generally are not included in the rate calculations.

Under traditional ratemaking procedures, at the end of the rate case the Commission establishes the rates an electric utility can charge. Once rates are established, the utility cannot change those rates without filing a new rate case and restarting the review process.

However, in 2005, the Missouri legislature passed a law allowing the Commission to establish a mechanism to allow an electric utility to make periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs.¹⁷ The sort of mechanism envisioned by the statute is generally known as a fuel adjustment clause.

AmerenUE has requested a fuel adjustment clause in this rate case and has modified the details of its proposed fuel adjustment clause several times during the course of this proceeding in response to concerns expressed by various parties.¹⁸ The details of the fuel adjustment clause AmerenUE now asks the Commission to approve are found in the surrebuttal testimony of Martin J. Lyons.¹⁹ The fuel adjustment clause AmerenUE proposes would net 100 percent of off-system sales revenue against fuel and purchased power costs. In other words, off-system sales revenue increases would offset rising fuel and purchased power costs. The proposed fuel adjustment clause would spread recovery or return of over- or under-collections over a subsequent 12-month period. It would also contain a four percent cap and deferral mechanism applied separately to each rate class. That deferral mechanism would dampen volatility in the three fuel adjustment clause rate adjustments allowed per true-up year. Additionally, the proposed fuel adjustment clause would contain a sharing mechanism to provide additional incentive to the

¹⁷ Section 386.266, RSMo Supp. 2006.

¹⁸ AmerenUE's initial direct testimony, filed along with its tariff on July 7, 2006, indicated that AmerenUE was requesting a fuel adjustment clause but did not provide a detailed proposal. AmerenUE's proposed fuel adjustment clause was not described in any detail until it filed supplemental direct testimony on September 29. Several parties filed motions objecting to AmerenUE's supplemental direct testimony, arguing that AmerenUE should not be allowed to supplement its rate increase request to add a fuel adjustment clause several months after filing its initial rate increase tariff. The Commission denied those motions in an order issued on November 2, 2006, but the State of Missouri renewed its objection at the hearing (Transcript page 135) and AARP again raised the issue in its brief. Since the Commission is denying AmerenUE's request for a fuel adjustment clause, it will not need to further address those objections.

¹⁹ Ex. 021.

company to lower its net fuel and purchased power costs by either reducing costs or increasing off-system sales.

While the new statute, Section 386.266, allows the Commission to approve a fuel adjustment clause, in effect, overturning a 1979 Missouri Supreme Court decision finding fuel adjustment clauses to be contrary to Missouri law,²⁰ the statute does not require the Commission to approve a fuel adjustment clause. Instead, it specifically gives the Commission authority to reject a proposed fuel adjustment clause after giving an opportunity for a full hearing in a general rate case.²¹ The statute does not, however, provide specific guidance on when a fuel adjustment clause should be approved.

A fuel adjustment clause is a powerful regulatory tool to be used with careful consideration. If a fuel adjustment clause is allowed in an inappropriate situation, the customers who pay for utility service can be forced to pay rates that are higher than they should be. In other circumstances, a fuel adjustment clause may be necessary to allow a utility an opportunity to earn a reasonable return on its investment.

A fuel adjustment clause should be used cautiously because it runs contrary to some of the basic principles of traditional utility regulation. One such principle is the matching of expenses and revenues. Over time, certain expenses incurred by the utility may go up. For example, the wages the electric utility pays its linemen may increase, or a major industrial customer may close, causing a loss of income. At the same time, perhaps the utility saves money when the interest rate it must pay to borrow money goes down, or it adds revenue by serving new customers. The increased costs or decreased income in one area may be balanced by decreased costs or increased revenue in another area.

In a traditional rate case, without a fuel adjustment clause, the Commission examines all the revenue and costs of the utility during a particular period known as a test year. The Commission then matches the revenue and costs, arriving at an amount the utility needs to recover from its ratepayers if it is to earn a reasonable return on its investment. If a fuel adjustment clause, or other tracking mechanism, is established, then the utility would be able to pass on increased costs in one area, in this case fuel and purchased power, without an examination of all the other areas in which its costs may have decreased or its revenues increased. As a result, ratepayers could be required to pay increased rates while the company enjoys increased profits.

Inclusion of a fuel adjustment clause also affects the operation of regulatory lag. Regulatory lag results because a rate case test year, at least in Missouri, is based on a historical test year, usually ending about the time the utility files for a rate increase. Since a rate case takes eleven months to complete, a utility will always be about eleven months behind. Of course, utilities do not particularly like regulatory lag when their costs are increasing, but regulatory lag can also favor the utility when their costs are decreasing. The good effect of regulatory lag is that it provides the utility with a strong incentive to maximize its income and minimize its costs. If, however, a fuel adjustment clause is in place, the utility has less financial incentive to minimize its fuel costs because those costs will be automatically recovered from ratepayers. Efforts can be made to design a fuel adjustment clause in a manner that maintains some incentive; for example, the Missouri statute authorizing a fuel

²⁰ *State ex rel. Utility Consumers Council of Mo., Inc. v. Pub. Serv. Comm'n*, 585 S.W. 2d 41 (Mo. banc 1979).

²¹ Section 386.266.4, RSMo Supp. 2006.

adjustment clause requires the utility to file a new rate case every four years and requires the Commission to review the prudence of the company's purchasing decisions every 18 months. But regulatory reviews are only a partial substitute for the direct incentives that can result from a utility's quest for profit.

Based on the previous paragraphs, it might seem that a fuel adjustment clause should never be inflicted upon ratepayers. But there might be circumstances when the use of a fuel adjustment clause may be necessary to preserve the financial health of the utility, and no one, including ratepayers, benefits when a utility becomes financially unhealthy. In an era where fuel costs are highly volatile, a fuel adjustment clause may be necessary if the company is to earn its authorized rate of return. The problem then is how to determine when a fuel adjustment clause is necessary.

Fuel adjustment clauses are common in other states. In fact, all but two of the 29 non-restructured states without retail competition, other than Missouri, allow their electric utilities to apply to recover fuel and purchased power costs through some type of fuel adjustment clause. The exceptions are Utah and Vermont.²² Therefore, other states' experiences with fuel adjustment clauses can be instructive for this Commission in making its decision whether to grant AmerenUE's request for a fuel adjustment clause.

AmerenUE's Argument for a Fuel Adjustment Clause

While AmerenUE contends the prices it must pay for fuel are volatile, its chief argument seems to be that it must have a fuel adjustment clause because most other similarly situated electric utilities already operate under such a clause. Evidence presented by AmerenUE indicates 51 of 58 utilities in other non-restructured states are able to use a fuel adjustment clause.²³ Although it may seem trivial, AmerenUE's desire to keep up with other utilities is a legitimate cause for the Commission's concern because AmerenUE must compete with those other utilities for investment dollars.

Investors like fuel adjustment clauses because their presence tends to reduce the risk to a utility's cash flow that can result from regulatory lag in a rising cost environment.²⁴ Those investors may be more likely to invest in another utility that has a fuel adjustment clause rather than AmerenUE unless they can receive a higher return on their AmerenUE investment. As a result, AmerenUE's borrowing costs could increase, with a resulting increase in costs being passed on to ratepayers in a future rate case.

Findings of Fact:

Michael L. Brosch, an independent consultant who appeared as a witness for the State, testified he has appeared before public utility commissions around the country on the subject of fuel adjustment clauses.²⁵ He testified that a cost or

²² Lyons Rebuttal, Ex. 020, Page 5, Lines 17-20.

²³ Lyons Surrebuttal, Ex. 020, Page 6, Lines 1-5.

²⁴ Transcript, Page 476, Lines 1-18.

²⁵ Brosch Direct (Revenue Requirement), Ex. 501, page 3, lines 1-8. Also Transcript, Pages 1090-1093.

revenue change should be tracked and recovered through a fuel adjustment clause only if that cost or revenue change is:

1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases;
2. beyond the control of management, where utility management has little influence over experienced revenue or cost levels; and
3. volatile in amount, causing significant swings in income and cash flows if not tracked.²⁶

Brosch based these criteria on his experience from working with expense tracking mechanisms from other proceedings.²⁷ The criteria proposed by Brosch appear to be well accepted in the regulatory community. AARP's expert witness, Ronald Binz, proposed similar criteria in his testimony.²⁸ Indeed, AmerenUE's witnesses do not challenge the validity of the criteria, although they contend AmerenUE's proposed fuel adjustment clause meets those criteria. The Commission will apply those criteria in its evaluation of AmerenUE's request for a fuel adjustment clause.

Are AmerenUE's Fuel and Purchased Power Expenses Substantial?

Brosch's first criterion is whether the expense to be tracked is substantial enough to have a significant impact on the utility. Fuel and purchased power expense is the largest item of expense AmerenUE incurs, comprising approximately 44 percent of the company's operations and maintenance expenses.²⁹ AmerenUE's fuel and purchased power expenses are substantial and meet the first criterion.

Does AmerenUE Have Control over Its Fuel and Purchased Power Expenses?

The second criterion is whether the utility has control over the expense that is to be tracked. The cost items that would be tracked in a fuel adjustment clause are coal, coal transportation, natural gas, oil, and nuclear fuel. AmerenUE generates 79 percent of its electricity from coal-fired power plants,³⁰ with most of the rest generated by nuclear power.³¹ That means the cost of coal and the cost of its transport to the power plants are the largest expenses facing the company. The price of coal and the railroad freight rates to transport coal are established by national or international markets; so AmerenUE does not have complete control

²⁶ Brosch Direct (FAC), Ex. 502, page 16, lines 3-11. Brosch also sets out two additional criteria for what a particular fuel adjustment clause should look like if allowed. Since the Commission has decided that AmerenUE will not be allowed to implement a fuel adjustment clause, those additional criteria need not be addressed.

²⁷ Transcript, Page 1123, Lines 3-5.

²⁸ Binz Direct, Ex. 750, Page 14, Lines 3-9.

²⁹ Ex. 133, Schedule 9.

³⁰ Neff Direct, Ex. 014, Page 3, Lines 14-15.

³¹ Cassidy Rebuttal, Ex. 208, Page 2, Lines 4-14.

over those prices. The same is true of the markets for natural gas, oil, and nuclear fuel.

Nevertheless, AmerenUE purchases and transports a large amount of coal from the Powder River Basin; so it has some ability to negotiate better rates from coal producers and railroads. It employs a staff of experts to conduct those negotiations and purchases.³² While AmerenUE clearly cannot control the markets, it has more ability to influence the prices it pays for fuel and purchased power costs than do its ratepayers who must simply pay the rates allowed by this Commission. Removing AmerenUE's financial incentive to control its fuel costs by allowing those costs to be passed through to ratepayers will not serve the interests of those ratepayers. On balance, the second criterion does not provide a strong basis for either approving or denying AmerenUE's request for a fuel adjustment clause.

Are AmerenUE's Fuel and Purchased Power Expenses Volatile?

The third criterion described by Brosch is that the costs to be tracked are volatile. AmerenUE was able to demonstrate that its fuel costs will be increasing in coming years. In fact, AmerenUE knows its coal costs will increase because it has already purchased a large percentage of the coal it will need for the next several years,³³ and freight costs are largely locked in through long-term contracts as well.³⁴ Thus AmerenUE's fuel costs, while certainly rising, cannot be said to be volatile.

Markets in which prices are volatile tend to go up and down in an unpredictable manner. When a utility's fuel and purchased power costs are swinging in that way, the time consuming ratemaking process cannot possibly keep up with the swings. As a result, in those circumstances, a fuel adjustment clause may be needed to protect both the utility and its ratepayers from inappropriately low or high rates. Because AmerenUE's costs are simply rising, that sort of protection is not needed. As Brosch explains, rising, but known, fuel costs are the worst reason to implement a fuel adjustment clause because such a fuel adjustment clause allows the utility to recover a single known rising cost while avoiding a rate case in which all its other expenses and revenue, which are changing in the background, will be examined and perhaps used to offset all or part of the rising fuel cost to avoid an unnecessary rate increase.³⁵

In addition to the fact AmerenUE's fuel costs are rising, but not volatile, Staff's witness, Dr. Michael Proctor, demonstrated that under some circumstances, AmerenUE's ability to profitably sell power into the wholesale market may mitigate some of the risk resulting from rising fuel costs. Proctor's explanation is based on the correlation between fuel prices and the price of electricity on the wholesale market. As he explains, "when fuel prices for coal and natural gas increase, the result is that spot market prices for electricity also increase. Thus revenues from

³² Transcript, Pages 888-899. The details of AmerenUE's coal and transportation strategies are confidential and will not be described in this order.

³³ Transcript, Page 931, Lines 8-22. The exact percentages of the needed coal that has already been bought is confidential and will not be stated in this order.

³⁴ Transcript, Page 902, Lines 21-25.

³⁵ Transcript, Page 1089, Lines 11-17.

sales increase and tend to offset any large negative impacts from higher fuel costs.”³⁶

AmerenUE has a lot of coal-fired production capability it uses to provide the baseload or intermediate power needed under routine conditions. However, under certain circumstances, for example, a hot day in July when household air conditioners are running, the demand for electricity will peak. The demand for peak electricity is usually met by natural gas-fired peaking generators. Proctor explains that when natural gas prices go up, usually drawing up coal prices as well, the price for which AmerenUE can sell peak electricity will also tend to go up. As a result, AmerenUE’s increased profits from off-system sales of electricity will tend to mitigate its increased fuels costs, and thereby reduce the need for a fuel adjustment clause.³⁷

AmerenUE demonstrated Dr. Proctor’s mitigation theory would not apply in all scenarios, and indeed, Dr. Proctor agreed his theory does not indicate that profits from off-system sales would completely offset rising fuel costs.³⁸ Nevertheless, the Commission concludes increased profits from off-system sales will tend to mitigate rising fuel costs in all likelihood. This mitigation effect would not be enough to eliminate the need for a fuel adjustment clause by itself, but it adds more weight to the balance in deciding whether a fuel adjustment clause is appropriate.

Conclusions of Law:

Section 386.266.1, RSMo Supp. 2006, the statute that allows the Commission to establish a fuel adjustment clause provides as follows:

Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation. The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.

Subsection 4 of that statute sets out some of the provisions that must be included in a fuel adjustment clause as follows:

The commission shall have the power to approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section only after providing the opportunity for a full hearing in a general rate proceeding, including a general rate proceeding initiated by complaint. The commission may approve such rate schedule after considering all relevant factors which may affect the cost or overall rates and charges of the corporation, provided that it finds that the adjustment mechanism set forth in the schedules:

³⁶ Proctor Rebuttal, Ex. 228, Page 28, Lines 5-7.

³⁷ Transcript, Page 1502-1503, Lines 10-25, 1-14.

³⁸ Transcript, Page 1497, Lines 7-12.

(1) Is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity;

(2) Includes provisions for an annual true-up which shall accurately and appropriately remedy any over- or under-collections, including interest at the utility's short-term borrowing rate, through subsequent rate adjustments or refunds;

(3) In the case of an adjustment mechanism submitted under subsections 1 and 2 of this section, includes provisions requiring that the utility file a general rate case with the effective date of new rates to be no later than four years after the effective date of the commission order implementing the adjustment mechanism.

...

(4) In the case of an adjustment mechanism submitted under subsections 1 or 2 of this section, includes provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals, and shall require refund of any imprudently incurred costs plus interest at the utility's short-term borrowing rate.

Subsection 7 of that statute provides that the Commission may:

take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed rate of return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

Finally, subsection 9 of that statute required the Commission to promulgate rules to "govern the structure, content and operation of such rate adjustments, and the procedure for the submission, frequency, examination, hearing and approval of such rate adjustments." In compliance with the requirements of the statute, the Commission promulgated Commission rule 4 CSR 240-3.161, which establishes in great detail the procedures for submission, approval, and implementation of a fuel adjustment clause.

Decision:

After carefully considering the evidence and arguments of the parties, and balancing the interests of ratepayers and shareholders, the Commission concludes that AmerenUE's fuel and purchased power costs are not volatile enough justify the implementation of a fuel adjustment clause at this time. Furthermore, based on Proctor's testimony about rising off-system sales margins, the Commission concludes that AmerenUE has a reasonable opportunity to earn a fair return on equity without a fuel adjustment clause. The Commission recognizes AmerenUE's fuel costs will likely rise in the next several years and to some degree be offset by rising off-system sales margins. Without a fuel adjustment clause, AmerenUE may need to file another rate case sooner rather than later. Obviously, rate cases are difficult and expensive endeavors for the Commission and intervening parties, as well as for the utility. A future rate case, not a fuel adjustment clause, is the proper means by which AmerenUE should recover its rising fuel costs.

The Commission emphasizes that its decision to deny AmerenUE's request for a fuel adjustment clause is entirely based on the evidence presented at this hearing and on the Commission's evaluation of AmerenUE's situation as it currently exists. The Commission certainly does not wish to imply that AmerenUE can never qualify for a fuel adjustment clause. If AmerenUE again wants to request a fuel adjustment clause in a future rate case, it is free to do so and the Commission shall give such a request all due consideration.

2. Off-System Sales

Discussion:

Most of the electric energy AmerenUE produces at the power plants it owns is sold to its native load customers, in other words, the people and businesses located within its service territory. However, if it can produce more energy than it needs to serve its native load, AmerenUE is able to earn extra profits by selling excess energy to off-system buyers, such as other utilities, municipalities, or cooperatives. Since the power AmerenUE is able to sell is produced by generating plants paid for by ratepayers, all parties, including AmerenUE, agree profits (revenues less incurred fuel costs) from these off-system sales should be recognized as a reduction to the company's revenue requirement.³⁹

AmerenUE proposed its off-system sales be netted against its fuel costs as part of a fuel adjustment clause. However, since the Commission has rejected the proposed fuel adjustment clause, another way must be found to determine how many dollars of off-system sales should be included when calculating AmerenUE's revenue requirement. The way it is done is to simply ascribe a certain amount of off-system sales profit to AmerenUE's revenue requirement. But it is very important for the Commission to be accurate when deciding how much profit to ascribe. If the profit level is set too high, the company will not be able to make enough profits and will not be able to earn its authorized returns. On the other hand, if the profit level is set too low, the company will earn extra profits that will not be credited to the ratepayers who made those profits possible. Of course, profits from off-system sales can be exactly determined after the fact, but the rates the Commission is setting in this case will apply in the future, and will not change until the next rate case. So an incorrect estimation cannot be corrected, except through another rate case.

In most cases, an appropriate level of anticipated off-system sales could be calculated in the same way other costs are calculated, by using historical information about sales made during the test year. Unfortunately, in this case, historical information is not a good predictor of future sales. The problem is, until December 31, 2006, including the entire test year, AmerenUE operated under a Joint Dispatch Agreement (JDA) with Ameren's Illinois affiliates, AmerenCIPS and Ameren Energy Generation (AEG).⁴⁰ Under the JDA much of AmerenUE's excess power was sold to AEG at incremental cost rather than being sold on the wholesale market.⁴¹ As a result, there is no track record for off-system sales to be used to estimate future sales.

³⁹ Transcript, Page 1184-1185, Lines 23-25, 1.

⁴⁰ Transcript, Page 1453, Lines 11-22.

⁴¹ Transcript, Page 1548, Lines 6-25.

To get around the lack of historical information, both AmerenUE and Staff ran production cost models to “simulate the dispatch of AmerenUE’s generation fleet to supply existing commitments including native load and wholesale sales, while buying or selling energy economically.”⁴² Essentially, the experts for AmerenUE and Staff developed computer programs to simulate the exact means by which AmerenUE’s generation system would be utilized throughout the year, including the specific plants used to produce electricity, the cost of fuel to produce it, and the price at which electricity could be sold.

While AmerenUE and Staff developed and ran different models, the separate models essentially agreed upon the amount of energy to be sold off system.⁴³ The differences between the positions of AmerenUE and Staff result from disagreements about the cost of certain inputs into the computer models.

Findings of Fact:

AmerenUE’s model predicts off-system sales of \$202.5 million per year and the company would set the base level at that amount.⁴⁴ The model run by Staff predicts annual off-system sales of \$241.3 million.⁴⁵ However, at the hearing, Staff’s witness, Dr. Michael Proctor, acknowledged that his calculation mistakenly used data supplied by the company that did not include congestion and losses. When Proctor corrected his calculation to account for congestion and losses, the level of off-system sales predicted by Staff’s model is reduced to \$233 million. After the results of true-up were known, Staff changed that amount to \$230 million.

The difference between the results of Staff’s model and that of AmerenUE is attributed to different inputs relating to fuel price for natural gas and market prices for electricity.⁴⁶ On-peak prices for electricity tend to swing in correlation with natural gas prices because much on-peak electricity is generated by natural gas-fired turbines.⁴⁷ Staff’s model used an input of \$7.00 as the price for natural gas. Staff arrived at that amount by averaging the monthly price of natural gas over a three-year period, 2004 through 2006.⁴⁸ AmerenUE’s model used an average price of natural gas of \$6.58, which is based on the average price of gas from January through December of 2006.⁴⁹ By using the average for that period, AmerenUE avoided including the high natural gas prices that occurred after Hurricane Katrina in 2005.

Staff’s witness, Dr. Proctor, agreed the abnormally high gas prices that occurred as a result of the hurricane should be removed from the calculations when

⁴² Schukar Direct, Ex. 028, Page 7, Lines 3-5.

⁴³ Transcript, Page 1452, Lines 18-23.

⁴⁴ Schukar Surrebuttal, Ex. 032, Page 7, Lines 4-7, as corrected at Transcript, Page 1174, Line 1.

⁴⁵ Proctor Surrebuttal, Ex. 229, Lines 24-27, as corrected at Transcript, Page 1018, Lines 10-12.

⁴⁶ Transcript, Page 1451, Lines 8-21.

⁴⁷ Proctor Direct, Ex. 227, Page 14, Lines 9-22. *See also*, Schukar Rebuttal, Ex. 030, Page 9, Lines 9-11.

⁴⁸ Transcript, Page 1455, Lines 10-14.

⁴⁹ Schukar Rebuttal, Ex. 030, Page 21, Lines 11-13.

determining the level of off-system sales.⁵⁰ However, he contended he had accomplished that goal by using a three-year average including periods clearly not affected by the hurricane in 2005.

The Commission finds Dr. Proctor's use of a three-year average to calculate the cost of natural gas to be a preferable method for making that calculation. The price of natural gas goes up and down in an unpredictable manner. Using only a 12-month average, particularly an average designed to avoid a particular high-cost month, while not adjusting for unusually low-cost months, can provide a distorted result. By using a three-year average, including both low and high cost months, a more accurate picture of average costs can be developed.

AmerenUE also argues Proctor's level of off-system sales should be adjusted to account for seasonal variations in the differences between gas prices and on-peak energy prices.⁵¹ However, Proctor demonstrated that on a month-to-month basis, spot-market electricity prices follow a cyclical monthly pattern, but fuel dispatch prices do not follow the same pattern. Therefore, these prices are not highly correlated on a month-to-month basis and can more accurately be correlated in the annual averages used by Staff.⁵² As a result, there is no need to further adjust Staff's off-system sales base level of \$230 million.

The State, joined by the Public Counsel, argue that rather than relying on the computer models run by AmerenUE and Staff, the Commission should set the off-system sales base level at the amount included for off-system sales by AmerenUE in its 2007 budget. The budgeted amount is highly confidential so it will not be stated in this order. However, it is substantially higher than the amount resulting from Staff's model. While Staff and MIEC do not directly advocate using the budgeted amount as the base level for off-system sales, they do suggest the budgeted amount is a strong indication Staff's calculation of the off-system sales levels should be treated as a minimum level and may, in fact, be too low.

It is tempting to use AmerenUE's budgeted amount for off-system sales as the base line. The person in charge of AmerenUE's budget, its Chief Financial Officer, Warner Baxter, testified that AmerenUE's budget assumptions are expected to be reasonable and achievable.⁵³ If AmerenUE believes it can attain the budgeted amount for off-system sales, why should it not be held to its own goal?

There are, however, a couple of flaws in that approach. First, the 2007 budgeted amount is not normalized to account for planned generation outages.⁵⁴ If fewer than normal outages are planned for 2007, as AmerenUE suggests, then the budgeted amount would not be indicative of the reasonably anticipated level of off-system sales that could be expected in a normal year. For that reason, the production models used by Staff and AmerenUE to predict a level of off-system sales may be more reliable going forward.

The second problem with using the 2007 budgeted amount to set a level for off-system sales is more fundamental. In Missouri, rates are set using a historical test year. The Commission examines the utility's revenues and expenses for that test

⁵⁰ Transcript, Page 1460, Lines 3-19.

⁵¹ Schukar Rebuttal, Ex. 030, Page 9, Lines 9-13.

⁵² Proctor Surrebuttal, Ex. 229, Page 11, Lines 3-15.

⁵³ Transcript, Page 157, Lines 10-18.

⁵⁴ Transcript, Page 2678, Lines 14-20.

year and uses that information to set rates to be charged in the future. The Commission does not use a forward-looking test year based on budgets and projections to set those rates. If it did, AmerenUE would no doubt appreciate an opportunity to base its rates on what it believes will be higher fuel costs in the coming years. Since the Commission uses historical expenses and revenues to set rates, it would be fundamentally unfair to reach forward to grab a single budget item to reduce AmerenUE's cost of service, while ignoring other anticipated costs that might increase that cost of service.

The level of off-system sales suggested by AmerenUE and Staff is based on sales of energy. The State and Public Counsel point out AmerenUE has recently also started to sell regulatory capacity off system. AmerenUE did not make any such capacity sales in 2006,⁵⁵ but it has started to make some capacity sales in 2007. Public Counsel and the State argue that an amount recognizing the potential to sell regulatory capacity should also be included in the base level established for off-system sales.

This argument for pulling a single item out of a future budget violates the test year and the matching principle that is the reason for using a test year, in the same way that principle would be violated by the use of the 2007 off-system sales budget to establish a base line. Furthermore, the amount of 2007 capacity sales are very small in relation to the established level of energy sales and would not have a significant impact on that base level.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission will establish \$230 million, the result of Staff's adjusted production cost model, as the off-system sales base level.

Rate of Return Issues

The next group of issues concerns the rate of return AmerenUE will be authorized to earn on its rate base. Rate base includes things like generating plants, electric meters, wires and poles, and the trucks driven by AmerenUE's repair crews. In order to determine a rate of return, the Commission must determine AmerenUE's cost of obtaining the capital it needs. The first step toward doing that requires a determination of the appropriate mix of capital sources AmerenUE will use to obtain its needed capital. That is called a capital structure and is the next issue.

3. Capital Structure

For purposes of determining an appropriate rate of return, AmerenUE has proposed to use its actual capital structure, which is the following:

Type	Amount	Percent of total	Cost
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⁵⁵ Transcript, Pages 1238-1239, Lines 19-25, 1-3.

UNION ELECTRIC COMPANY D/B/A AMERENUE

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	(Millions)		
Long-Term Debt	\$2,522	44.964%	5.473%
Short-Term Debt	\$45	0.795%	5.360%
Preferred Stock	\$115	2.017%	5.189%
Common Equity	\$2,964	52.224%	TBD
Total	\$5,675	100%	

The cost of long- and short-term debt and preferred stock is determined simply by reviewing the interest rates specified in the debt or stock instruments issued by AmerenUE. Those costs are not challenged by any party and are not an issue. Public Counsel, however, proposed a “double leverage” adjustment to account for its assertion that a portion of AmerenUE’s equity is actually debt held at the parent company level.⁵⁶ Public Counsel would adjust the capital structure as follows:

Long-Term Debt	47.3%
Short-Term Debt	0.8%
Preferred Stock	2.0%
Common Equity	49.8% ⁵⁷

In his surrebuttal testimony, Public Counsel’s witness continues to insist that a double leverage adjustment to the capital structure is necessary. But, while he explains how the adjustment would work, he does not explain why it is necessary, other than to explain that AmerenUE’s rates will be higher if such an adjustment is not made.⁵⁸

Findings of Fact:

Double leverage may exist if a corporate parent uses relatively low-cost debt to acquire equity in its subsidiary. Since equity is more expensive than debt, a utility is allowed a greater return on equity than it is on debt. Therefore, through double leveraging, a parent could convert low-cost debt into relatively higher cost equity, and thereby increase its returns.⁵⁹ There is no double leverage in AmerenUE’s capital structure as the Commission is using it for purposes of this case. As explained by AmerenUE’s witness, double leverage would exist if a parent company used proceeds of a debt issuance to make an equity investment in a subsidiary, thereby turning inexpensive debt into more expensive equity. Since it was formed in 1997, Ameren has not issued debt that was contributed to the equity capital of AmerenUE. Therefore, there is no double leverage. Occasional short-term loans from Ameren to AmerenUE are reflected as debt on AmerenUE’s books, not as equity.⁶⁰

In his direct testimony, Staff’s witness, Steven Hill, also proposes some adjustments to AmerenUE’s capital structure.⁶¹ Hill’s proposed adjustments were not

⁵⁶ King Direct, Ex. 403, Pages 4-5, Lines 20-29, 1-2.

⁵⁷ King Direct, Ex. 403, Schedule CWK-1.

⁵⁸ King Surrebuttal, Ex. 410, page 3.

⁵⁹ An explanation of the concept of double leveraging may be found in *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm’n*, 706 S.W. 2d 870 (Mo. App. W.D. 1985).

⁶⁰ Nickloy Rebuttal, Ex. 057, page 3.

⁶¹ Hill Direct, Ex. 214, Pages 20-24.

mentioned again by Staff at the hearing or in its brief, and Staff does not propose an adjustment for capital structure in its revised true-up reconciliation. As a result, it is not clear that this is a live issue, but the Commission will briefly address Hill's arguments.

Hill points out AmerenUE's proposed capital structure nets short-term debt against average construction work in progress (CWIP) balances.⁶² Hill acknowledges that what AmerenUE has done is standard regulatory practice in Missouri.⁶³ But he points out that if the company's five-month average short-term debt in the capital structure instead would produce a capital structure that would decrease the company's allowed capital costs.⁶⁴ Hill does not, however, offer any testimony to support such a change in standard regulatory practice.

Similarly, Hill suggests AmerenUE erred when it made an adjustment to remove a negative balance of \$6.5 million from its equity balance relating to the company's investment in Union Electric Development Corporation (UEDC). AmerenUE's witness, Lee Nickloy, effectively refuted Hill's suggestion in his rebuttal testimony.⁶⁵ Staff never further pursued either suggested modification, but if Staff would contend that either adjustment to capital structure should be made, those contentions are rejected.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission rejects Public Counsel's proposed double leverage adjustment because double leverage does not exist in AmerenUE's capital structure. The following capital structure shall be used as the capital structure of AmerenUE:

Long-Term Debt	44.964%
Short-Term Debt	0.795%
Preferred Stock	2.017%
Common Equity	52.224%

4. Return on Equity

Discussion:

Determining an appropriate return on equity is without a doubt the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them. In contrast, in determining a return on equity the Commission must consider the expectations and requirements of investors when they choose to invest their money in AmerenUE rather than in some other investment opportunity. As a result, the Commission cannot simply find a rate

⁶² Id. at Page 21, Line 13-15.

⁶³ Id. at Page 21, Lines 14-15.

⁶⁴ Id. at Page 22, Lines 3-21.

⁶⁵ Nickloy Rebuttal, Ex. 057, Page 2-3, Lines 7-23, 1-5.

of return on equity that is unassailably scientifically, mathematically, or legally correct. Such a "correct" rate does not exist. Instead, the Commission must use its judgment to establish a rate of return on equity attractive enough to investors to allow the utility to fairly compete for the investors' dollar in the capital market, without permitting an excessive rate of return on equity that would drive up rates for AmerenUE's ratepayers. In order to obtain guidance about the appropriate rate of return on equity, the Commission considers the testimony of expert witnesses.

Six financial analysts offered recommendations regarding an appropriate return on equity in this case. Two analysts testified on behalf of AmerenUE. James H. Vander Weide is a professor at the Fuqua School of Business of Duke University. He holds a Ph.D. in Finance from Northwestern University. He recommends AmerenUE be allowed a return on equity of 12.2 percent. Kathleen C. McShane is a consultant from Bethesda, Maryland, who holds a Masters in Business Administration with a concentration in Finance from the University of Florida. She recommends AmerenUE be allowed a return on equity of 12.00 percent.

Four other parties offered recommendations regarding return on equity. Testifying on behalf of MIEC, Michael Gorman, a consultant from St. Louis, Missouri, who holds a Masters in Business Administration with a concentration in Finance from the University of Illinois at Springfield, recommends AmerenUE be allowed a return on equity of 9.8 percent. Charles W. King testified on behalf of the Public Counsel. Mr. King, a consultant from Washington D.C., who holds a Masters in Government Economic Policy from the George Washington University, recommends AmerenUE be allowed a return on equity of 9.65 percent. Steven G. Hill, a consultant from West Virginia, who holds a Masters in Business Administration from Tulane University, testified on behalf of Staff. He recommends AmerenUE be allowed a 9.25 percent return on equity. Finally, J. Randall Woolridge, Professor of Finance in Business Administration at Pennsylvania State University, holder of a Ph.D. from the University of Iowa, testified on behalf of the State of Missouri. He recommends AmerenUE be allowed a return on equity of 9.00 percent. In addition, Billie S. LaConte, a consultant from St. Louis, Missouri, who holds a M.B.A. in finance from Washington University, testified on behalf of MEG. She offered analysis of the recommendations made by the other experts, but did not recommend a specific rate of return on equity.

There is one more source the Commission must consider in establishing an appropriate return on equity. In a survey of regulatory decisions from around the country, as reported by Regulatory Research Associates, the average allowed return in the electric utility industry for 2006 was 10.36 percent, with a median return of 10.25 percent.⁶⁶ That is the market in which AmerenUE will be seeking to raise capital.

The Commission does not believe it would be appropriate for its return on equity finding to unthinkingly mirror the national average. Obviously, if all commissions took that approach, returns on equity would never change, despite changing economic facts, leading to unjust results. However, the national average is a good indicator of the capital market in which AmerenUE will have to compete for the equity needed to finance its operations. The Commission has an obligation under the law and well as a matter of practical necessity, to allow AmerenUE an

⁶⁶ Ex. 519.

opportunity to earn a return that will allow it to compete in the capital market. No one, including ratepayers, benefits if AmerenUE is starved for capital.

Findings of Fact:

In recent rate cases, the Commission has used what has been described as a zone of reasonableness to assist it in evaluating the recommendations offered by return on equity experts. The zone of reasonableness has been described as a range 100 basis points above and 100 basis points below the national average allowed return on equity. If the national average is taken to be 10.36 percent, then the zone of reasonableness runs from 9.36 percent to 11.36 percent.

The zone of reasonableness is simply a tool to help the Commission evaluate the recommendations offered by various rate of return experts. It should not be taken as an absolute rule precluding consideration of recommendations falling outside that zone. However, a recommendation greatly varying from the national norm will be viewed with skepticism.

Each of the expert witnesses who offered testimony on the rate of return issue performed multiple calculations using various methods to justify their recommendations for the return on equity the Commission should use in calculating the rates AmerenUE will be allowed to charge its customers. Collectively, they devoted hundreds of pages of testimony to discrediting each others opinions. In the end, despite their best efforts to educate, the experts have managed to create a thicket of conflicting opinions. If the Commission were to attempt to force its way through the tangle, it could easily lose its way or even become ensnared.

Rather than chase the rabbit into the thicket, the Commission must pursue its prey from a greater distance. Rather than attempt to untangle each of the narrow, technical disputes between the parties, the Commission will attempt to step back and examine the problem from a broader perspective.

When the Commission steps back, the first pattern that emerges is the realization that the rate of return advocated by the experts who testified for AmerenUE is too high. James Vander Weide advocates a return on equity of 12.2 percent. Kathleen McShane, AmerenUE's other witness, is nearly as high, recommending a return on equity of 12.0 percent. Yet, Vander Weide acknowledged that, so far as he knew, if this Commission allowed AmerenUE a return on equity of 12.2 percent, or even 12.0 percent, it would be the highest return on equity allowed to any integrated electric utility in the country.⁶⁷

In large part, the overly high return on equity recommendations put forward by AmerenUE's witnesses result from their inclusion of a large financial risk add-on premium, based on the allegedly greater financial risk resulting from the market value of common equity in AmerenUE's capital structure. The witnesses use this premium adjustment to increase McShane's return on equity recommendation by 100 basis points, and Vander Weide's by 70 basis points. But despite his advocacy of an adjustment to account for AmerenUE greater risk, Vander Weide acknowledged at the hearing that AmerenUE's risk is about average for the electric utility industry.⁶⁸

⁶⁷ Transcript, Page 2880, Lines 8-14.

⁶⁸ Transcript, Page 2880, Lines 4-7.

In addition to the obvious incongruity of a large risk adjustment for a company with an average level of risk, the opposing experts convincingly explained that the proposed upward adjustment for financial risk was inappropriate for more technical reasons as well. In particular, the Commission accepts as credible the testimony of MIEC's witness, Michael Gorman, who explains that AmerenUE's proposed adjustment for financial risk is an incomplete assessment of AmerenUE's overall risk because it ignores the difference in operating risk between AmerenUE and comparable companies,⁶⁹ because it does not properly evaluate the financial risk differential between the proxy groups and AmerenUE,⁷⁰ and because it fails to recognize that a company's book value financial risk is already captured in a company's stock price.⁷¹

In sum, the financial risk upward adjustment proposed by AmerenUE's witnesses appears to be a transparent effort to inflate the company's proposed return on equity to obtain a better bargaining position in the hope the Commission would simply split the difference between the extreme positions. Such efforts call into question the credibility of these witnesses. Indeed, Vander Weide came close to acknowledging that his proposed return on equity was extreme when at the hearing he indicated an eleven percent return on equity, in line with the amounts that the Commission has allowed Kansas City Power & Light and The Empire District Electric Company in recent rate cases, "would be a benchmark that the financial community would look at."⁷²

On the other side of the thicket, the returns on equity proposed by some of the experts are clearly too low. If the Commission were to impose the return on equity they advocate, AmerenUE would have the lowest allowed return on equity in the country. AmerenUE is an average company with an average risk. It should be allowed something close to an average return on equity.

In setting rates, the Commission's obligation is to reasonably balance shareholder and ratepayer interests. This is not an intellectual game designed to fatten or drive down the company's bottom line. Economic theories must be tempered by a realistic appraisal of the effect the numbers derived from those theories will have on the company and on ratepayers. For once, the Commission would like to see a rate case in which the witnesses present a balanced analysis rather than race to the extremes.

Of the witnesses who testified in this case, Michael Gorman, the witness for MIEC, does the best job of presenting the balanced analysis that the Commission seeks. His overall recommendation was for a return on equity of 9.8 percent. Gorman performed three different analyses to arrive at his overall recommendation. His Constant Growth Discounted Cash Flow (DCF)⁷³ analysis resulted in a recommended return on equity of 9.2 percent,⁷⁴ his Bond Yield Plus Risk Premium

⁶⁹ Gorman Direct, Ex. 705, Pages 25-26, 1-12.

⁷⁰ Id, at Pages 26-27, Lines 13-25, 1-16.

⁷¹ Id. At Pages 27-28, Lines 17-25, 1-6.

⁷² Transcript, Page 2880, Lines 16-19.

⁷³ Gorman explains that "[t]he DCF model posits that a stock price is valued by summing the present value of expected future cash flows discounted at the investor's required rate of return (ROR) or cost of capital." Gorman Direct, Ex. 705, Page 7, Lines 3-5.

⁷⁴ Id. at Page 9, Line 17.

Model analysis results in a recommended return on equity of 10.2 percent,⁷⁵ and his Capital Asset Pricing Model (CAPM)⁷⁶ results in a recommended return on equity of 10.3 percent.⁷⁷ Gorman's overall recommendation of 9.8 percent is a blending of these three analyses.

In examining Gorman's three analyses, it seems the results of the DCF analysis are somewhat inconsistent with the results of the other two analyses. If the results of the Risk Premium and CAPM are accepted as more reasonable, Gorman's recommendation is pushed up into the low 10 percent area. Also, Gorman's overall recommendation of 9.8 percent should be pushed up a bit in recognition of the Commission's denial of AmerenUE's request for a fuel adjustment clause. With no fuel adjustment clause, AmerenUE takes on more risk and its return on equity should be increased to compensate.

Some of the analyses offered by other witnesses provide additional support for a return on equity in the low 10 percent area. Charles King testifying on behalf of Public Counsel offered an overall recommendation of 9.65 percent, but his classic DCF study results in an expected return on equity of 9.9 percent to the electric utility comparison group.⁷⁸ Furthermore, Steven Hill, testifying on behalf of Staff recommends a return on equity in a range going up to 9.75 percent.⁷⁹ From the other direction, James Vander Weide, testifying for AmerenUE, indicated his classic DCF analysis results in an expected return on equity of 10.61 percent for his electric utility comparison group. According to Steven Hill, if Vander Weide's DCF analysis is adjusted to eliminate very high and very low results, Vander Weide's median DCF analysis would result in an estimate of about 9.6 to 9.8 percent.⁸⁰ The Commission was not persuaded by the recommendations offered by AmerenUE's witnesses and the State's witness because they were not consistent with the recommendations of the other witnesses.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

Based on its analysis of the expert testimony offered by the parties, and on its balancing of the interest of the company's ratepayers and shareholders, the Commission finds that 10.2 percent is a fair and reasonable return on equity for AmerenUE that will allow it to compete in the capital market for the funds needed to maintain its financial healthy.

Some parties suggest that having established what it believes to be a fair and reasonable rate, the Commission should reduce that rate to punish AmerenUE for

⁷⁵ Id. at Page 14, Lines 22-23.

⁷⁶ Gorman explains that "[t]he CAPM method of analysis is based upon the theory that the market required ROR for a security is equal to the risk-free ROR, plus a risk premium associated with the specific security." Id. at Page 15, Lines 3-5.

⁷⁷ Id. at Page 19, Lines 15-16.

⁷⁸ King Direct, Ex. 403, Page 16, Lines 25-28.

⁷⁹ Hill Direct, Ex. 214, Page 4, Lines 6-7.

⁸⁰ Transcript, Page 3018, Lines 4-5.

what they believe was a poor performance during the severe storms of 2006 and 2007. The Commission will not do so in this case. The Commission's decision regarding the return on equity that AmerenUE will be allowed is based on the evidence presented in this case. Based on that evidence, the Commission concludes AmerenUE is entitled to a below average return on equity compared to other vertically integrated utilities in the United States. No return on equity performance adjustment is necessary. The Commission will enforce service quality, reliability, and performance standards through pending rulemakings designed to establish expected performance levels for all Missouri's electric utilities.

5. Electric Energy, Inc.

Discussion:

Staff, Public Counsel, the State, The Commercial Group, and MIEC argue that the Commission should reduce AmerenUE's revenue requirement by between \$63 and \$75 million to account for what they believe to be the company's imprudence regarding the expiration of a low-cost power supply contract with Electric Energy, Inc. (EEInc). AmerenUE contends such an adjustment would be unnecessary, as well as illegal.

EEInc is a for-profit, Illinois corporation that is not, and has never been, subject to the jurisdiction of this Commission. It is, however, an affiliate of AmerenUE. EEInc. was formed in 1950 by a group of five electric utility companies for the purpose of building a power plant to provide electricity to the Atomic Energy Commission's uranium enrichment facility located at Paducah, Kentucky. Union Electric Company purchased 40 percent of the shares of EEInc. The other shares were purchased by Illinois Power Company – 20 percent, Central Illinois Public Service Company – 20 percent, Kentucky Utilities Company – 10 percent, and Middle South Utilities, Inc. – 10 percent.⁸¹

Subsequently, Middle South Utilities, Inc. sold its 10 percent share to Kentucky Utilities. In addition, Illinois Power Company and Central Illinois Public Service Company have subsequently been acquired by AmerenUE's corporate parent, Ameren. Ameren's resulting 40 percent share of EEInc. is now controlled by another subsidiary, Ameren Energy Resources Company.⁸² So today, AmerenUE owns 40 percent of the stock of EEInc., its parent, Ameren, through Ameren Energy Resources, owns another 40 percent, and Kentucky Utilities owns the remaining 20 percent.

The Commission approved Union Electric's purchase of its portion of EEInc.'s stock in a report and order issued on December 8, 1950.⁸³ Union Electric purchased the EEInc. stock using shareholder funds,⁸⁴ and EEInc. has always remained a separate corporate entity.

⁸¹ Meyer Direct, Ex. 225, Page 6, Lines 8-19.

⁸² Brosch Direct, Ex. 501, Page 19, lines 16-17.

⁸³ *In the Matter of the Application of Union Electric Company of Missouri for Authorization to Acquire Shares of the Capital Stock of Electric Energy, Inc.*, Report and Order, Case No. 12,064, Ex. 971.

⁸⁴ Transcript, Page 2709, Lines 14-17.

Shortly after it came into being, EEInc. constructed a 1,000 MW coal-fired electric power plant across the Ohio River from Paducah in Joppa, Illinois. EEInc. financed the construction of the Joppa plant with a capital structure that was composed almost entirely of debt, with only small equity infusions by the sponsoring utilities.⁸⁵ Because so much of the value of EEInc. was based on debt, the lenders required the sponsoring utilities to agree to:

be responsible for the for the use or sale of the capacity of such generating facilities in case the Atomic Energy Commission should terminate its purchase of power from Electric Energy, Inc., in the same proportions as their respective investments in the Capital Stock of Electric Energy, Inc.⁸⁶

Since AmerenUE owns 40 percent of EEInc.'s stock, it is responsible for 40 percent of the capacity of the Joppa plant.

Beginning in 1951, EEInc. entered into power contracts with the Atomic Energy Commission, (now the Department of Energy) and the sponsoring utilities. Any power not purchased by the federal government would be purchased by the sponsoring utilities. In keeping with its obligation to support the debt of EEInc. by taking any power not used by the federal government, the power contracts Union Electric signed with EEInc. required Union Electric and the other sponsoring utilities to purchase their share of electricity from the Joppa plant even if EEInc. was actually unable to generate that electricity.⁸⁷

The last power supply contract Union Electric entered into with EEInc. was signed in 1987. It provided that EEInc. would sell electricity to Union Electric at cost of service, including operating expenses, taxes and interest, plus a 15 percent return on equity capital, net of federal income tax.⁸⁸ That contract expired by its terms on December 31, 2005.⁸⁹ The agreement also provided it could be canceled by either party by giving a minimum of five years' notice.⁹⁰

During the Joppa plant's early years, the federal uranium enrichment plant used most of the electricity produced. Overall, from 1954 to 2005, the federal government and the sponsoring utilities, other than AmerenUE, took approximately 85 percent of the output of the Joppa plant, while paying for a similar level of EEInc.'s total costs associated with producing that output.⁹¹ However, in recent years, the federal government has not needed as much electricity so more power has been available to the sponsoring utilities under their respective cost-based power supply contracts, all of which expired on December 31, 2005.⁹² The power supplied by EEInc. was inexpensive and reliable, and purchase of that power under the power supply agreement was a good deal for AmerenUE's ratepayers. When the last power supply contracts were entered into in 1987, EEInc. had no choice but to sell its

⁸⁵ Moehn Surrebuttal, Ex. 037, Page 5, Lines 22-24.

⁸⁶ *In the Matter of the Application of Union Electric Company of Missouri for Authorization to Acquire Shares of the Capital Stock of Electric Energy, Inc.*, Report and Order, Case No. 12,064, Ex. 971.

⁸⁷ Brosch Surrebuttal, Ex. 504, Page 33, lines 1-19.

⁸⁸ Schallenberg Rebuttal, Ex. 236, Page 6, Lines 26-30.

⁸⁹ Power Supply Agreement, Section 6.01, Ex. 130.

⁹⁰ Power Supply Agreement, Section 6.02, Ex. 130.

⁹¹ Moehn Rebuttal, Ex. 036, Page 8, Lines 4-7.

⁹² Moehn Direct, Ex. 035, Page 14, Lines 18-23.

power on a cost basis. At that time, there was no transparent market for wholesale electric power. Indeed, the FERC required sales of wholesale power to occur only through bilateral cost based sales contract of the type entered into by Union Electric and EEInc.⁹³

After it entered into the power supply agreement in 1987, Union Electric merged with Central Illinois Public Service and became AmerenUE. Then, during the late 1990s, a true transparent market for wholesale power began to develop. It soon became apparent EEInc. could make more money selling power into the market than it could by selling power through cost-based bilateral contracts. EEInc.'s cost of producing power is approximately \$20 per MWh. Approximately \$1 would be tacked onto the sale price for a 15 percent return on equity, resulting in a \$21 per MWh sale price under a cost-based contract. The market price is approximately \$40 per MWh for the same energy.⁹⁴ Although the cost-based contracts allow EEInc. a 15 percent return on equity, that return does not amount to much because very little equity has ever been invested in EEInc.⁹⁵ Of course, if EEInc. earns more money from power sales, its shareholders, including Ameren and AmerenUE, which between them own 80 percent of those shares, earn greater returns on their investments.

Before 2000, AmerenUE briefly considered terminating the cost-based power supply agreement under the five-year notice provision of the contract but chose not to do so because in the words of Gary Rainwater, Ameren's Chairman, President, and Chief Executive Officer, "a contract is a contract, and the right thing to do is to honor the contract."⁹⁶ At the same time, EEInc. considered canceling the contract from its end; but according to Gary Rainwater, who was also a member of the board of directors of EEInc., decided not to because at that time there was not a sufficient wholesale market to confidently make that change.⁹⁷ After 2000, it was too late for either party to cancel the contract because of the five-year notice provision, so the contract remained in effect.

During the last years of the contract, EEInc. applied for and received approval from the FERC in December 2005 to sell power at market-based rates.⁹⁸ When December 31, 2005 arrived, the power supply contract expired under its own terms and AmerenUE made no attempt to negotiate an extension of the cost-based supply contract. EEInc. now sells its power supply on the wholesale market at market-based rates. The federal government still purchases power from EEInc., but now does so at market-based rates.⁹⁹ AmerenUE no longer purchases power from EEInc., and indeed, under the terms of the Commission's affiliate transaction rule, cannot do so at market rates.¹⁰⁰

⁹³ Transcript, Page 2348, Lines 18-23,

⁹⁴ Transcript, Page 1947, Lines 1-7.

⁹⁵ Transcript, Page 1992, Lines 17-21. About \$8 million of equity is invested in EE Inc. Transcript, Page 2294, Lines 10-12.

⁹⁶ Transcript, Page 1837, Lines 20-21.

⁹⁷ Transcript, Page 1835, Lines 17-22.

⁹⁸ Moehn Surrebuttal, Ex. 037, Page 7, Lines 1-5.

⁹⁹ Transcript, Pages 2289-2290, Lines 18-25, 1-13.

¹⁰⁰ Transcript, Page 2729, Lines 13-19.

After the switch to market-based rates, EEInc.'s income more than doubled from 2005 to 2006.¹⁰¹ That resulted in increased earnings for EEInc.'s shareholders, including AmerenUE and ultimately the shareholders of AmerenUE. Of course, the increased payments to shareholders came, at least in part, at the expense of AmerenUE's ratepayers.

Under the expired cost-based contract, AmerenUE was able to purchase relatively inexpensive power produced at the Joppa facility. AmerenUE used that power to serve its native load. When power from the Joppa plant was no longer available, AmerenUE had to replace that power with more expensive power produced by its own combustion turbine generators.¹⁰² In addition, when it had more power than it needed to serve its native customers, it could sell the excess into the market at a profit. Such profits would be used to offset the company's other costs and ultimately would benefit ratepayers.

Several parties contend the lost savings to ratepayers resulting from the expiration of the cost-based electricity supply from the Joppa plant should be restored to ratepayers through this case. Staff does so by imputing power from Joppa at cost in its production cost model.¹⁰³ Using that method, Staff proposed to reduce AmerenUE's revenue requirement by \$65,296,469.¹⁰⁴

The State of Missouri also proposes to adjust AmerenUE's revenue requirement to account for the loss of power from the Joppa plant. The State would, however, employ a different method for calculating its adjustment. The State would determine what it claims to be the excess profits of EEInc. by calculating the difference between EEInc.'s profit in 2005 (under the cost-based sales contract) and 2006 (using market-based sales). It would then impute 40 percent of those excess profits, after factoring up for tax effects, to reduce AmerenUE's revenue requirement.¹⁰⁵ Using this method, the State would reduce AmerenUE's revenue requirement by \$73,137,000.¹⁰⁶

Using Staff's calculations, but adding \$9,270,000 to account for lost capacity sales revenue, Public Counsel would reduce AmerenUE's revenue requirement by \$75,016,469.¹⁰⁷ Using a slightly different method of calculation, the Commercial Group would reduce AmerenUE's revenue requirement by \$62,599,866. MIEC also supports a reduction in AmerenUE's revenue requirement but does not independently calculate the amount of such a reduction.

Findings of Fact:

The parties advance two theories to justify their proposed reduction of AmerenUE's revenue requirement. The first theory is that by purchasing power from EEInc., AmerenUE's ratepayers somehow acquired an ownership interest in the

¹⁰¹ Transcript, Pages 2239-2240, Lines 24-25, 1-19. See also Brosch Surrebuttal, Ex. 504, Schedule MLB-12, Page 28 of 35.

¹⁰² Transcript, Page 2762, Lines 23-25.

¹⁰³ Meyer Direct, Ex. 225, Page 7, Lines 8-14.

¹⁰⁴ Revised True-Up Reconciliation filed April 19, 2007.

¹⁰⁵ Brosch Direct, Ex. 501, Page 28, Lines 9-20.

¹⁰⁶ Revised True-Up Reconciliation, filed April 19, 2007.

¹⁰⁷ Id, the entire basis of Public Counsel's argument for an additional adjustment for lost capacity sales is found in footnote (9) to the reconciliation.

Joppa power plant. The second argument used to justify the proposed reduction in AmerenUE's revenue requirement is that AmerenUE was imprudent in not forcing EEInc. renew the cost-based power supply agreement.

a. Equitable ownership of the Joppa plant and its power

The first argument is premised on terms of the long-term purchased power contracts between AmerenUE and EEInc., together with a Union Electric guaranty of a portion of EEInc.'s debt. The contracts, by their terms, provided that the payments made for power would cover the costs of production, plus provide a reasonable return on equity. A further term required AmerenUE and the other sponsoring utilities to purchase portions of the output of the Joppa plant that were not purchased by the Federal government, even if the plant was in fact unable to produce power. The parties also point to a 1977 case in which Union Electric sought Commission authority to guaranty certain financial obligations of EEInc.. EEInc. was issuing bonds to finance the \$10,000,000 cost to install air pollution control equipment at the Joppa plant, and the lender required the sponsoring utilities to guaranty the repayment of those bonds as an additional security. In a Report and Order issued in Case No. EF-77-197, the Commission granted Union Electric authorization to guaranty EEInc.'s debt.¹⁰⁸ The parties claim this guaranty shifted the risk associated with EEInc. to AmerenUE's ratepayers and bolsters the ratepayers claim to an equitable ownership of the power generated by the Joppa plant.¹⁰⁹

Thus, according to the theory, the payment for power by ratepayers was analogous to the inclusion of the Joppa plant in AmerenUE's ratebase. In the words of Michael Brosch, witness for the State:

equity and fairness dictates a regulatory outcome in which ratepayers who shouldered the costs and risks associated with the UE share of Joppa for many prior decades through their rates should not be denied continuing participation in the current market value of energy output of the Station.¹¹⁰

This equitable ownership theory fails because it is based upon false premises. The only money EEInc. has received, even indirectly from AmerenUE's ratepayers was for power under terms of the various power supply agreements in effect since the 1950s. The energy that EEInc. provided to AmerenUE was full consideration for the money it received under the contract. The purchase of power does not give the purchaser an ownership interest in the supplier of power any more than the purchase of a new car gives the purchaser an ownership interest in Ford Motor Company.

The other leg of this theory ignores that the guaranty given by Union Electric, now AmerenUE, was the guaranty of the company, not the guaranty of its ratepayers. Because EEInc. paid off its debts on its own no one can ever know for sure what might have happened if AmerenUE had been required to pay the debts of EEInc. But it is inconceivable that this Commission would, at any time in its history, have allowed a utility to include the cost of guarantying the debt of an unregulated affiliate in its rates and thereby pass those costs on to its ratepayers. It is equally

¹⁰⁸ *In the Matter of the Application of Union Electric Company for Authority to "Guaranty" Certain Financial Obligations of Electric Energy, Inc., an Affiliate*, Report and Order, Case No. EF-77-197, June 24, 1977, Ex. 972.

¹⁰⁹ Brosch Surrebuttal, Ex. 504, Page 34, Lines 6-10.

¹¹⁰ Brosch Direct, Ex. 501, Pages 24-25, Lines 23, 1-3.

inconceivable that this Commission would require ratepayers to pay for purchased power that was not actually delivered. If any such costs had ever been incurred, they would have been the responsibility of the company and its shareholders. Therefore, AmerenUE and its shareholders bore any risk associated with AmerenUE's ownership of the stock of EEInc. AmerenUE's ratepayers merely paid to purchase low cost power from EEInc.'s Joppa plant and did not acquire any ownership interest in EEInc. by doing so.

b. Imprudence in allowing the cost-based contract to expire

AmerenUE owns 40 percent of the shares of EEInc., with another 40 percent owned indirectly by its corporate parent Ameren. The parties argue that by combining its 40 percent ownership with the 40 percent ownership of Ameren, AmerenUE could have forced the board of directors of EEInc. to continue to sell AmerenUE power from the Joppa plant at cost-based rates. In the alternative, AmerenUE could have combined its 40 percent ownership with the 20 percent ownership of Kentucky Utilities to the same end.

Although Illinois law controls the corporate governance of EEInc., Missouri law controls the regulatory treatment afforded to transactions between a regulated utility and its unregulated affiliates. Section 393.140(12) RSMo 2000 specifically authorizes a regulated utility to conduct unregulated business. Missouri law imposes other conditions on transactions between a regulated utility and an unregulated affiliate, all of which AmerenUE appears to have observed.

Union Electric secured Commission authorization before making its initial investments in EEInc., as required by section 393.190.2. Union Electric also secured Commission authorization before pledging its credit in guaranty for EEInc, as required by section 393.180. AmerenUE has maintained the financial affairs of EEInc. separate and apart, in compliance with section 393.140(12).

The Commission's affiliate transaction rule, 4 CSR 240-20.015 prescribes the terms on which a regulated affiliate may deal with an unregulated affiliate. No party contended that the expired cost-based power contract violated those provisions. Because EEInc. now offers power at market rates and AmerenUE's cost to produce power is generally below market rates, AmerenUE has not engaged in affiliate transactions with EEInc. since the expiration of that contract in 2005. The Commission's rule does not, and cannot, require an unregulated affiliate to provide service to its regulated utility affiliate advantageous terms not available otherwise.

In support of their argument that AmerenUE was imprudent by not imposing its will on the board of directors of EEInc., the parties advocating a reduction in AmerenUE's revenue requirement cite two pieces of evidence. The first is a statement Ameren made to the FERC in connection with its application for authority to acquire Illinois Power Company. In testimony, filed on March 25, 2004, Craig D. Nelson, a Vice-President of Ameren Services Company and Central Illinois Public Service Company d/b/a AmerenCIPS, testified:

So as to prevent any ability of Ameren, following closing of the IP Sale, to 'freeze out' KU from receiving the 20 percent of the EEInc capacity and output to which it is presently entitled, **Ameren commits to: (i) direct its representative members of the EEInc Board of Directors to take no action** which would result in decisions to restrict KU's ability to receive up to 20 percent of the capacity and output of the generation facilities owned by EEInc (if KU desires to receive such capacity and output); and (ii) direct AER and AmerenUE (the Ameren

subsidiaries that are EEInc shareholders) to undertake no action at shareholder votes that would restrict KU's ability to receive up to 20 percent of the capacity and output of the generating facilities owned by EEInc. (if KU desires to receive such capacity and output. (emphasis added)¹¹¹

The second evidentiary item is the corporate by-laws of EEInc., which provide in part:

In the event that any holder of voting capital stock of EEInc. (including, for these purposes, such holder's Affiliates) owns in excess of 50% of the voting capital stock of EEInc., then all corporate restructuring transactions and other major corporate actions shall be decided by the vote of the holders of 75% or more of the outstanding shares of the Corporation entitled to vote. Corporate restructuring transactions and other major corporate actions shall include: (a) sale of all or substantially all of EEInc.'s stock (or other securities) or assets; (b) issuance of new securities; (c) change in the relative percentages of ownership of stock (or other securities) of EEInc held by the current owners of EEInc.; (d) any other change in the ownership or control of EEInc.; **(e) decisions to allocate the sale of the generating capacity of EEInc. among the EEInc. stockholders in a manner other than in accordance with their percentages of ownership of EEInc. stock in the event that the amount of such capacity available for sale to parties other than the U.S. Enrichment Corporation changes materially;** and (f) a material change in the business purpose or objectives of EEInc. (emphasis added)¹¹²

These provisions merely provide assurances that minority interests in EEInc. will not be abused by Ameren's majority position. Neither states, explicitly or implicitly, the price at which power will be offered to the sponsoring utilities. AmerenUE's ability to influence EEInc.'s corporate governance does not, without more, require it to exercise that influence for the benefit of its ratepayers.

The Commission emphasizes the unusual nature of the facts in this case. A regulated utility made a minority investment in an unregulated affiliate fifty years ago. That affiliate had as a principal purpose the provision of service to the United States government. The utility and its affiliate conducted ancillary business during that time on conditions favorable to the utility. Such facts do not often present themselves, and readers should not read this decision expansively to apply to other affiliate transactions, or to the ability of a regulated utility to avoid its obligations to its native load customers.

Fundamentally, however, the argument that AmerenUE should have taken steps to force EEInc. to continue to sell it power at cost-based rates is based on the premise that AmerenUE had an obligation to forego shareholder profits from an unregulated affiliate to benefit ratepayers. Certainly, as a regulated utility, AmerenUE has an obligation to obtain its power supply at the lowest prudent cost. It did that by buying low cost power from EEInc. for 50 years, to the benefit of

¹¹¹ Ex. 263, Pages 10-11.

¹¹² By Laws of Electric Energy Inc., Article II, Section 6. Voting, Exhibit Svanda 2, attached to the deposition of David Svanda, Hearing Ex. 261.

ratepayers. AmerenUE also has an obligation to engage in fair dealing with an affiliated company, and the Commission's affiliate transaction rule prohibits an action to benefit an affiliate to the detriment of its ratepayers. But, contrary to the heated rhetoric of some parties, AmerenUE did not conspire to remove EEInc. from regulation; EEInc. was never subject to regulation by this Commission and AmerenUE's Missouri ratepayers have no ownership interest in EEInc or the power produced by the Joppa plant.

Conclusions of Law:

EEInc. is an Illinois corporation that is not subject to regulation by this Commission. AmerenUE owns 40 percent of the shares of EEInc. Those shares were purchased using funds provided by AmerenUE's shareholders. As a shareholder, AmerenUE owns stock in EEInc., but it does not own the assets of EEInc. nor the power that is produced at EEInc.'s Joppa power plant.

AmerenUE's claim to a portion of power from the Joppa plant was based on contractual rights found in a series of power supply agreements dating back to the Joppa plant's inception in the 1950s. The last power supply agreement expired by its own terms on December 31, 2005, and has not been renewed.

By paying for AmerenUE's purchase of power from EEInc., AmerenUE's ratepayers paid for power and received power. They did not purchase an interest in EEInc. In the words of the United States Supreme Court:

[c]ustomers pay for service, not for the property used to render it. . . . By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company.¹¹³

Therefore, AmerenUE's ratepayers have no special claim to the power produced by EEInc.

Section 393.140(12) provides:

In case any electrical corporation, gas corporation, water corporation or sewer corporation engaged in any other business than owning, operating, managing a gas plant, electric plant, water system or sewer system which other business is not otherwise subject to the jurisdiction of commission, and is so conducted that its operations are to be substantially kept separate and apart from the owning, operating, managing or controlling of such gas plant, electric plant, water system or sewer system, such corporation in respect to such other business shall not be subject to any of the provisions of this chapter and shall not be required to procure the consent or authorization of the commission to any act in such other business or to make any report in respect thereof.

Section 393.190.2 provides in pertinent part:

No such corporation shall directly or indirectly acquire the stock or bonds of any other corporation incorporated for, or engaged in, the same or similar business . . . unless, in either case, authorized by the commission to do so. . . .

¹¹³ *Board of Pub. Utility Com'rs v. New York Telephone Co.*, 271 U.S. 23, 32, 46 S.Ct. 363, 70 L.Ed. 808 (1926).

Section 393.180 provides:

The power of gas corporations, electrical corporations, water corporations, or sewer corporations to issue stocks, bonds, notes and other evidences of indebtedness and to create liens upon their property situated in this state is a special privilege, the right of supervision of which is and shall continue to be vested in the state, and such power shall be exercised as provided by law and under such rules and regulations as the commission may prescribe.

Commission rule 4 CSR 240-20.010 prescribes generally the terms and conditions for transactions between a regulated utility and its unregulated affiliates. See, *State ex rel. Atmos Energy Corp. v. Public Service Commission*, 103 S.W. 3d 753 (Mo. Banc 2003).

AmerenUE had no legal obligation with respect to its separate, non-regulated investment to force EEInc. to continue to sell its cost-based power after the purchased power agreement expired by its terms on December 31, 2005. Since it had no legal obligation to force EEInc. to renew the expired purchased power agreement, AmerenUE was not imprudent in not taking that action.

Decision:

While AmerenUE undoubtedly is obligated to deal fairly with its ratepayers, it has no obligation to donate what is clearly an asset of its shareholders to the benefit of its ratepayers. AmerenUE's stock in EEInc. belongs to its shareholders, not to ratepayers. For many years AmerenUE's ratepayers benefited from the ability of AmerenUE to purchase power from its affiliate. But power is the only thing ratepayers bought. They did not buy the right to own or otherwise control AmerenUE's shares of stock in EEInc. EEInc. made a rational business decision to stop selling cost-based power to AmerenUE and to instead seek much greater profits by selling power on the newly available market. As an entity subject to regulation by the FERC, and not by this Commission, EEInc. had every right to make that decision. AmerenUE had no power, and no obligation to change EEInc.'s decision. AmerenUE has not acted imprudently. No reduction in revenue requirement is warranted.

6. Inclusion of Combustion Turbine Generators in Rate Base

A. Pinckneyville and Kinmundy

Discussion:

A part of the method the Commission uses to determine the just and reasonable rates AmerenUE may charge its customers requires a determination of the value of the property the company uses to serve its customers. That property is known as the company's rate base. Two issues are presented for the Commission's decision regarding the value of property to be included in AmerenUE's rate base. Both concern the value to be placed on combustion turbine generators (CTGs) that AmerenUE has recently acquired to provide electricity to its customers.

The first issue is related to CTGs located in Pinckneyville and Kinmundy, Illinois, which AmerenUE purchased from an unregulated affiliated company,

Ameren Energy Generating Company. The purchase closed on May 2, 2005.¹¹⁴ The Pinckneyville generating facility consists of eight CTG units with a total capacity of 316 MW. The Kinmundy facility includes two CTG units with a total capacity of 232 MW. AmerenUE paid its affiliate the net book value of the units, which was \$161.5 million for Pinckneyville and \$96.4 million for Kinmundy.¹¹⁵

The price AmerenUE paid to acquire these units is important because the Commission's affiliate transaction rule requires that when a utility purchases goods or services from an affiliated company it must pay the lesser of fair market value or cost.¹¹⁶ AmerenUE acquired the units at net book values, which are presumed to be cost. But Public Counsel and the State contend the fair market value at the time of purchase was less than net book value and, therefore, AmerenUE should be allowed to include only the fair market value of these units in its rate base.

Findings of Fact:

CTGs vary in the amount of energy they are capable of producing. Therefore, when comparing prices for generators, their value is expressed in terms of dollars per kW. The net book value purchase price AmerenUE paid for the Pinckneyville unit was \$511 per kW and \$416 per kW at Kinmundy.¹¹⁷ The blended purchase price for the Pinckneyville and Kinmundy units was \$439.50 per kW.¹¹⁸

CTGs are generally powered by natural gas, although some can also be powered by fuel oil. They are relatively inexpensive to install, but because of high fuel costs, they are expensive to operate. For that reason, they are usually operated to provide summer peaking power. CTGs are not all the same. They can be classified into three categories: (1) aero-derivatives; (2) small frame; and (3) large frame. Each type has different operational capability and cost structures and performs a specialized function. For that reason, AmerenUE needs to have a variety of CTG categories in its system.¹¹⁹

The installed cost of large frame CTGs are less per kW than the smaller aeroderivative CTGs, but the larger units offer less operating flexibility, higher operations and maintenance costs and higher start-up costs. As a result, large frame CTGs are dispatched to generate electricity less frequently. The installed cost of aero-derivative CTGs are higher, but they cost less to start and can be started more quickly. They have intraday cycling capability, meaning they can be run more than once per day, and they can count toward operating reserves.¹²⁰

The Kinmundy site contains two large frame units with a summer peak rating of 116 MW each. The Pinckneyville site includes 4 aero-derivative units with a summer peak rating of 44 MW each, and 4 small frame units rated at 36 MW each.¹²¹

The State and Public Counsel contend AmerenUE was imprudent when it chose to pay its affiliate net book value for the Pinckneyville and Kinmundy CTG

¹¹⁴ Transcript, Page 3075, Lines 11-14.

¹¹⁵ Brosch Direct, Ex. 501, Page 52, Lines 6-12.

¹¹⁶ Commission Rule 4 CSR 240-20.015(2)(A)1.

¹¹⁷ Brosch Direct, Ex. 501, Page 52, Lines 21-22.

¹¹⁸ Voytas Rebuttal, Ex. 060, Page 4, Line 14.

¹¹⁹ Voytas Rebuttal, Ex. 060, Pages 7-8, Lines 17-23, 1-2.

¹²⁰ Id. at Page 8, Lines 3-19.

¹²¹ Id. at Pages 8-9, Lines 20-22, 1-3.

units. While AmerenUE has the overall burden to prove that the rates it is proposing are just and reasonable, a slightly different rule applies when a party alleges the utility has been imprudent in some manner. The party alleging imprudence has the burden of creating a serious doubt as to the prudence of an expenditure. If that is accomplished, then the company has the burden of proving the expenditure was in fact prudent.

The State and Public Counsel base their allegations of imprudence on their measurements of the market value of the CTGs at the time they were purchased. They allege that the market for such units was depressed at the time of the purchase and that AmerenUE overpaid for the units simply to bail out its affiliate. However, the evidence they garner to support that allegation is very thin.

Public Counsel recommends the Commission use the blended price per kW AmerenUE recently paid for CTG facilities at Audrain, Goose Creek and Raccoon Creek as the presumptive market price for the Pinckneyville and Kinmundy units. It claims the blended cost of those other CTGs was \$193.80 per kW. As a secondary recommendation, Public Counsel recommends using a price of \$312.50 per kW for which the Audrain plant was reputedly offered to AmerenUE in 2002.¹²²

AmerenUE did recently purchase CTG facilities at Audrain, Goose Creek and Raccoon Creek, but for various reasons their purchase price is not a good measure of the market price for Pinckneyville and Kinmundy. First, the Audrain plant includes eight large frame units with a summer peak rating of 75 MW.¹²³ The Goose Creek facility has six large frame CTGs with a total summer capability rating of 432 MW. The Raccoon Creek facility is comprised of four large frame CTGs with a total net summer capability rating of 300 MW.¹²⁴ The Kinmundy plant can burn either oil or natural gas. Audrain, as well as Goose Creek and Raccoon Creek, are limited to natural gas. The Pinckneyville units have a lower heat rate constituting a significant improvement in efficiency.¹²⁵ All of these factors indicate the Pinckneyville and Kinmundy units have a higher market value than the Audrain plant or Goose Creek and Raccoon Creek.

More significantly, AmerenUE was able to purchase those three facilities in what was essentially a forced sale. NRG Energy, Inc., the owner of the Audrain plant, was in bankruptcy at the time the plant was sold. AmerenUE actually purchased the plant at a bargain price of \$199 per kW out of the bankruptcy proceeding.¹²⁶ The purchase of the Goose Creek and Raccoon Creek plants from Aquila occurred in similar circumstances. At the time of the sale, Aquila was anxious to sell off assets to improve its financial situation.¹²⁷ A market price can be described as the price at which a willing seller, under no compulsion to sell, will sell to a willing buyer under no compulsion to buy.¹²⁸ The fact that these sales were forced sales indicates that they are not good indicators of the market value for the Pinckneyville and Kinmundy facilities.

¹²² Kind Direct, Ex. 404, Page 35, Lines 19-27.

¹²³ Voytas, Rebuttal, Ex. 060, Page 9, Lines 4-6.

¹²⁴ Id. at Page 37, Lines 7-9.

¹²⁵ Id. at Pages 9-10, Lines 25-26, 1-8.

¹²⁶ Transcript, Pages 3169-3170, Lines 21-25, 1-6. also, Page 3116, Line 5.

¹²⁷ Transcript, Page 3170, Lines 7-13.

¹²⁸ *Shirley's Realty, Inc. v. Hunt*, 160 S.W.3d 804 (Mo. App. W.D. 2005)

As a secondary position, Public Counsel contends the Commission should base its determination of market value for the Pinckneyville and Kinmundy plants on a proposal letter AmerenUE received in 2002 from the owner of the Audrain plant, which offers to sell that facility to AmerenUE for \$200 million.¹²⁹ According to Public Counsel's calculations, a \$200 million offer for 640 MW amounts to an offer price of \$312.50 per kW, and Public Counsel would use that amount as the market value of the Pinckneyville and Kinmundy plants.¹³⁰

As previously indicated, the Audrain plant is not a good match for the Pinckneyville and Kinmundy plants and does not indicate the market value for those plants. In addition, even if the offer from NRG is accepted as a firm offer, at the time the offer was made the Audrain plant suffered from severe transmission constraints. In the view of AmerenUE, without firm transmission, the value of the Audrain plant in 2002 was no more than salvage value.¹³¹ A possible offer to sell a plant under those circumstances cannot be used to establish the market value for the Pinckneyville and Kinmundy plants.

The State's witness, Michael Brosch, took a somewhat different approach to determining the market value of the Pinckneyville and Kinmundy plants. Brosch testified that he has not conducted a prudence investigation of the price AmerenUE paid for the Pinckneyville and Kinmundy plants. He did, however, examine comparable pricing information for transactions involving combustion turbine capacity that was compiled by AmerenUE and provided to the State in response to a data request. Based on that information, which consisted of magazine articles reporting only public information, he concluded that AmerenUE paid higher than market price for the Pinckneyville and Kinmundy plants.¹³² Specifically, he averaged eight publicly reported sales between nonaffiliates, found an average market transaction price of \$288 per kW and re-priced the Pinckneyville and Kinmundy plants to that level.¹³³

However, Brosch acknowledges that the sales that he is using for comparison include a wide variety of types of CTG units; some are large frame and some are small frame.¹³⁴ He did not know whether any of the CTG units that were sold had transmission constraint problems.¹³⁵ He also did not know whether the units he was comparing to the Pinckneyville and Kinmundy plants were of the same general size and type as those units.¹³⁶

Brosch's inability to provide more details about his evaluation is not surprising because the information upon which he relied to make his evaluation is simply a compilation of magazine articles. The data he relied upon does not contain any information about the rating of the plants that were sold. It does not provide any specific nonpublic information about the transaction that could affect the valuation of the purchase. It does not provide any details of the fuel type used by the CTG, or

¹²⁹ The letter is attached to Voytas Rebuttal, Ex. 060 as RAV 2.

¹³⁰ Kind Direct, Ex. 404, Page 35, Lines 24-27.

¹³¹ Voytas Rebuttal, Ex. 060, Page 14, Lines 11-17.

¹³² Brosch Direct, Page 56, Lines 5-11.

¹³³ Transcript, Page 3271, Lines 11-24.

¹³⁴ Transcript, Page 3272, Lines 12-18.

¹³⁵ Transcript, Pages 3272-3273, Lines 23-25, 1-2.

¹³⁶ Transcript, Page 3273, Lines 21-25.

their cycling capability.¹³⁷ Because of the lack of detail in his study, Brosch's price comparison cannot provide a reasonable basis for establishing the market value for the Pinckneyville and Kinmundy CTGs.

Conclusions of Law:

With regard to a utility's purchase of goods and services from an affiliated company, the Commission's affiliate transaction rule for electric utilities provides as follows:

(A) A regulated electrical corporation shall not provide a financial advantage to an affiliated entity. For purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if –

1. It compensates an affiliated entity for goods or services above the lesser of –

A. The fair market price; or

B. The fully distributed cost to the regulated electrical corporation to provide the goods or services for itself.

The fact that the State and Public Counsel are challenging AmerenUE's prudence in paying net book cost for these CTG units brings into effect the Commission's prudence standard. The Commission established its prudence standard in a 1985 case involving the costs incurred by Union Electric Company in constructing its Callaway nuclear plant.¹³⁸ In determining how much of those costs were to be included in Union Electric's rate base, the Commission adopted a standard for determining the prudence of costs established by the United States Court of Appeals, District of Columbia, in a 1981 case.¹³⁹ The standard adopted by the Commission recognizes that a utility's costs are presumed to be prudently incurred, and that a utility need not demonstrate in its case-in-chief that all expenditures are prudent. "However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling those doubts and proving the questioned expenditures to have been prudent."¹⁴⁰

The Commission, in the Union Electric case, further established that the prudence standard was not based on hindsight, but upon a reasonableness standard. The Commission cited with approval a statement of the New York Public Service Commission that:

... the company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In

¹³⁷ Transcript, Pages 3205-3206, Lines 1-25, 1-25.

¹³⁸ *In the Matter of the Determination of In-Service Criteria for the Union Electric Company's Callaway Nuclear Plant and Callaway Rate Base and Related Issues. In the Matter of Union Electric Company of St. Louis, Missouri, for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company*, 27 Mo. P.S.C. (N.S.) 183, 192-193 (1985).

¹³⁹ *Anaheim, Riverside, Etc. v. Fed. Energy Reg. Com'n*, 669 F.2d 799, 809 (D.C. Cir. 1981).

¹⁴⁰ *Union Electric*, 27 Mo. P.S.C. (N.S.) 183, 193 (1985).

effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.¹⁴¹

Decision:

The State and Public Counsel have not demonstrated sufficient facts to create a serious doubt about the prudence of AmerenUE's decision to purchase the Pinckneyville and Kinmundy plants at net book value. There is no basis for an adjustment and AmerenUE's full purchase price for the Pinckneyville and Kinmundy plants shall be included in the company's rate base.

**B. Peno Creek
Discussion:**

The second issue regarding the inclusion of a CTG in rate base concerns a CTG facility that AmerenUE installed at Peno Creek in Pike County, Missouri. The four units at Peno Creek are aero-derivative simple cycle CTGs rated at approximately 48 MW in peak summer conditions. The units have dual fuel capability and are capable of reaching full output in eight minutes. As a result, the CTGs can be used to comply with the operating reserve requirements of MISO.¹⁴²

Leon Bender, a regulatory engineer employed by the Commission, conducted a construction audit of the Peno Creek units as they were being installed. He testified that as a result of his audit, "Staff has not identified any construction costs during construction that should not be allowed in rate base."¹⁴³ Staff recommends the full cost of construction be allowed in rate base.

Public Counsel, however, contends the gross value of the Peno Creek facility should be reduced from a value of \$550 per kW to \$390 per kW. Public Counsel did not do a construction audit; but its witness, Ryan Kind, argues the cost of Peno Creek was inflated because AmerenUE delayed the start of construction on needed CTGs because it hoped to be able to push a regulatory restructuring bill through the Missouri legislature. If such a bill were to be approved, needed capacity could be built more profitably through an affiliated non-regulated generation company. When restructuring did not occur in Missouri, Public Counsel says AmerenUE had to rush the construction of the facility at Peno Creek by using a type of CTG that was more expensive because it could be installed quicker. It also asserts the rush caused other increased construction costs. To correct for these increased costs, Public Counsel advocates the use of a lower cost of construction, \$390 per kW, that it took from AmerenUE's filing in an earlier case, EA-2000-37.¹⁴⁴

In response to Public Counsel's proposal, AmerenUE established that the \$390 per kW cost was taken from a 1995 asset mix optimization study and represents a generic installed cost for a large frame CTG based on 1995 information.¹⁴⁵

¹⁴¹ *Union Electric*, at 194, quoting *Consolidated Edison Company of New York, Inc.*, 45 P.U.R. 4th 331 (1982).

¹⁴² Voytas Rebuttal, Ex. 060, Page 30, Lines 17-21.

¹⁴³ Bender Direct, Ex. 201, Page 5, Lines 3-4.

¹⁴⁴ Kind Direct, Ex. 404, Page 30, Lines 4-7.

¹⁴⁵ Voytas Rebuttal, Ex. 060, Page 30, Lines 1-4.

Furthermore, AmerenUE established it would not necessarily cost more to install a CTG on an expedited basis.¹⁴⁶

Findings of Fact:

The Commission finds that a 1995 estimate of the cost to construct a large frame CTG has no relevance to the actual cost to construct an aero-derivative CTG in 2002 and is not a reasonable estimation of reasonable construction costs. Staff's engineer, who actually inspected the plant and audited its construction, testified that the full cost of the construction should be included in rate base. Against these facts, Public Counsel offers only speculations about increased costs, offered by a witness who is an economist, not an engineer, and who has no particular expertise in the design of AmerenUE's generation fleet.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

Mere speculation about political motivations and possibly increased prices does not create a serious doubt about the prudence of AmerenUE's expenditures on the Peno Creek CTG facility. There is no basis for an adjustment and AmerenUE's full construction cost for the Peno Creek plant shall be included in the company's rate base.

7. SO2 Allowance Sales**Discussion:**

Sulfur Dioxide (SO₂) emissions allowances are issued by the United States Environmental Protection Agency as part of the Clean Air Act. A single allowance permits the holder of the allowance to emit one ton of SO₂. A utility holding an allowance may choose to figuratively burn that allowance along with its coal and send the remains of the allowance up its smokestack as SO₂. However, the holder of the allowance does not need to burn its allowance, it may instead buy, sell, or trade the allowance to another utility or other producer of sulfur dioxide. An active market exists for these SO₂ allowances in which companies that may not be in full compliance with the Clean Air Act can obtain needed SO₂ allowances from companies that are not producing as much SO₂.

AmerenUE tends to have more SO₂ allowances than it needs to burn,¹⁴⁷ largely because its power plants burn mostly low sulfur coal from the Powder River Basin in Wyoming. As a result, AmerenUE has been able to sell unneeded allowances into the market, sometimes at a considerable profit. In addition, unused allowances do

¹⁴⁶ Transcript, Page 3321, Lines 21-25.

¹⁴⁷ Transcript, Page 3456, Lines 6-8.

not expire and can be kept by the company and banked for future use. AmerenUE has managed to accumulate a valuable bank of SO2 allowances.¹⁴⁸

The cost of SO2 premiums and discounts must also be considered along with revenue produced from the sale of SO2 allowances. AmerenUE pays SO2 premiums to coal suppliers and collects discounts from them. The amount of the premium or discount is based on the difference between the sulfur content of the coal as agreed upon in the coal supply contract and the sulfur content of the coal that is actually delivered.¹⁴⁹

All costs of complying with the Clean Air Act, including payment of SO2 premiums, are included in AmerenUE's cost of service and are recovered from ratepayers. Therefore, all parties, including AmerenUE, agree that any revenue the company receives from SO2 sales should be used to offset AmerenUE's cost of service in calculating its revenue requirement. The only question is about the best way of doing that.

Public Counsel recommends the Commission include nearly \$24 million per year in AmerenUE's revenue requirement to account for a five-year average of SO2 sales.¹⁵⁰ The State recommends the inclusion of approximately \$20.3 million per year in AmerenUE's revenue requirement, again based on a four-year average of sales.¹⁵¹

The State also recommends, in addition to including \$20.3 million per year in SO2 sales, the Commission should establish a regulatory tracking mechanism to track variations in that amount in future years. In other words, if in a future year, AmerenUE makes sales totaling more than \$20.3 million, it would accumulate a regulatory liability that could be used to reduce the company's earnings in a future rate case. If, on the other hand, the company made sales totaling less than \$20.3 million, the company could be allowed to recover the shortfall in a future rate case.¹⁵²

Staff and AmerenUE have now reached the same position regarding the treatment of SO2 sales. In its prefiled surrebuttal testimony, AmerenUE proposed its 2006 SO2 allowance sales in the amount of approximately \$33 million¹⁵³ be netted against approximately \$34 million in operating and maintenance (O&M) expenses resulting from the 2006 severe storms in AmerenUE's service area.¹⁵⁴ The company would forego recovery of the remainder of its O&M storm costs in this or any other rate case.¹⁵⁵ In its prefiled surrebuttal testimony, Staff proposed AmerenUE's gains from the sale of SO2 allowances be netted against the SO2 premiums it paid with the remainder of \$20.4 million to be offset against the \$34 million in 2006 O&M

¹⁴⁸ The number of allowances that AmerenUE has banked and their value is highly confidential. The number, as of November, 2006, may be found in the highly confidential testimony of Brosch Direct, Ex. 501, Page 38, Lines 4-5.

¹⁴⁹ Transcript, Page 3464-3465, Lines 23-25, 1-7.

¹⁵⁰ Kind Surrebuttal, Ex 408, Page 17, lines 3-7.

¹⁵¹ Brosch Direct, Ex. 501, Page 39, Line 1.

¹⁵² Transcript, Page 3560, Lines 1-13.

¹⁵³ Transcript, Page 3505, Line 11.

¹⁵⁴ Transcript, Page 3406, Lines 6-8. These numbers were designated as highly confidential in the prefiled testimony but they were revealed by the company's witness at the hearing. The company indicates that numbers about past sales do not need to be protected from disclosure.

¹⁵⁵ Baxter Rebuttal, Ex. 002, Page 12, Lines 5-7.

storm costs. Staff suggested the balance of the storm costs of \$13.6 million be amortized over five years and be recovered from ratepayers.¹⁵⁶

At the hearing, AmerenUE's witness indicated the company was willing to accept Staff's proposal, but also stood behind its proposal to offset all 2006 O&M storm costs.¹⁵⁷ Staff's witness testified at the hearing that AmerenUE's proposal was "much cheaper for customers," and indicated Staff would accept the company's proposal.¹⁵⁸

After offsetting the 2006 O&M storm costs, Staff and AmerenUE both propose that after January 1, 2007, all future SO₂ Premiums, net of SO₂ discounts, as well as all gains associated with SO₂ allowance sales be tracked in a regulatory liability account. The net balance in that account would then be addressed as part of the fuel expense calculation in the company's next rate case.¹⁵⁹ Except for the starting date, this portion of Staff and AmerenUE's proposal is the same as the tracking mechanism proposed by the State.

Findings of Fact:

Prices of emission allowances have been volatile in the recent past, as have volumes of emission sales and SO₂ premiums paid.¹⁶⁰ As a result, it would be difficult to project an appropriate amount of SO₂ allowance sales. If the base amount were set too low, the Company could reap undeserved profits as the result of high sales. If the base amount were set too high, the company could fall short of sales and lose the opportunity to earn an appropriate return. These costs and revenues are extraordinary because they are unpredictable and really a by-product of a process designed to protect air quality. Therefore, it is appropriate to set up a tracking mechanism to adjust for any over-recovery or shortfall. Three of the four parties filing testimony regarding SO₂ sales agree such a tracking mechanism is appropriate. The fourth, Public Counsel did not propose such an arrangement, but did not oppose it either. Therefore, the Commission will set up the requested tracking mechanism.

The real question is whether a base amount of sales should be imputed into AmerenUE's revenue requirement as part of that tracking mechanism. Under the State's proposal, AmerenUE's revenue requirement would be reduced by \$20.3 million (\$24 million if Public Counsel's average is used) for each year that the tracking mechanism remains in effect. However, the \$34 million in 2006 O&M storm costs would be recovered from ratepayers over a five-year period, at approximately \$7 million per year. Under Staff and AmerenUE's proposal, ratepayers do not have to pay the \$34 million in 2006 O&M storm costs, but they also do not receive the benefit of a \$20.3 million per year reduction in the company's revenue requirement. Of course, ultimately, all of AmerenUE's net revenue from SO₂ sales will be given back to ratepayers through the operation of the tracking mechanism under either proposal.

¹⁵⁶ Meyer Surrebuttal, Ex. 226, Page 3, Lines 8-18.

¹⁵⁷ Transcript, Page 3442, Lines 20-24.

¹⁵⁸ Transcript, Page 3554, Lines 14-19.

¹⁵⁹ Cassidy Surrebuttal, Ex. 209, Pages 12-13, Lines 21-23, 1-6

¹⁶⁰ Id. at Page 13, Lines 10-11.

In the short run, the State's proposal looks like a better deal for ratepayers. But it is important to remember SO₂ allowances were not created as a means for speculation or enrichment of the company or ratepayers. Their primary purpose is to regulate the emission of SO₂. That means AmerenUE must carefully manage its supply of allowances to ensure it remains in compliance with the nation's environmental laws. AmerenUE recognizes this fact by not including an estimation of prospective SO₂ sales in its annual budget.¹⁶¹ Establishing a base amount for SO₂ sales would, in effect, give AmerenUE a strong incentive to continue making those sales each year or face a revenue shortfall, and would discourage appropriate management of its allowance bank.

If AmerenUE depletes its allowance bank, it would be forced to go into the market to buy expensive allowances from other companies, or it could be forced to accelerate the installation of scrubbers or other pollution control costs at a substantial capital cost that would be recovered from ratepayers.¹⁶² Both results would have an adverse impact on ratepayers in the longer term. In addition, environmental regulations are tightening in the future and AmerenUE will need to use more of its allowances for compliance purposes.¹⁶³ For those reasons, the Commission finds it in the long-term best interest of ratepayers to establish a regulatory tracking mechanism without including a base amount of SO₂ sales in AmerenUE's revenue requirement.

Aside from its advocacy for establishment of a base amount of SO₂ sales, the State expresses two objections to the regulatory tracking mechanism proposed by Staff and AmerenUE. First, the State argues the proposed regulatory tracking mechanism would create a perverse incentive for AmerenUE to structure its future coal supply contracts with higher SO₂ premium pricing. The tracking mechanism would only account for the SO₂ premium portion of coal costs, while the other portions of coal costs would be recovered in a future rate case through the company's base rates. That means AmerenUE could agree with a coal supplier to pay a higher SO₂ premium in order to get a lower coal price, passing the higher SO₂ premium on to ratepayers, while pocketing the benefit of the lower coal price.

The State's concerns are not persuasive. First, the tracking mechanism proposed by the State's witness would exhibit exactly the same flaw. The Commission believes the benefits associated with having a tracking mechanism would outweigh the remote risk identified by the State. Second, Staff would be able to detect any such manipulation and disallow the costs associated with such a manipulation of the system in a future rate case.¹⁶⁴ Furthermore, AmerenUE has already purchased most of its coal for the next several years.¹⁶⁵ Therefore, it would be several years before State's scenario could occur.

The State's second argument is that the tracking mechanism proposed by Staff and AmerenUE would constitute forbidden retroactive ratemaking. This argument derives from the fact Staff and AmerenUE would allow the company to begin tracking revenue from allowance sales beginning as of January 1, 2007. The rates established by this case will not go into effect until approximately five months after

¹⁶¹ Transcript, Page 3428, Lines 10-14.

¹⁶² Moore Surrebuttal, Ex. 063, Page 2, Lines 10-12.

¹⁶³ Transcript, Page 3480, Lines 1-19.

¹⁶⁴ Transcript, Page 3539, Lines 2-10.

¹⁶⁵ Transcript, Page 3542, Lines 6-15.

that date. The State contends the retroactive start of the tracking mechanism would allow AmerenUE to reach back to inappropriately capture past gains or losses. This is a legal question that will be addressed under the conclusions of law section regarding this issue.

Conclusions of Law:

The Missouri Supreme Court discussed the principle of retroactive ratemaking in the 1979 decision that declared an earlier version of a fuel adjustment clause for Missouri electric utilities to be illegal. In that decision, *State ex rel. Util. Consumers Council of Missouri, Inc.*,¹⁶⁶ the court addressed Public Counsel's request that the electric utilities be ordered to calculate and refund excess charges they were able to collect under the illegal fuel adjustment clauses. In denying that request, the court said:

The commission has the authority to determine the rate to be charged. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery. It may not, however, redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process.¹⁶⁷

This ruling means neither the Commission, nor the courts, can go back and redetermine utility rates to allow recovery or refund of past over or under charges. The Missouri Court of Appeals has, however, held that it is not improper to consider past costs when setting rates that will apply only in the future.¹⁶⁸

Using that rationale, the Court of Appeals upheld this Commission's Emergency Cold Weather Rule establishing an accounting authority order (AAO) that allowed utilities to track, defer and recover the extra costs of complying with the cold weather rule.¹⁶⁹ The court explicitly found that such a deferral of expenses for consideration in a future rate case was not retroactive ratemaking.¹⁷⁰

The regulatory device that Staff and AmerenUE propose to track SO₂ allowance sales in this case is analogous to an AAO, which has been found to be legal by reviewing courts. The tracking mechanism will merely defer extraordinary costs and revenue for consideration in a future case. It does not guarantee future recovery and it is not forbidden retroactive ratemaking.

Decision:

The Commission concludes that AmerenUE's 2006 storm related operating and maintenance costs shall be offset against its 2006 SO₂ allowance sales revenue.

¹⁶⁶ 585 S.W. 2d 41 (Mo banc 1979).

¹⁶⁷ Id. at 58.

¹⁶⁸ *State ex rel. Midwest Gas Users' Ass'n v. Pub. Serv. Comm'n*, 976 S.W.2d 470, 481 (Mo. App. W.D. 1998).

¹⁶⁹ *Missouri Gas Energy v. Pub. Serv. Comm'n*, 210 S.W.3d 330 (Mo. App. W.D. 2006).

¹⁷⁰ Id. at 336.

Thereafter, the company's 2006 storm related operating and maintenance costs shall not be considered in any manner in any future rate proceeding.

The Commission will establish an accounting mechanism to track AmerenUE's future SO2 sales. Beginning on January 1, 2007, all SO2 premiums, net of SO2 discounts, shall be accounted for in FERC USOA Account 254, a regulatory liability account. All gains associated with SO2 allowance sales, beginning on January 1, 2007, shall also be recorded in the same regulatory liability account. The net balance of the SO2 premium expenses (or discounts) and corresponding gains associated with SO2 allowance sales shall be addressed as part of the fuel expense calculation in AmerenUE's next rate proceeding. The question remains of whether a base amount of SO2 sales should be included in that tracking mechanism.

The tracking mechanism will ensure that ultimately all income from SO2 sales will flow back to ratepayers. But while the tracking mechanism is operating, AmerenUE will receive the cash from those sales. The ratepayers' benefits will simply accrue in a regulatory account to be considered in AmerenUE's next rate case, whenever that case might be filed. If income from SO2 sales is simply allowed to accumulate, that regulatory account could grow to a substantial sum. That would result in intergenerational inequity as today's ratepayers would, in effect, be subsidizing tomorrow's ratepayers.

For that reason, the Commission will include an amount in the calculation of AmerenUE's revenue requirement to recognize income from SO2 sales. From year to year, as sales fluctuate above and below the base level, the amount of money accumulating in the tracking mechanism will also go up and down.

The Commission wants to encourage AmerenUE to manage its balance of SO2 allowances wisely and does not want to effectively force it to meet an annual quota of sales to earn its allowed rate of return. Therefore, the Commission will establish the annual base level of SO2 sales as \$5 million, which is approximately one fourth of the four-year average calculated by the State's witness.

8. Depreciation

Depreciation is the means by which a utility is able to recover the cost of its investment in its rate base by recognition of the reduction in value of that property over the useful life of the property. The parties have identified several issues regarding depreciation and they will be addressed in turn.

A. Commission Rule 4 CSR 240-10.020

Discussion:

This is a silly, almost frivolous issue, upon which the parties have lavished far too much time and attention. In his direct testimony filed at the start of this case, an AmerenUE witness, Gary Weiss, cited an obscure Commission rule that he said:

prescribes the method that the Commission must follow in accounting for income derived by gas electric, water, telegraph, telephone and heating utilities from their investment of depreciation funds.¹⁷¹

¹⁷¹ Weiss Direct, Ex. 010, Page 29, Lines 7-9.

Weiss indicated if the Commission were to follow this rule in setting rates in this case, AmerenUE would be entitled to recover twice the amount in rates that it was actually requesting. Weiss emphasized that AmerenUE was not actually asking the Commission to follow this rule in setting rates, but contended that the rule would provide additional justification for the amount of revenue AmerenUE is seeking.¹⁷² Again, at the hearing, AmerenUE emphasized it is not proposing to implement rates that would reflect compliance with this rule.¹⁷³

In response to Weiss' alternative hypothetical method for calculating depreciation income, Staff filed rebuttal testimony explaining that the rule in question dates back to a general order the Commission issued in 1946. It was carried unchanged into the Code of State Regulations in 1975 when the Commission made an effort to codify all of its old rules in compliance with Chapter 536, RSMo.¹⁷⁴ Staff concludes the Commission actually abandoned the use of this rule by 1958.¹⁷⁵ Staff also indicated that AmerenUE – then Union Electric – has not complied with the reporting requirements of the rule since 1951.¹⁷⁶ Nevertheless, Staff delves into the arcane requirements of the obsolete rule and determines that AmerenUE's interpretation of the rule is incorrect. If properly interpreted, Staff contends the rule would require a reduction in the company's revenue requirement of over \$134 million.¹⁷⁷

Findings of Fact:

The Commission does not need to determine the proper hypothetical application of this rule. It is enough to know that no party has asked the Commission to apply the rule in this case. Furthermore, the Commission finds that this rule has been obsolete since the 1950s and that no utility has attempted to follow the provisions of this rule since that time. In addition, AmerenUE has not complied with the reporting requirements of this rule since 1951. This rule is obsolete and has no application to this case.

Conclusions of Law:

Commission Rule 4 CSR 240-10.020 purports to determine the means by which depreciation is to be used in determining the reasonableness of rates charged by utilities. Subsection (5) of that rule requires affected utilities to prepare and include in their annual reports schedules showing income from investment in depreciation funds.

Decision:

No party has asked the Commission to apply the provisions of this rule in this case. In any event, the rule is obsolete and has been ignored by the Commission

¹⁷² Id. at Page 30, Lines 8-16.

¹⁷³ Transcript, Page 3604, Lines 16-19.

¹⁷⁴ Schallenberg Rebuttal, Ex. 236, Pages 11-12, Lines 16-23, 1-3.

¹⁷⁵ Id. at Page 13, Lines 13-15.

¹⁷⁶ Id. at Page 12, Lines 10-12.

¹⁷⁷ Id. at Page 8, Lines 9-13.

and the utilities it regulates for more than 50 years. The rule has no application to this case and the Commission will not attempt to offer a hypothetical interpretation of the meaning of that rule. The Commission instructs its Staff to consider the repeal of 4 CSR 240-10.020.

**B. Life Span of Fossil Fuel and Hydro Power Plants
Discussion:**

AmerenUE, supported by MIEC, proposes to use a life-span method of calculating depreciation rates for categories of property that are components of its steam and hydraulic production plants. Under the life-span method, a survivor curve is used to determine the average expected useful life for the various components of the power plant. Those ages are then used to calculate the appropriate rate at which the value of those components will be depreciated. AmerenUE, however, would go one step farther. It would truncate all the survivor curves of the components at the date when it anticipates the entire power plant will be removed from service. AmerenUE reasons that when the power plant as a whole is retired, all its components must also be retired.¹⁷⁸ AmerenUE contends life-span treatment of power plant components is a widely accepted practice by other state commissions.¹⁷⁹

In its direct testimony, for purposes of calculating depreciation, AmerenUE used a retirement date of June 30, 2026, for all its fossil fuel steam production plants. This date was chosen because it was 20 years in the future and AmerenUE's witness believed that operation of any steam plant was uncertain beyond that date.¹⁸⁰

In response to criticism from other parties about the arbitrary nature of the chosen retirement date, AmerenUE's witness calculated new individual retirement dates for each steam production plant, based on the potential for future environmental requirements, future development of new generating technologies, and the finite life of certain heavy wall components. AmerenUE's witness also considered the age and condition of each major component, the service history of each facility and the expected future service conditions, anticipated near term capital investment for each facility, and the time and resources required to permit and construct replacement base load production capacity.¹⁸¹ After making this careful evaluation, the witness concluded that AmerenUE would retire all of its coal-fired steam plants as follows:

Facility	Est. Retirement Year	App. Age at Retirement
Meramec	2021	63 years
Sioux	2027	60 years
Labadie	2033	61 years
Rush Island	2037	60 years

In other words, AmerenUE estimated that all the plants would be retired when they reach approximately 60 years of age.¹⁸² In addition, AmerenUE estimated its Osage hydroelectric plant at Bagnell dam will be retired in 2046.

¹⁷⁸ Stout Direct, Ex. 069, Page 12, Lines 7-22.

¹⁷⁹ Stout Rebuttal, Ex. 070, Page 8, Lines 1-5.

¹⁸⁰ Wiedmayer Direct, Ex. 072, Schedule jfwe1, Page II-25.

¹⁸¹ Birk Rebuttal, Ex. 026, Pages 1-2, Lines 17-23, 1-9.

¹⁸² Id. at Page 2, Lines 12-14.

In opposing AmerenUE's use of truncated survivor curves based on estimated plant retirement dates, Staff's witness, Jolie Mathis, testified that a determination of the exact timing of retirement of a particular facility can be made only relatively close to the time of retirement. Because the retirement date for steam production is not certain, it would be inappropriate to truncate the survivor curve at this time.¹⁸³

In addition to their disagreement about the use of plant retirement dates to truncate survivor curves for components of those plants, the witnesses for Staff and AmerenUE also disagree about the length of the survivor curves Staff's witness has utilized. AmerenUE contends that because Staff's witness used only interim retirement data and did not truncate those curves, she over-estimated the average service lives for those accounts and understated the depreciation rates.

Findings of Fact:

Staff contends the retirement date for AmerenUE's base load coal-fired electric generating plants cannot be known with any degree of certainty at this time. Based on the company's unconvincing attempts to estimate such retirement dates, the Commission must conclude that Staff is correct. In its initial direct testimony, AmerenUE simply assumed all its coal-fired production plants would be retired on the same date twenty years in the future. After hearing criticism of that arbitrary approach, AmerenUE took a closer look at the question and concluded that all of its coal-fired plants would be retired at approximately age 60 years. The second approach appears to be as arbitrary as the first.

It is very unlikely AmerenUE will actually choose to retire and replace such a large percentage of its base load generation capacity within the short span of 16 years between 2021 and 2037.¹⁸⁴ It is certain that AmerenUE filed an integrated resource plan in December 2005 that did not make any mention of any plan to replace base load generation capacity.¹⁸⁵

AmerenUE also criticizes the length of the survivor curves Staff's witness, Jolie Mathis, chose to utilize in calculating the life span of the components of these power plants. At the hearing, Mathis was extensively cross-examined about the life spans those curves would produce, with the implication that those expected lives were unreasonably long.¹⁸⁶ However, the survivor curves that Mathis used are the same curves AmerenUE's witness used, except not truncated for the speculative retirement of the plant.¹⁸⁷ Based on the evidence before the Commission, it appears AmerenUE's criticism of the Staff's choice of survivor curves is merely a further attempt to discredit Staff's decision not to truncate those curves to account for speculative retirement dates for AmerenUE's generating plants.¹⁸⁸

¹⁸³ Mathis Direct, Ex. 222, Pages 8-9, Lines 18-22, 1-2.

¹⁸⁴ Gilbert Rebuttal, Ex. 211, Page 4, Lines 1-4.

¹⁸⁵ Integrated Resource Plan, Executive Summary, Ex. 273HC.

¹⁸⁶ Transcript, Pages 3736-3750.

¹⁸⁷ Transcript, Page 3737, lines 7-13.

¹⁸⁸ AmerenUE's brief at page 133 attempts to develop a more extensive argument about including both interim and final retirement data in a survivor curve. However, a party's brief is not evidence and cannot be used to support a decision of this Commission.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

Obviously, at some point, all of AmerenUE's electric production plants will be retired. But at this time, there is really no way to be sure when that retirement will occur. It all seems like an unimportant matter, but the truncation of survivor curves and the resultant decrease in the expected life of the components of these power plants would significantly increase the amount of money AmerenUE would be allowed to recover as depreciation expense. In turn, the calculation of depreciation expense will have a significant impact on the rates that AmerenUE will be allowed to charge its customers.¹⁸⁹ Without better evidence of when those plants are likely to be retired, allowing the company to increase its depreciation expenses based on what is little more than speculation about possible retirement dates would be inappropriate. Staff's use of non-truncated survivor curves is appropriate and Staff's curves shall be used for calculation of AmerenUE's depreciation expense.

C. Callaway Plant Life Span**Discussion:**

The Callaway Plant is a 1,292 MW nuclear plant located in Callaway County, Missouri. In 2005, the Callaway Plant was the third largest power producer on AmerenUE's system, producing 10.3 percent of AmerenUE's total generation.¹⁹⁰ The Callaway Plant was granted a 40-year license to operate by the Nuclear Regulatory Commission (NRC) in 1984. That license will expire in 2024. The NRC has established a process whereby license holders can apply for a 20-year license extension, which would extend the Callaway Plant's operating license until 2044.¹⁹¹

AmerenUE proposes depreciation on the Callaway Plant be calculated using a 40-year life span because the plant's current license will expire in 2024. AmerenUE indicates it has not yet decided whether to seek a 20-year license renewal.¹⁹² It also suggests there is a possibility the NRC may refuse to extend the license, or necessary repairs at the plant may be too expensive to justify the 20-year extension of the license. Therefore, AmerenUE contends it would be more prudent to continue depreciation at its current levels by using the 2024 retirement date when calculating depreciation.¹⁹³

Staff, Public Counsel, MIEC, and the State all contend that depreciation of the Callaway Plant should be calculated using a 2044 retirement date. They argue AmerenUE is nearly certain to apply to renew the operating license for the Callaway Plant and the NRC is quite likely to grant the requested renewal. Use of a 60-year life span instead of a 40-year life span will spread the capital costs over a longer period and will have the effect of reducing AmerenUE's revenue requirement in this

¹⁸⁹ The Revised True-Up Reconciliation filed on April 19, 2007, indicates that use of Staff's survivor curves will reduce AmerenUE's revenue requirement by \$57,701,438.

¹⁹⁰ Naslund Direct, Ex. 047, Page 3, Lines 5-8.

¹⁹¹ Id. at Page 9, Lines 7-11.

¹⁹² Id. at Page 9, Lines 13-14.

¹⁹³ Stout Direct, Ex. 069, Page 30, Lines 17-20.

case by \$27,919,066 according to Staff and Public Counsel.¹⁹⁴ MIEC's witness, James Selecky, calculates the revenue requirement reduction as \$46,570,693.¹⁹⁵

Findings of Fact:

The evidence overwhelmingly supports a finding that AmerenUE will apply for and receive a 20-year operating extension for the Callaway Plant. More than 90 of the 104 nuclear power plants in the United States eligible for license renewal have either sought or indicated they will seek a 20-year renewal of their operating license.¹⁹⁶ Although AmerenUE has not yet sought to renew the Callaway Plant's license, there is no good reason to believe it will not do so. Furthermore, the NRC has never refused to renew a commercial nuclear power reactor's initial license for the additional 20 years.¹⁹⁷

AmerenUE has recently made major capital additions to replace major components of the Callaway Plant, including four new steam generators,¹⁹⁸ and has budgeted funds in 2013 for reactor head replacement.¹⁹⁹ The Callaway Plant provides a very large percentage of the power AmerenUE produces, including an even larger percentage of its base load generation.²⁰⁰ Quite simply, AmerenUE has too much invested in the Callaway Plant not to seek a 20-year license extension.

AmerenUE's response to those who say it is highly likely the Callaway Plant's license will be extended is simply to claim it has not yet decided to apply to extend the license and probably will not do so until 2014,²⁰¹ and something could change before 2024 to prevent such an extension. But AmerenUE is not aware of any safety or environmental issues to preclude an extension of the Callaway Plant's operating license.²⁰² Under the circumstances, the Commission finds the Callaway Plant's depreciation should be calculated using a retirement date of 2044.

The decision to use a retirement date of 2044 still leaves the question of which witness' depreciation schedule the Commission should accept. MIEC's proposed depreciation schedule utilizes a method of calculating net salvage the Commission has rejected in previous cases and rejects again later in Section 8-E&F of this order. Staff's calculation of net salvage uses the traditional accrual method the Commission once again approves in this order. Therefore, the depreciation schedules proposed by Staff will be accepted.

Conclusions of Law:

There are no additional conclusions of law for this issue.

¹⁹⁴ The number is taken from the Revised True-Up Reconciliation filed on April 19, 2007.

¹⁹⁵ The number is taken from the Revised True-Up Reconciliation filed on April 19, 2007. Selecky's calculations are shown in his Direct Testimony, Ex. 707, Page 26, Lines 1-11 and Schedule JTS-8.

¹⁹⁶ Wood Surrebuttal, Ex. 247, Page 3, Lines 6-9.

¹⁹⁷ Dunkel Direct, Ex. 400, Page 10, Lines 9-10.

¹⁹⁸ Naslund Direct, Ex. 047, Page 4, Lines 10-20.

¹⁹⁹ Dunkel Surrebuttal, Ex. 402, Page 4, Lines 8-13.

²⁰⁰ Transcript, Page 4220, Lines 7-15.

²⁰¹ Transcript, Page 4241, Lines 3-15.

²⁰² Selecky Direct, Ex. 707, Page 24, Lines 15-20.

Decision:

The Commission finds it more likely than not that AmerenUE will obtain a 20-year extension of the operating license of the Callaway Nuclear Plant. Therefore, the Commission will direct that 2044 be used as the retirement date for that plant. The Commission also directs that the depreciation rates developed by Staff be used to calculate depreciation on the Callaway Plant.

D. Terminal Net Salvage and Inflation Costs Relating to Retirement of Generating Plants**Discussion:**

The first portion of this issue concerns the appropriate net salvage percentages to be used for Steam and Hydraulic Plant accounts. In a non-unanimous stipulation and agreement, Staff and AmerenUE agreed that Staff's net salvage percents for Steam and Hydraulic Plant depreciation rates were to be used. MIEC and Public Counsel objected to that stipulation and agreement and demanded a hearing on the issue. As a result, the stipulation and agreement was not approved and now indicates only a change of position by the signatory parties.

The second portion of the issue concerns terminal net salvage relating to AmerenUE's Steam and Hydraulic Plant. In the objected to stipulation and agreement, AmerenUE changed its position to renounce any recovery of terminal net salvage from its ratepayers. All other parties agree that terminal net salvage should not be recovered from ratepayers.

Findings of Fact:

Staff's net salvage percentages are calculated in accordance with the traditional accrual method approved by the Commission in previous cases²⁰³ and reaffirmed by the Commission later in Section 8-E&F of this order. The method for calculating depreciation rates advocated by MIEC are rejected by the Commission in Section 8-E&F of this order. Therefore, the Commission will accept the net salvage percentages advocated by Staff.

All parties now agree terminal net salvage relating to Steam and Hydraulic Plant depreciations should not be recovered from ratepayers at this time.

Conclusions of Law:

Commission rule 4 CSR 240-2.115(D) provides:

A nonunanimous stipulation and agreement to which a timely objection has been filed shall be considered to be merely a position of the signatory parties to the stipulated position, except that no party shall be bound by it. All issues shall remain for determination after the hearing.

Decision:

²⁰³ Mathis Direct, Ex. 222, Page 7, Lines 15-25. and Schedule JLM-2

The Commission accepts the net salvage percentages advocated by Staff. Terminal net salvage relating to Steam and Hydraulic Plant depreciation shall not be recovered from ratepayers at this time.

**E. Historic or Future Inflation Rates When Estimating Net Salvage
and
F. Should Net Salvage Be Based on Actual Net Salvage Expense?
Discussion:**

These two sub-issues are closely connected so they will be discussed and decided together.

Salvage is the scrap value of a depleted asset that has reached the end of its useful life. Net salvage is the value remaining after the cost of removing the asset is subtracted from its salvage value. Often, net salvage is negative because the cost of removing the asset exceeds its salvage value.

In recent cases the Commission has mandated the use of the traditional accrual method for calculating a depreciation rate using the following formula:

$$\text{Depreciation Rate} = 100\% - \% \text{ Net Salvage/Average Service Life (years)}$$

The net salvage percentage is determined by dividing the net salvage experienced for a period of time by the original cost of the property retired during the same period of time. Because net salvage costs are incurred in the future, when the asset is retired, the net salvage to be determined for the investments currently in service is called future net salvage.²⁰⁴ Estimates of future net salvage are based on historical analysis of net salvage as a percent of the original cost of the facilities that are retired.²⁰⁵

As his primary position, MIEC's witness, James Selecky, recommends the Commission abandon the traditional accrual method for calculating net salvage and instead allow the company to recover only the average net salvage expense it incurs in a particular year.

As a secondary position, MIEC's witness joins with Public Counsel's witness, William Dunkel, to recommend the Commission adjust the accrual method of calculating future net salvage by substituting a projection of future inflation for the historic inflation actually experienced when conducting an analysis of net salvage.

Inflation enters into the calculation because net salvage is stated in current dollars while the original cost of the investment is stated in historic dollars. Inflation occurring during the service life of the asset thus has a major impact on the net salvage calculation.²⁰⁶ Most of the plant being retired now, and which would be included in a current depreciation study to estimate future net salvage, was installed and paid for 30-50 years ago.

MIEC and Public Counsel point out that this country's economy experienced unusually high inflation rates during the 1970s and early 1980s. That high inflation rate would be reflected in the inflation experienced during the life of plant now being retired. They contend inflation in the future, during the period plant now in service

²⁰⁴ Dunkel Direct, Ex. 400, Page 19, Lines 5-10.

²⁰⁵ Stout Rebuttal, Ex. 070, Page 11, Lines 11-12.

²⁰⁶ Dunkel Rebuttal, Ex. 401, Page 11-17.

will be moving toward retirement, will likely be lower. To correct for this, they propose to substitute an anticipated, hypothetical inflation rate for the historical inflation rate actually experienced by the plant now being retired.

Both MIEC and Public Counsel base their proposed future inflation rates on predictions by financial experts. MIEC relies on the Annual Energy Outlook of 2006,²⁰⁷ while Public Counsel relies on a survey of professional forecasters produced by the Federal Reserve Bank of Philadelphia.²⁰⁸ Relying on these projections, they recommend use of a future inflation rate of 2.5%.

In response to the proposals put forth by MIEC and Public Counsel, AmerenUE provided evidence arguing that the analysis of the other parties is flawed because it overstates the average age of historical retirements by incorrectly assuming the historical retirements occurred at an average age equal to the estimated average service life.²⁰⁹

Findings of Fact:

The Commission recently addressed the question of whether the traditional accrual method should be used in calculating depreciation. In the Laclede Case, Case No. GR-99-315, the Commission found "the fundamental goal of depreciation accounting is to allocate the full cost of an asset, including its net salvage cost, over its economic or service life so that utility customers will be charged for the cost of the asset in proportion to the benefit they receive from its consumption."²¹⁰ The Commission reaffirmed that position in another 2005 rate case, this time involving The Empire District Electric Company.²¹¹

MIEC's proposal to abandon the accrual method of calculating depreciation would abandon what the Commission found to be a fundamental goal by once again divorcing recovery of net salvage cost from the customers who will benefit from the use of the asset during its lifetime. It would instead push those costs onto future ratepayers who would be saddled with the full cost of net salvage at the time the asset is retired. The Laclede and Empire District cases were decided properly and the Commission will not revisit those decisions.

The proposal to substitute projections of future inflation for historic rates of inflation is flawed by an overstatement of the average age of historical retirements used in the formulas for substituting projected future inflation for historic rates of inflation. As explained by AmerenUE's witness, William Stout, MIEC and Public Counsel would use average service life as the average age of future retirements. The average age of future retirements is not the average service life, but rather is the average probable life. The average probable life is the same as average service life when an asset is first placed in service, but as time passes the average probable life continues to increase beyond the average service life. This is the same effect experienced in human life expectancy. At birth, a child may have a life expectancy of 70 years, but a 69 year old may still have a life expectancy of more than one year.

²⁰⁷ Selecky Direct, Ex. 707, Page 35, Line 20.

²⁰⁸ Dunkel Direct, Ex. 400, Page 24, Lines 7-9.

²⁰⁹ Stout Rebuttal, Ex. 070, Page 12, Lines 5-17.

²¹⁰ In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules, 13 Mo. P.S.C. 3d 215, 220 (2005).

²¹¹ In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase, 13 Mo. P.S.C. 3d 350 (2005).

The use of probable life would result in the inclusion of more future inflation than was recognized by MIEC and Public Counsel and would invalidate their proposed adjustments.²¹²

Even more fundamentally, MIEC and Public Counsel have failed to demonstrate any reason to believe their estimates of future inflation are a more reliable predictor of future inflation than the past history used by Staff and AmerenUE in their calculations. Expert predictions of future inflation can be little more than guesswork. It is impossible to accurately predict what inflation might occur 30 or 40 years in the future. No doubt if an esteemed panel of experts had been polled in 1960 they never would have predicted the severe inflation of the 1970s and 1980s. Similarly, today's experts cannot possibly foresee whatever inflation may occur in 2023. The Commission finds past history to be a better predictor of future inflation for ratemaking purposes.

Conclusions of Law:

No additional conclusions of law are made for this issue:

Decision:

The Commission will continue to use traditional accrual accounting for calculation of net salvage. The future inflation adjustments proposed by MIEC and Public Counsel are rejected. The Commission also notes that in the Laclede case the Commission required that company to separately accrue and account for net salvage amounts received in rates separately from other components of depreciation expense.²¹³ The Commission will impose the same requirement on AmerenUE.

The Commission believes this decision regarding inflation is consistent with past practices of the Commission as decided in the Laclede case. If Staff believes this decision is inconsistent with past practice, the Commission expects Staff to so advise the Commission in an application for reconsideration or clarification.

G. Is There a Difference between Actual Book Accumulated and Theoretical Accrued Depreciation?

Discussion:

In her direct testimony for Staff, Jolie Mathis indicated AmerenUE's theoretical reserve has become imbalanced with actual book accumulated depreciation. At the time Mathis filed her testimony, Staff did not recommend any adjustment to correct that imbalance, but noted the imbalance would need to be monitored in future depreciation studies.²¹⁴

No other party responded to that statement in testimony, but in the nonunanimous stipulation and agreement regarding certain stipulation issues, AmerenUE and Staff agreed as follows:

²¹² Stout Surrebuttal, Ex. 071, Page 7, Lines 8-16.

²¹³ In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules, 13 Mo. P.S.C. 3d 215, 224 (2005).

²¹⁴ Mathis Direct, Ex. 222, Pages 9-10, Lines 15-22, 1-17.

e. AmerenUE shall not seek to recover from its customers the difference between the book reserve balance and the theoretical reserve balance reserve for any account. AmerenUE shall transfer \$82,067,828 of the accumulated depreciation reserve from the Distributed Plant accounts to the General Plant accounts.

Conclusions of Law:

Although two parties objected to other aspects of the depreciation stipulation and agreement, no party objected to this provision. The provision can be taken as an expression of the positions of the signatory parties.

Findings of Fact:

This stipulated position of Staff and AmerenUE is necessary to correct an imbalance between depreciation accounts and will have no impact on depreciation rates. It is not opposed by any party.

Decision:

The stipulated position of Staff and AmerenUE is accepted.

H. Net Salvage Percentage to Be Used for Assets in Account 322

Discussion:

In her depreciation study described in her direct testimony, Staff witness, Jolie Mathis, used a net salvage percentage for assets in Account 322 of -37 percent.²¹⁵ AmerenUE's witness, John Wiedmayer, used a net salvage percentage for that account of zero percent for his depreciation study. No other party filed testimony on this issue, but MIEC indicates its supports AmerenUE's position on this question in its brief.²¹⁶

In the objected to stipulation and agreement described several times in this order, Staff and AmerenUE agreed this issue could be resolved by adding an additional .2 percent to the depreciation rate for Account 322, and by adding an additional .1 percent to the depreciation rates of the other nuclear plant accounts. At the hearing, Mathis testified that the .2 percent figure relating to Account 322 was acceptable to Staff.²¹⁷

Findings of Fact:

There is very little evidence in the record on this question. Two experts included different numbers in their accounting schedules with no explanation offered. The parties who offered the testimony of those two experts now agree .2 percent should be added to the depreciation rate for Account 322. In the absence of any counter-

²¹⁵ Mathis Direct, Ex. 222, Schedule JLM-2.

²¹⁶ Missouri Industrial Energy Consumers' Post Hearing Brief, Page 49-50.

²¹⁷ Transcript, Page 7351, Lines 6-10.

evidence, the Commission will accept the position espoused by Staff and AmerenUE.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

To account for net salvage related to interim retirements, an additional .2 percent shall be added to the depreciation rate for Account 322.

As previously indicated, in the objected-to stipulation and agreement, which the Commission cannot approve, Staff and AmerenUE agree that an additional .1 percent would be added to the depreciation rates of the other nuclear plant accounts. The depreciation rates for other accounts were not identified as a separate issue and no evidence was offered on that question. The Commission has no basis for making a decision regarding those accounts.

9. Metro East

Discussion:

On February 10, 2005, the Commission issued a Report and Order on Rehearing authorizing AmerenUE to transfer its Illinois property and customers to AmerenCIPS, its sister company under the Ameren umbrella. The parties referred to this as the Metro East order. Part of that order provided as follows:

That AmerenUE may seek recovery in a future rate proceeding (a rate increase or excess earnings complaint) of up to 6% of the unknown generation-related liabilities associated with the generation that was formerly allocated to AmerenUE's Metro East service territory, if it proves by a preponderance of the evidence that the sum of the Missouri ratepayer benefits attributable to the transfer in the applicable test year is greater than the 6% of such unknown generation-related liabilities sought to be recovered. AmerenUE will be entitled to recover that part of the 6% that is offset by benefits directly flowing from the transfer.²¹⁸

AmerenUE sought to recover \$137,986 representing the six percent of the generation-related liabilities contemplated by the Metro East order in this rate case.

AmerenUE did not address the recovery of the \$137,986 in its direct testimony. Public Counsel's witness, Ryan Kind, points that fact out in his direct testimony and asserted that AmerenUE had not shown by a preponderance of the evidence that the benefits to Missouri ratepayers from the transfer outweigh the \$137,986 in costs, and therefore AmerenUE should not be allowed to recover those costs.²¹⁹

AmerenUE responded to Public Counsel's proposed adjustment in the rebuttal testimony of Gary Weiss. Weiss testified that the benefits of the transfer far outweigh the costs to Missouri's ratepayers. He indicates fuel savings to AmerenUE's

²¹⁸ Ex. 119. The Report and Order may also be found at 13 Mo. P.S.C. 3d 266 (2005).

²¹⁹ Kind Direct, Ex. 404, Page 10, Lines 22-24, 1-5.

Missouri customers as a result of the Metro East transfer amounted to \$22.3 million in the test year alone.²²⁰

Findings of Fact:

AmerenUE's \$22.3 million in fuel savings is greater than its \$137,986 in generation-related liabilities.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

AmerenUE has proved by a preponderance of the evidence that the sum of the Missouri ratepayer benefits attributable to the transfer in the applicable test year is greater than the 6% of such unknown generation-related liabilities sought to be recovered. No adjustment relating to this issue shall be made to AmerenUE's revenue requirement.

10. Class Cost of Service, Rate Design, and Tariff Issues

A. Economic Development and Retention Riders

Discussion:

AmerenUE has proposed two new tariffs relating to economic development. The Economic Development and Retention Rider (EDRR) would offer a discounted rate to new or expanding industrial customers who can show they have an option to move out of AmerenUE's service territory to an area with lower electric rates.²²¹ AmerenUE has also proposed an Economic Redevelopment Rider (ERR) that could be used to encourage redevelopment in defined areas within the City of St. Louis. The ERR targets areas that have lost industries but already contain extensive but underutilized electric infrastructure.²²² Both the EDRR and the ERR will expire on December 31, 2008, unless the term is extended by the company and approved by the Commission. Customers who have signed up by the expiration date will continue to receive the discounted rates for five years so long as they continue to meet the requirements of the tariffs.²²³ AmerenUE's shareholders are paying the cost of both programs.²²⁴

Staff and Public Counsel support both economic development riders. The State also generally supports the riders but urges the Commission to remove the expiration dates from the tariffs. AmerenUE replies it would like to keep the

²²⁰ Weiss Rebuttal, Ex. 012, Page 18, Lines 20-21.

²²¹ Mill Direct, Ex. 040, Pages 5-6, lines 18-23, 1-6.

²²² Id. at Page 8, Lines 8-15.

²²³ Id. at Page 8, Lines 1-6.

²²⁴ Mill Surrebuttal, Ex. 042, at Page 2, Lines 20-21.

expiration date to enable it to “tweak this tariff, to adjust it to the market, to the needs.”²²⁵

Unfortunately, MIEC, which represents the large industrial customers who are most likely to be able to take advantage of the EDRR, thoroughly dislikes the new rider. It would prefer AmerenUE instead renew a previous economic development rider, known as the EDR.²²⁶ The EDR terminated on March 31, 2006 and was not renewed by AmerenUE.²²⁷ MIEC believes the old EDR has many features that are more attractive to customers than the newly proposed EDRR.

Findings of Fact:

Economic development is an important goal that benefits all Missourians. It is vital that AmerenUE have workable economic development tariffs that actually help to further that goal. But it is also important AmerenUE’s tariffs not become simple giveaways to large ratepayers, leaving residential customers to pick up the slack. MIEC does not like many features of the new EDRR, but the other concerned parties, Staff, Public Counsel and the State, including the Department of Economic Development, generally support the EDRR.

The EDRR is being funded by AmerenUE’s shareholders, not ratepayers, so the Commission is willing to give the company more discretion in designing what it believes to be an appropriate economic development tariff. For that reason, the Commission will approve the EDRR and will not require AmerenUE to bring back the EDR. The Commission will, however, require AmerenUE to modify the EDRR tariff to eliminate the termination date. That is a small modification that should not create an undue burden on AmerenUE but will have a positive effect on economic development. Of course, AmerenUE will be able to modify the terms of the EDRR at any time by filing a tariff revision for the Commission’s approval.

No party opposes the ERR rider and it will be approved, also without a termination date.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission will approve the Economic Development and Retention Rider (EDRR) tariff and the Economic Redevelopment Rider (ERR) tariff, provided that AmerenUE remove the termination dates from the tariffs.

B. Industrial Demand Response Program

Discussion:

AmerenUE has submitted a proposed tariff to implement a new industrial demand response pilot program known as Rider IDR. The pilot program is designed

²²⁵ Transcript, Page 4165, Lines 16-19.

²²⁶ The text of the EDR is Ex. 524.

²²⁷ Transcript, Pages 4123-4124, Lines 24-25, 1-6.

to assess whether industrial process customers are able to respond to load curtailments in exchange for a lower monthly demand charge. The Rider IDR requires customers to interrupt their use of power when they are directed to do so by the company.²²⁸ The tariff defines the occasions when a customer could be asked to interrupt but the decision to interrupt is at the discretion of AmerenUE.²²⁹ The Rider IDR would limit the hours available for interruption to 200 per year.²³⁰ The customer can choose the amount of curtailable load to be included in the program.²³¹ The availability of the program is limited to no more than five customers with a total demand response aggregated load of 100 MW and would last for three years.²³² Customers who agree to participate in the program would be paid a demand credit of \$2.00 per kW per month with an additional credit of 8 cents per kWh when interrupted.²³³ This is designed to be a pilot program and AmerenUE indicates it will evaluate the results of the program but has not yet designed the evaluation methods for the program.²³⁴

Staff and the State do not oppose the proposed IDR tariff. Public Counsel is not opposed to the concept of an IDR but is concerned that AmerenUE has not yet designed a method to evaluate the success or failure of this program, despite having filed the sample tariff with its direct testimony in July 2006.²³⁵

The MEG, a group of industrial users who might be inclined to sign up for this pilot program, asks the Commission to approve the IDR but with modifications to make it more attractive for potential users. The MEG asks the Commission to impose the following modifications:

- (a) increase the demand credit to \$3.33/kW per month;
- (b) modify the start date to enable customers to sign up immediately upon Commission approval of the tariff;
- (c) extend the length of the pilot to at least 3 years;
- (d) require any interruption of less than an hour to be counted as an hour;
- (e) require the notice period for the impending interruption to be no less than 60 minutes; and
- (f) require a full evaluation of the IDR pilot at the end of the pilot period.

AmerenUE objected to all of these proposed modifications except that it agreed to modify the start date of the tariff to July 1, 2007, instead of June 1 so customers can sign up this year to allow for a full two-year evaluation of the pilot program.²³⁶ AmerenUE indicated it is willing to consider changes to the program but since the entire program is being paid with shareholder funds, it is not willing to substantially expand the program unless the cost of the program is included in rates.²³⁷

²²⁸ Mill Direct, Ex. 040, Page 11, Lines 10-15.

²²⁹ Transcript, Page 3934, Lines 2-6.

²³⁰ Mill Direct, Ex. 040, Page 11, Lines 18-19.

²³¹ Id. at Page 11, Lines 15-16.

²³² Id. at Page 12, Lines 2-4.

²³³ LaConte Direct, Ex. 553, Page 2, Lines 2-5.

²³⁴ Mill Direct, Ex. 040, Page 12, Lines 19-23.

²³⁵ Transcript, Page 4170, Lines 9-12.

²³⁶ Transcript, Page 4160, Lines 9-16.

²³⁷ Transcript, Page 4286, Lines 18-25.

Findings of Fact:

The Commission is very interested in promoting the development of demand response programs. It is concerned that this IDR pilot in its current form may not be attractive to the customers most likely to participate in it. But, since the IDR Pilot is being funded by AmerenUE's shareholders, not ratepayers, the Commission is hesitant to impose additional costs on the company and will give it more discretion to design an IDR Pilot it believes is appropriate.

However, the lack of a plan for evaluating the effectiveness of the pilot plan will prevent the Commission from approving the proposed tariff at this time. Such a plan is a requirement of the Commission's Electric Utility Promotional Practices rule and the Commission is not willing to waive that rule. In any event, Mr. Mill testified it would be a good idea to have an evaluation plan in place before the tariff goes into effect.²³⁸

Conclusions of Law:

Commission Rule 4 CSR 240-3.150(3), the Commission's Electric Utility Promotional Practices rule provides:

The utility shall provide the following supporting information for each promotional practice:

(B) For promotional practices that are designed to evaluate the cost-effectiveness of potential demand-side resources, a description of the evaluation criteria, the evaluation plan and the schedule for completing the evaluation;

This regulation requires AmerenUE to file the required supporting information about its plans for evaluating the success of the IDR Pilot Program before the Commission can approve such a tariff.

Decision:

The Commission will not approve the submitted tariff that would implement an IDR Pilot Program at this time because the submitted tariff does not comply with the filing requirements of the Commission's Electric Utility Promotional Practices rule. The Commission orders AmerenUE to submit a revised tariff including an evaluation plan within 30 days from the effective date of this order. In a separate order, the Commission will open a new case to consider that revised tariff. The revised tariff does not need to be submitted as part of the compliance tariffs resulting from this report and order. As it reevaluates its proposed tariff, the Commission directs AmerenUE to consult with the other parties and to give due consideration to the revisions urged by the MEG. If AmerenUE does not file a tariff that is acceptable to all other parties, the Commission may impose the revisions urged by MEG.

The Commission is interested in promoting the use of industrial demand response programs for the purpose of reducing the demand for additional generation of electricity. These issues are being discussed in the Integrated Resource Plan (IRP) filings that are periodically made by Missouri's electric utilities. AmerenUE's IRP process is currently on going and additional demand response

²³⁸ Transcript, Page 4171, Lines 14-17.

programs may emerge from that process. But the Commission believes that more should be done. Therefore, it will open a new investigative case for the purpose of discussing demand response programs with all of Missouri's electric utilities, as well as other interested parties. The Commission will issue a separate order opening the investigative case.

C. Essential Services Rate Discussion:

The Missouri Association for Social Welfare (MASW) proposes AmerenUE adopt what it described as an essential services rate. The essential services rate would charge a lower rate to residential customers for the number of kilowatt hours needed to provide essential service to a typical low income resident.²³⁹ The program would be designed to be revenue neutral for AmerenUE so higher rates would need to be charged to customers who use more kilowatt hours. MASW did not do any study of AmerenUE's particular system, but indicates that national studies have put the average usage for a low-income household at approximately 680 kilowatt hours per month.²⁴⁰ MASW suggests any rate increase resulting from this case be added entirely to the block of usage above the essential use dividing line with the rates for usage below that line being held steady.²⁴¹ All residential customers would receive the benefit of this essential services rate. There would be no income eligibility requirements.

Staff and AmerenUE both opposed the proposed essential services rate. AmerenUE claims four reasons to oppose such a rate. First, there is no need for an essential services rate because other programs are available to assist low-income customers.²⁴² Second, the program is not well targeted in that most households in AmerenUE's service territory are heated with gas rather than electricity so customers would not be able to reduce their space heating bills.²⁴³ Third, the proposed rate would subsidize all residential customers, not just those in need.²⁴⁴ And fourth, an inverted block rate such as MASW proposes could hurt low-income customers in energy inefficient housing that use more than the average amount of electricity.²⁴⁵

Findings of Fact:

MASW acknowledges that the essential services rate it has proposed is more of a concept than a specific tariff proposal.²⁴⁶ There simply is not enough information before the Commission to enable it to implement an essential services rate in this case. However, the Commission is interested in further evaluating MASW's proposal. Some of the criticisms of the proposal may actually reveal its strengths.

²³⁹ Quinn Direct, Ex. 800, Page 4, Lines 18-20.

²⁴⁰ Id. at Page 4, Lines 20-23.

²⁴¹ Id. at Pages 5-6, Lines 21-22, 1-2.

²⁴² Hanser Rebuttal, Ex. 024, Page 7, Lines 9-14.

²⁴³ Id. at Page 9, 10-21.

²⁴⁴ Id. at Page 10, Lines 2-10.

²⁴⁵ Id. at Page 11, Lines 3-19.

²⁴⁶ Transcript, Page 4091, Lines 22-24.

For example, since it would be available to all customers without any needs test, it might provide rate relief to low-income customers without the bureaucracy and indignity fostered by a needs-based program. It might also foster energy conservation by encouraging people to reduce their usage to stay in the lower cost block. The Commission thanks MASW for bringing this concept to its attention and encourages MASW and the other parties to give this concept further consideration before the next rate case.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

There is not enough information available in this case to enable the Commission to implement an essential services rate. However, the Commission believes the concept warrants further study.

D. Safety Net Proposal

Discussion:

The safety net proposal was submitted by the Consumers Council of Missouri. The Consumers Council is a party to this case but did not present any testimony at the hearing. Instead its safety net proposal was offered by its President, Alberta Slavin, at a local public hearing held at the University of Missouri-St. Louis on January 8, 2007. In her sworn testimony, Ms. Slavin indicated concern about the extensive and extended customer outages resulting from severe thunderstorms in July 2006, followed by a severe ice storm in December of that year. She urged the Commission to require AmerenUE to adopt a Safety Net Program modeled after a program implemented by Pacific Gas and Electric in California.

As an exhibit to her testimony, Ms. Slavin submitted a brochure from Pacific Gas and Electric describing its Safety Net program. The brochure indicates Pacific Gas and Electric will provide payments of \$25 to \$100 to residential customers who were left without power after a severe storm.²⁴⁷ Neither Ms. Slavin, nor the brochure, provide any further details about the Safety Net program. The Consumers Council's attorney emphasized at the hearing that the funds to pay for the program should come from AmerenUE's shareholders, not its ratepayers.²⁴⁸

AmerenUE opposes the proposal, arguing that the limited record is insufficient to allow the Commission to adopt the proposal. The company also points out the proposal does not distinguish between outages caused by natural events and those that may be the fault of the company. AmerenUE contends that it should not be penalized for natural disasters that are beyond its control. AmerenUE further argues there is no evidence in the record for this case to indicate that AmerenUE's restoration efforts after the storms were inadequate.

Findings of Fact:

²⁴⁷ Ms. Slavin's testimony may be found at Volume 6 of the Transcript, Pages 64-74.

²⁴⁸ Transcript, Page 3385, Lines 5-8.

The Commission finds there is not sufficient evidence in the record to justify imposing a program of this sort on AmerenUE.

Conclusions of Law:

Any decision of this Commission must be supported by competent and substantial evidence on the record as a whole.²⁴⁹ A pamphlet issued by a utility in California describing a program by which that utility gives money to its customers, unsupported by any other evidence, is not substantial evidence to justify the imposition of such a program on AmerenUE.

Decision:

The Commission shall not require AmerenUE to implement a Safety Net program of the type described by the Consumer Council of Missouri.

E. Wind Power

Discussion:

AmerenUE has committed to adding 100 MW of wind power to its generating fleet by 2010.²⁵⁰ On January 31, 2007, AmerenUE issued a Request for Proposal for a minimum of 100 MW of wind generation. AmerenUE intends to bring this new generation on line by late 2009 or early 2010.²⁵¹ Staff and the Missouri Department of Natural Resources support the efforts AmerenUE has made to obtain wind generation capacity, but urge the company to do more.²⁵² No party has made any request for an adjustment to AmerenUE's revenue requirement relating to wind power, nor has any party requested the Commission make any sort of decision or order about this issue.

F. Demand Side Management

Discussion:

Demand Side Management is the concept of reducing the need for additional generation by reducing the demand for electricity. The Commission's integrated resource planning rules require AmerenUE to consider demand side management as part of its resource management planning process. AmerenUE is currently working with various stakeholders in preparing to file its next integrated resource plan in February 2008 and demand side management programs will be a part of that process. In order to guide AmerenUE in that process, the Department of Natural Resources proposes the Commission set demand side management targets for AmerenUE to attain through the integrated resource planning process. The

²⁴⁹ State ex rel. Utility Consumers Council of Missouri, Inc. v. Pub. Serv. Comm'n, 585 S.W. 2d 41 (1979).

²⁵⁰ Moehn Direct, Ex. 035, Page 17, Lines 12-13.

²⁵¹ Barbieri Surrebuttal, Ex. 043, Page 4, Lines 7-8.

²⁵² Wilbers Direct, Ex. 650, Pages 13-14, Lines 19-23, 1-6.

Department of Natural Resources suggests AmerenUE be given a goal of reducing peak demand and energy growth by:

- 10 percent in 2009/2010;
- 15 percent by 2011-2012;
- 20 percent by 2013/2014; and
- 25 percent by 2015/2016.²⁵³

Staff supports those goals but is concerned they may be unreasonably low. AmerenUE does not oppose the proposed goals and indicates much greater reductions may be achieved in the future.²⁵⁴ Staff and the Department of Natural Resources agree these goals should be reassessed in the upcoming IRP process.

The Department of Natural Resources also proposes AmerenUE commit at least \$10 million annually, rising to one percent of AmerenUE's Missouri annual sales revenue, or a minimum of \$20 million by 2010, to implement energy efficiency programs.²⁵⁵ AmerenUE responded by indicating it believes its final spending level should be determined through the integrated resource planning process. It did, however, commit to spending \$13 million on demand side management programs, ramping up to \$20 million by 2010.²⁵⁶ The Department of Natural Resources was concerned that AmerenUE's spending proposal would include both demand response measures as well as energy efficiency measures, believing that its proposed amounts should be spent just on energy efficiency with additional amounts to be spent on demand response measures.

Staff does not believe a specific dollar amount of funding for demand response measures should be required, instead the cost-effectiveness of the programs that are implemented should be the guiding principle.²⁵⁷

Findings of Fact:

The Commission finds that demand side management programs must be a vital part of AmerenUE's resource mixture. The Commission agrees that the setting of demand side management targets for AmerenUE to attain through the integrated resource planning process is reasonable. Since no party opposes the setting of such goals, the Commission will establish them.

AmerenUE has already made a commitment to expand its spending for energy efficiency measures. The Department would like to see that funding increased still more. The Commission certainly encourages AmerenUE to increase its demand side management and energy efficiency spending; but in keeping with Staff's recommendation, it will not require AmerenUE to meet a specific goal for such spending. The Commission expects AmerenUE to comply with, and if possible, exceed the goals it has already set for itself.

Conclusions of Law:

²⁵³ Wilbers Direct, Ex. 650, Pages 7-8, Lines 21-22, 1.

²⁵⁴ Moehn Direct, Ex. 035, Page 16, Lines 12-14.

²⁵⁵ Wilbers Direct, Ex. 650, Page 8, Lines 6-9.

²⁵⁶ Moehn Surrebuttal, Ex. 037, Page 28, 16-20.

²⁵⁷ Mantle Rebuttal, Ex. 221, Page 3, Lines 6-16.

The Policy Objectives section of the Commission's integrated resource planning rule, 4 CSR 240-22.010(2), requires a utility to:

(A) Consider and analyze demand-side efficiency and energy management measures on an equivalent basis with supply-side alternatives in the resource planning process.

Decision:

AmerenUE is given a goal of reducing peak demand and energy growth by:
10 percent in 2009/2010;
15 percent by 2011-2012;
20 percent by 2013/2014; and
25 percent by 2015/2016.

G. Low Income Programs

Discussion:

As a result of the stipulation and agreement that resolved Staff's last rate complaint against AmerenUE, the company agreed to initiate a low-income weatherization program. That program is currently funded by AmerenUE at an annual level of \$1.2 million. The Department of Natural Resources recommends the program continue to be funded at that level.²⁵⁸ Staff recommends AmerenUE shareholders provide \$600,000 of that funding, with the other \$600,000 recovered from ratepayers.²⁵⁹

AmerenUE contends it is under no obligation to continue funding the low-income weatherization program. However, it is willing to pay the \$600,000 recommended by Staff as a component of its proposal for implementation of a fuel adjustment clause.²⁶⁰

Staff and the Department of Natural Resources also agree that AmerenUE should include the program in its tariff and use up to \$120,000 of the program funding to do a process and impact evaluation of the weatherization program. AmerenUE accepts those recommendations.

Findings of Fact:

Richard Mark, testifying for AmerenUE, agreed the weatherization program has been successful and should continue to be supported by AmerenUE.²⁶¹ So all the parties agree the program should be continued. However, AmerenUE appeared to make its promise of future support contingent upon the Commission approving its request for a fuel adjustment clause. The Commission denies that request in this order.

Conclusions of Law:

²⁵⁸ Wilbers Direct, Ex. 650, Page 12, Lines 4-6.

²⁵⁹ Mantle Rebuttal, Ex. 221, Page 4, Lines 21-23.

²⁶⁰ Mark Surrebuttal, Ex. 039, Page 3, Lines 7-11.

²⁶¹ Transcript, Page 1669, Lines 6-8.

No additional conclusions of law are made for this issue.

Decision:

AmerenUE and its customers would benefit from continuation of the low-income weatherization program. The Commission assumes that AmerenUE really did not intend to hold those low-income customers hostage to try to force this Commission to grant it a fuel adjustment clause. Therefore, the Commission directs that the low-income weatherization program continue with funding provided \$600,000 by ratepayers and \$600,000 by AmerenUE's shareholders. In addition, AmerenUE shall include the program in its tariff and use up to \$120,000 of the program funding to do a process and impact evaluation of the weatherization program.

H. Voluntary Green Power Program

Discussion:

AmerenUE has proposed a tariff that would implement a Voluntary Green Program. This program would allow AmerenUE's customer to purchase and retire Renewable Energy Certificates (RECs). A REC is defined as the environmentally beneficial component of renewable energy and is equivalent to 1,000 kilowatt hours.²⁶² The REC does not actually deliver a renewable energy commodity to the customer or to the AmerenUE system. Customers who sign up for the program will be billed an additional 1.5 cents per kilowatt hour for their total monthly usage, plus any add-on taxes.²⁶³

The Department of Natural Resources supports AmerenUE's proposal, but Staff objects, arguing AmerenUE should be putting its resources into actually producing renewable energy rather than providing a way for customers to buy RECs.²⁶⁴ Staff is also concerned customers would be confused about what they are actually buying when they purchase a REC.²⁶⁵

Findings of Fact:

The sale of RECs is not a substitute for the actual generation of power from renewable resources. But building renewable-powered generation takes time and the implementation of the plan to sell RECs can be implemented almost immediately.²⁶⁶ There is some risk of confusion among customers who are not familiar with the concept of a REC, but the program is voluntary and AmerenUE has engaged the services of an experienced company to perform customer education and marketing for the program.²⁶⁷ The Commission finds that the plan to facilitate the sale of RECs is reasonable and is unlikely to cause undue confusion among AmerenUE's customers.

²⁶² Mill Direct, Ex. 040, Page 13, Lines 6-8.

²⁶³ Id. at Page 13, Lines 21-23.

²⁶⁴ Mantle Rebuttal, Ex. 220, Page 1, Lines 22-29.

²⁶⁵ Id. at Page 3, Lines 3-5.

²⁶⁶ Barbieri Surrebuttal, Ex. 043, Page 3, Lines 3-6.

²⁶⁷ Mill Direct, Ex. 040, Page 13, Lines 8-10.

Conclusions of Law:

No additional conclusions of law are made for this issue.

Decision:

AmerenUE's tariff implementing a Voluntary Green Program shall be approved.

Taum Sauk Regulatory Capacity**Discussion:**

Public Counsel has attempted to raise one additional issue. In the Revised True-Up Reconciliation filed on April 19, 2007, Public Counsel for the first time proposed a \$10,320,000 reduction to AmerenUE's revenue requirement for what Public Counsel called "Taum Sauk Hold Harmless – Capacity Sales. In a single paragraph at the end of its post-hearing brief, Public Counsel asserted this issue arose for the first time at the hearing, when the parties allegedly learned AmerenUE's commitment to hold ratepayers harmless with respect to the failed Taum Sauk plant did not account for the potential sale of regulatory capacity associated with that plant. The brief indicates: "Public Counsel calculated a value for that capacity using UE's value for regulatory capacity of \$2.00/kw month, and a capacity value for Taum Sauk of 430 MWs."

AmerenUE filed its brief the day before on April 20, so it could not respond to Public Counsel's newly raised issue in that brief, although it did manage to insert a footnote reacting to the inclusion of new adjustment in the reconciliation. No reply briefs were scheduled; so in order to allow AmerenUE and the other parties an opportunity to respond, the Commission issued an order on May 4 directing any party wishing to offer additional arguments regarding the Taum Sauk Regulatory Capacity issue do so no later than 12:00 Noon on May 9.

AmerenUE filed a response on May 9, including a motion to strike the portions of Public Counsel's brief dealing with this matter. The State also filed a response on May 9 supporting Public Counsel's position. Public Counsel did not file any further argument on May 9, but on May 17, it filed a reply to AmerenUE's response, again arguing for an adjustment relating to the capacity question. AmerenUE responded later on May 17 with a motion to strike Public Counsel's response. Public Counsel filed a response to that motion on May 18, and AmerenUE replied to Public Counsel's response on May 18.

AmerenUE contends Public Counsel's newly proposed adjustment is far out-of-time and violates the Commission's rules and its procedural order for this case. The Commission agrees. Public Counsel's proposed adjustment regarding sales of regulatory capacity should ordinarily have been raised as part of its case in chief in its direct testimony filed in December 2006.²⁶⁸ However, Public Counsel argues that it did not learn that AmerenUE is making capacity sales until the hearing.

Commission rule 4 CSR 240-2.130((8) provides in part: "A party shall not be precluded from having a reasonable opportunity to address matters not previously disclosed which arise at the hearing." But AmerenUE disputes Public Counsel's

²⁶⁸ Commission Rule 4 CSR 240-2.130(7).

assertion that these matters first arose during the hearing, contending Public Counsel could have been aware of the facts needed to raise this issue months before the hearing.

AmerenUE also disputes the factual basis for the numbers Public Counsel uses to support the calculation of its proposed \$10 million adjustment. Public Counsel's calculation assumes regulatory capacity from the Taum Sauk plant could have been sold for \$2.00 per kW month, a value appropriated from the price included in AmerenUE's proposed industrial demand response program, the Rider IDR discussed earlier in this Report and Order. It also assumes the entire capacity of the Taum Sauk plant would have been available for sale for the entire year, another fact for which there is no supporting evidence in the record.

At this point, very late in this proceeding, it is far too late for the Commission to gather the evidence needed to make any findings of fact or conclusions of law regarding these questions. If Public Counsel had actually raised this issue at the hearing when it says it first became aware of the issue, the Commission might have been willing to allow Public Counsel, AmerenUE, and the other parties a reasonable opportunity to present additional evidence on that question, as indicated in the Commission's procedural rule. It might even have been possible to schedule an additional day of hearings to consider that issue. But instead, Public Counsel waited until it filed its brief, over 20 days after hearing ended and the evidentiary record closed, to spring this issue on the Commission and the other parties.

As the Commission indicated earlier in this order when discussing the Safety Net proposal offered by the Missouri Consumers Council, any decision by this Commission must be supported by competent and substantial evidence on the record as a whole. There is insufficient competent and substantial evidence in this record to support Public Counsel's proposed adjustment. The Commission cannot just assume that evidence into existence without giving AmerenUE and the other parties an opportunity to rebut that evidence. To do so would deny AmerenUE, and the other parties, their constitutionally protected due process rights and would likely lead a reviewing court to reverse this Report and Order. The Commission cannot make the Taum Sauk regulatory capacity adjustment proposed by Public Counsel.

AmerenUE has made a commitment to hold the public harmless from the effects of the Taum Sauk disaster, and the Commission intends to hold it to that commitment. Based on Public Counsel's allegations, it appears AmerenUE could be making additional sales of regulatory capacity if not for the loss of Taum Sauk's capacity. Unfortunately there is no way, based on the record in this case, to calculate the amount of adjustment that should be made to AmerenUE's income to account for that loss of capacity.

While the Commission cannot make that adjustment in this case because of insufficient evidence in the record, it will direct its Staff to investigate whether ratepayers are being held harmless from the Taum Sauk disaster, especially with regard to lost regulatory capacity sales. If Staff finds that such regulatory capacity sales have been lost, it shall propose an appropriate adjustment in AmerenUE's next rate case or other action as it believes appropriate.

IT IS ORDERED THAT:

1. The Motion to Dismiss filed by the Office of the Public Counsel is denied.

2. The tariff sheets filed by Union Electric Company d/b/a AmerenUE on July 7, 2006, and assigned tariff number YE-2007-0007, are rejected.

3. Union Electric Company d/b/a AmerenUE is authorized to file a tariff sufficient to recover revenues as determined by the Commission in this order. AmerenUE shall file its compliance tariff no later than May 28, 2007.

4. Beginning on January 1, 2007, all SO₂ premiums, net of SO₂ discounts, shall be accounted for in FERC USOA Account 254, a regulatory liability account. All gains associated with SO₂ allowance sales, beginning on January 1, 2007 shall also be recorded in the same regulatory liability account. The net balance of the SO₂ premium expenses (or discounts) and corresponding gains associated with SO₂ allowance sales shall be addressed as part of the fuel expense calculation in AmerenUE's next rate proceeding.

6. Union Electric Company d/b/a AmerenUE shall keep a separate accounting of its amounts accrued for recovery of its initial investment in plant from the amounts accrued for the cost of removal.

7. Any pending motions that the Commission has not specifically ruled upon are denied.

8. This report and order shall become effective on June 1, 2007.

Davis, Chm., Murray, and Appling, CC., concur;
Clayton, C., concurs, concurring opinion to follow;
Gaw, C., dissents, dissenting opinion to follow;
and certify compliance with the provisions of
Section 536.080, RSMo 2000.

ORDER CORRECTING REPORT AND ORDER NUNC PRO TUNC

Issue Date: June 4, 2007 Effective Date: June 4, 2007

In the body of the Commission's Report and Order issued on May 22, 2007, the Commission rejected Union Electric Company d/b/a AmerenUE's request to implement a fuel adjustment clause. AmerenUE filed its request for a fuel adjustment clause in tariff number YE-2007-0223, separate from its main rate increase tariff, YE-2007-0007. In ordered paragraph 2 of its Report and Order, the Commission specifically rejected tariff number YE-2007-0007 but did not mention YE-2007-0223. The Commission will correct that oversight nunc pro tunc.

IT IS ORDERED THAT:

1. Ordered paragraph 2 of the Commission's Report and Order issued on May 22, 2007 is corrected, nunc pro tunc, to provide as follows:

The tariff sheets filed by Union Electric Company, d/b/a AmerenUE on July 7, 2006, and September 29, 2006, and assigned tariff numbers YE-2007-0007 and YE-2007-0223, are rejected.

2. This order shall become effective on June 4, 2007.

Morris L. Woodruff, Deputy Chief Regulatory Law
Judge, by delegation of authority

pursuant to Section 386.240, RSMo 2000.

**ORDER DENYING APPLICATIONS FOR REHEARING. GRANTING
CLARIFICATION, AND CORRECTING ORDER NUNC PRO TUNC**

Issue Date: June 28, 2007

Effective Date: July 8, 2007

On May 22, 2007, the Commission issued a Report and Order regarding Union Electric Company d/b/a AmerenUE's tariffs to increase its rates for electric service. That Report and Order became effective on June 1. On May 31, the Office of Administration and the Department of Economic Development (the State of Missouri); the Consumers Council of Missouri; the Missouri Industrial Energy Consumers; the Office of the Public Counsel; and AmerenUE filed timely applications for rehearing. AmerenUE filed a response to the other applications for rehearing on June 11. No other responses were filed.

Section 386.500.1, RSMo (2000), indicates the Commission shall grant an application for rehearing if "in its judgment sufficient reason therefor be made to appear." The applications for rehearing restate the positions the parties espoused at the hearing. The Commission rejected those positions in its Report and Order. Each application for rehearing will be denied.

The Commission will, however, address an issue raised in the applications for rehearing to further explain the Commission's decision. The applications for rehearing filed by Public Counsel, the State, the Consumers Council of Missouri, and MIEC, note that the Commission's Report and Order spoke approvingly of the testimony offered by MIEC's expert witness, Michael Gorman, regarding an appropriate return on equity. As indicated in the Report and Order, Gorman's overall recommendation for a return on equity was 9.8 percent, but the Commission found a 10.2 percent return on equity to be appropriate. The requests for rehearing seize upon one sentence of the Report and Order that states Gorman's overall recommendation should be "pushed up a bit in recognition of the Commission's denial of AmerenUE's request for a fuel adjustment clause." Based on that sentence, the parties argue that the Commission arbitrarily and inappropriately added .4 percent to the allowed return on equity for the denial of a fuel adjustment clause.

That argument ignores the bulk of the Commission's explanation for why it found a 10.2 percent return on equity to be appropriate. In fact, as indicated in the Report and Order, the Commission found Gorman's Bond Yield Plus Risk Premium Model and Capital Asset Pricing Model, both indicating an appropriate return on equity of 10.2 percent or greater, to be more reasonable than his DCF analysis that resulted in a recommended return on equity of 9.2 percent. Gorman's proxy group for his DCF analysis consisted of 13 comparables, which was smaller and less reliable than the proxy groups suggested by some of the other experts providing return on equity testimony in this case. Thus an upward adjustment to account for manipulation of the proxy group to achieve an artificially low number is appropriate.

Gorman's testimony, in its totality, was and is the most credible of all the testimony offered on the issue; however, it was not without its shortcomings as evidenced above and with regard to the issue of fuel adjustment. Gorman failed to

identify which members of his proxy group were already operating with a fuel adjustment clause and what the effect might be on the company if its request for a fuel adjustment mechanism were denied. There is abundant evidence in this proceeding and in other proceedings before this Commission that most vertically-integrated utilities operating in states that are not restructured have fuel adjustment clauses and less risk. When Billie LaConte, the return on equity witness for the Missouri Energy Group, was asked the following question by a Commissioner: "If we did not give AmerenUE a fuel adjustment clause, then what would your recommendation be in order to try not to hurt this company?", she replied: "I would suggest that the Commission allow a small adjustment on the return on equity to reflect that, ...".¹ Accordingly, it is appropriate to compensate companies with additional basis points for assuming that risk and the addition of 40 basis points to Gorman's recommendation is just and reasonable under these circumstances.

More fundamentally, the criticisms of the Commission's return on equity decisions are based on the mistaken assumption that the Commission must accept, without change, a return on equity recommendation suggested by one of the expert witnesses. None of the return on equity experts offering their testimony in this case recommended a return on equity of 10.2 percent, but the Commission is not limited to simply choosing from among the submitted expert recommendations when establishing a return on equity.

Establishing a return on equity is part of the Commission's attempt to establish just and reasonable rates. As the Missouri Court of Appeals has indicated, "[under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts."² For all the reasons set out in its Report and Order, the Commission has established a return on equity it believes to be just and reasonable. The criticisms of the return on equity allowed by the Commission are without merit and do not justify rehearing.

The State's application for rehearing also raises a matter that can properly be described as a request for clarification rather than a request for rehearing. In criticizing the Commission's decision to establish an annual base level of SO₂ sales of \$5 million, the State points out that while the Commission's decision creates a tracking mechanism to account for sales over and under that \$5 million base level, it does not indicate whether AmerenUE should pay interest to ratepayers for accrued sales over that amount, or collect carrying costs from ratepayers if sales fall below the base level. The Commission's Report and Order is silent on that question and that silence could result in confusion and misunderstandings in a future rate case. Therefore, the Commission will clarify its Report and Order to provide that AmerenUE shall pay interest to ratepayers at its short-term borrowing rate for annual accrued SO₂ sales above a base level of \$5 million and collect carrying costs from ratepayers at the same rate if sales fall below that base level. Interest or carrying costs shall be calculated based on the amount by which the balance in the tracking account varies from the \$5 million baseline established in the Report and Order, on December 31, 2007, and each subsequent December 31, until the Commission issues a final order in AmerenUE's next rate case.

¹ Transcript, Page 2945, Lines 13-18.

² *State ex rel. Assoc. Natural Gas Co. v. Pub. Serv. Com'n of Missouri*, 706 S.W. 2d 870, 873 (Mo App. W.D. 1985)

AmerenUE's application also raises a matter for which it seeks clarification. At page 95 of its Report and Order, the Commission addresses an issue defined as "Net Salvage Percentage to be Used for Assets in Account 322." In its decision on this issue, the Commission held that an additional .2 percent should be added to the depreciation rate for Account 322. However, the Commission also found that Staff and AmerenUE's agreement that an additional .1 percent should be added to the depreciation rates for other nuclear plant accounts was not identified as a separate issue and was not supported by any evidence. Therefore, the Commission found that it had no basis for making a decision regarding those accounts.

AmerenUE interpreted the Commission's inability to decide whether an additional .1 percent should be added to the depreciation rates for other nuclear accounts to mean that the net salvage percentages for those accounts must be set at zero. As a result, AmerenUE calculated its rates using zero net salvage percentages for those accounts – specifically accounts 321, 323, 324, and 325. Because net salvage percentages for those accounts were set at zero, AmerenUE's allowed revenue requirement was reduced by approximately \$1 million below the revenue requirement contemplated in the Report and Order. The compliance tariffs submitted by AmerenUE and approved by the Commission reflect that lower revenue requirement, although AmerenUE indicates it does not believe the Commission intended that result.

AmerenUE explains that the depreciation rates proposed by Staff in its testimony include net salvage percentages of -3 percent for account 321, -3 percent for account 323, -2 percent for account 324, and -1 percent for account 325. Those net salvage percentages were not challenged by any party and AmerenUE contends the Commission should have ordered it to use those net salvage percentages for those accounts.

AmerenUE is correct. In holding that it lacked sufficient evidence to decide whether to add .1 percent to the net salvage percentages proposed by Staff for accounts 321, 323, 324, and 325, the Commission did not set those net salvage percentages at zero. The net salvage percentages proposed for those accounts by Staff are reasonable and are not opposed by any party. AmerenUE shall use those net salvage percentages when calculating its allowed revenue requirement. AmerenUE may file tariffs to reflect the revised calculations.

AmerenUE also identified three factual errors in the Report and Order that it suggests be corrected nunc pro tunc. First, AmerenUE's legal counsel is identified in the Report and Order as James B. Lowrey. The attorney's last name is in fact spelled Lowery. Second, the Report and Order, at page 9, states that AmerenUE serves approximately 2 million customers in Missouri. In fact, AmerenUE serves approximately 1.2 million Missouri customers. Third, at page 75 of the Report and Order, the Commission indicates it will establish a regulatory tracking mechanism "without including a base amount of SO₂ sales in AmerenUE's revenue requirement." In fact, later in the Report and Order, the Commission included a base amount of \$5 million in the regulatory tracker. All the identified factual errors will be corrected nunc pro tunc.

IT IS ORDERED THAT:

1. The Office of Administration and the Department of Economic Development's (the State of Missouri's) Application for Rehearing is denied.
2. The Consumers Council of Missouri's Application for Rehearing is denied.
3. The Missouri Industrial Energy Consumers' Application for Rehearing is denied.

4. The Office of the Public Counsel's Application for Rehearing is denied.
5. Union Electric Company d/b/a AmerenUE's Application for Rehearing is denied.
6. The Commission's Report and Order is clarified to provide that AmerenUE shall pay interest to ratepayers at its short-term borrowing rate for annual accrued SO2 sales above a base level of \$5 million and collect carrying costs from ratepayers at the same rate if sales fall below that base level. Interest or carrying costs shall be calculated based on the amount by which the balance in the tracking account varies from the \$5 million baseline established in the Report and Order, on December 31, 2007, and each subsequent December 31, until the Commission issues a final order in AmerenUE's next rate case.
7. The Commission's Report and Order is clarified to provide that AmerenUE shall use the following net salvage percentages when calculating its allowed revenue requirement:
 - Account 321 -3%
 - Account 323 -3%
 - Account 324 -2%
 - Account 325 -1%

AmerenUE shall file tariffs to reflect the revised calculations.

8. The following items in the Commission's May 22, 2007 Report and Order are corrected nunc pro tunc:
 - a. In the Appearances section of page 1, the name of AmerenUE's attorney is correctly spelled Lowery, not Lowrey;
 - b. On page 9, AmerenUE serves approximately 1.2 million Missouri customers, not 2 million; and
 - c. On pages 74-75 the following sentence is deleted: "For those reasons, the Commission finds it in the long-term best interest of ratepayers to establish a regulatory tracking mechanism without including a base amount of SO2 sales in AmerenUE's revenue requirement."
9. This order shall become effective on July 8, 2007.

Davis, Chm., Murray, Clayton and Appling, CC., concur
Gaw, C., dissents

Woodruff, Deputy Chief Regulatory Law Judge

Dissenting Opinion of Commissioner Steve Gaw

For the reasons that follow, this Commissioner in good conscious must dissent from the Order in hope that those voices that have tried so hard to be heard will not feel that their efforts were completely in vain. It is my belief that the record supports a different conclusion than reached in the Majority Order. The difference in that result is significant. The bottom line is that the Commission's Order is millions of dollars over the amount which would have resulted from a decision following the rationale in this dissent. Instead of a \$42 million increase in rates, ratepayers should have received a decrease of approximately \$60 million.

Return On Equity (ROE)

There is some relatively positive news in this Order. After watching the Commission pushing the Return of Equity (ROE) numbers to the highest in the nation in recent cases, the recommendation in this case appears more reasonable in comparison. Nevertheless, the Commission seems more driven to justify a particular ROE result than to accept and follow a particular analysis. This Commissioner believes the more credible evidence supports a ROE of approximately 9.8% determined through a Discounted Cash Flow (DCF) analysis. Prior to a change in policy in the last two years, the Commission placed significant reliance on the DCF model as the principle method of determining the ROE range. The more recent decisions of the Commission have given substantial weight to the ROE awards generated by other states for other companies, without a thorough analysis of the methodologies used in the cases in those states, or a studied comparison of the other companies. The Majority of the Commission in cases within the last two years, has used different mechanisms including Capital Asset Pricing Model (CAPM) to justify its result – leaving parties in future rate cases to speculate on which analysis would be used in the next rate case.

Adjustment Factors

In this matter before the Commission, it is appropriate to consider whether the calculation of ROE accepted by the Commission should have been adjusted to take into account the absence of a fuel adjustment clause (FAC). If the calculation does not take additional risk of the absence of a FAC into account, then it is appropriate to adjust the ROE slightly upward.

On the other hand, the Commission has the authority to adjust the ROE downward for poor performance based upon the actions and inactions of AmerenUE. Hundreds of thousands of customers were out of electricity for days, and in some cases for weeks, on multiple occasions, causing significant financial losses to customers, diminished quality of life at home, and in some cases life threatening consequences. There was evidence that some of these outages were due not just to storms but to inadequate tree trimming and inadequate infrastructure inspection and replacement. Testimony indicated that there are areas of AmerenUE territory that have experienced frequent outages not related to storms that in some cases significantly impaired the ability of businesses to function. There was substantial testimony indicating that there are areas in AmerenUE's territory where sub-standard service exists. Testimony from cotton gin operators in Southeast Missouri, that went without refute, made it clear that the unreliability of the circuits serving the cotton gins has caused significant additional expenses to those businesses during the time of highest activity. Additionally, in some residential areas there were reports of multiple outages over the years outside of those outages attributable to storms.

This is a partial list of the complaints of hundreds of Missourian's – customers of AmerenUE – that were voiced to the Commissioners at the 16 public hearings held in this case. Yet despite having taken time from work, caring for children and other duties that AmerenUE customers contend with in their lives in order that they could ask the Public Service Commission to address their concerns, there is not one

repercussion to AmerenUE expressed in the Majority Order unless it has already been conceded by AmerenUE.

This Commissioner was struck with the consistency of the testimony from residential and business customers, and municipal and county officials complaining about the quality of service received and the apparent lack of interest by AmerenUE's management in the problems being faced by them. This Commissioner notes that in the 16 public hearings held, not once did an AmerenUE senior official come to hear in person the concerns of AmerenUE customers. This Commissioner recognizes that coming to these meetings may not have been a positive personal experience. But it would have demonstrated a willingness to listen and provide an opportunity to express empathy for the hundreds of thousands of people who suffered through the major power outages in 2006.¹ AmerenUE's actions at the public hearings may not be a reason to lower the ROE, but poor performance is. While AmerenUE presented evidence that overall the system reliability does not appear substandard, the total system picture is of little comfort to those served by poor performing circuits. The evaluation of performance at the circuit level is one of the important proposals in the new reliability rules that Commissioner Clayton and I have proposed. However, it would not be necessary to have such oversight of a utility if adequate management of the system was done by utilities in the first place. Further, the facts consistently show that AmerenUE has done a poor job of vegetation management in much of its system. Many pictures of trees and vines intertwining power lines are in the record.

Then, there was a horrific disaster on a mountain top in southern Missouri that seriously injured a family and destroyed areas of one of Missouri's scenic parks. The collapse of Taum Sauk is admitted by Ameren to have been its responsibility. The Company has stated it takes responsibility for the incident. While all of the details are not available in this record, there is significant information known, including the payment by AmerenUE of a multi-million dollar fine levied by the FERC. Evidence suggests that the failure of the reservoir and the subsequent injuries, damage of property, and loss of income was due to multiple failures in AmerenUE's management of the plant that were known to the Company prior to the dam collapse.

The evidence in this case provided an opportunity for the Commission to send a message to AmerenUE that poor performance will not be tolerated and would have consequences to its bottom line. Such a message should have been sent in this case with a specific reduction in ROE due to the Company's performance. Instead the Commission found such a reduction inappropriate.

Electric Energy, Inc. (EEInc.)

AmerenUE began a partnership with certain Illinois utilities and the predecessors to Kentucky Utilities about a half century ago. The purpose of the partnership, structured through a jointly owned corporation, EEInc., was to serve a federal facility built to enhance uranium and to use the remaining energy to serve customers of the partners. UE clearly believed its activities in this partnership required Commission approval, as it requested permission from the Commission on

¹ It is worth noting that nearly all of the comments received about the line workers were positive, in contrast to the criticism levied against the company itself.

its initial investment. Subsequently, for nearly 50 years, customers of UE paid not just for the incremental cost of energy, but also a 15% return on equity. One of AmerenUE's arguments, which fortunately appears to not have been accepted by the Majority, was essentially that the contract which had been regularly renewed by the partners had expired and there was nothing that AmerenUE could have done to continue to access this power. This argument ignores the controlling interest of Kentucky Utilities and AmerenUE in the partnership and the fact that Kentucky Utilities, the only non-Ameren owner, wanted the arrangement to continue. AmerenUE further argued that the Board of Directors of EEInc., which included the "AmerenUE" directors, was legally required to change the purpose of EEInc. from one of providing excess capacity and energy to the partners' customers, to becoming a part of the generation portfolio of Ameren's unregulated energy marketing affiliate; in order to maximize profits. Ameren's arguments on this issue are disingenuous and ignore an important part of the requirements governing the arrangement of EEInc's owners.

AmerenUE offered multiple witnesses who testified that it was their opinion that the members of the Board of Directors of the company were bound by ethics to vote for the best interests of EEInc., even though they represented AmerenUE on the Board, and in fact were in the management of UE, these votes were to be made even if the vote was contrary to the interests of UE itself. Ameren's witnesses asserted that Kentucky Utilities had violated their ethical duties when they voted for EEInc. to continue to provide power from the Joppa Plant at a cost based price. Curiously, AmerenUE seemed to find little inconsistency in its position in this case and the fact that AmerenUE's Board of Directors had allowed AmerenUE to enter into a Joint Dispatch Agreement (JDA) with affiliates, a contract that continued to exist until recently. The JDA, as staff has maintained for several years, cost AmerenUE millions of dollars a year while benefiting Ameren's unregulated affiliates. The JDA required generation transactions between Ameren affiliates to be at incremental cost (not cost plus a ROE as with EEInc.). This harmed AmerenUE's bottom line because AmerenUE held more low cost generation than it needed and Ameren affiliates found it a ready source of low cost energy. Under the JDA, AmerenUE was required to sell excess capacity on the AmerenUE system to Ameren affiliates rather than sell that power on a bilateral basis to non-affiliates, or into the organized markets such as MISO, at a higher price. The affiliates had access to AmerenUE's capacity and energy at a price that would normally be less than the price of power available from non-affiliates. In effect, the profits were shifted from AmerenUE to affiliates, some of which were not regulated. The bottom line is that the Ameren companies in total would not be harmed and could be more profitable. However, AmerenUE itself lost opportunities for significant additional revenues. AmerenUE, despite significant opposition to the JDA from Staff, the Office of Public Counsel (OPC), and others refused to terminate the JDA in the Ameren MetroEast transfer case. AmerenUE's position finally changed just before the filing of this case.

Clearly, AmerenUE's position that EEInc. board members were required to discontinue use of the Joppa Plant to provide excess power as a shared asset of the owners of EEInc. because it was detrimental to the bottom line of EEInc. contradicts its support of the JDA which hurt AmerenUE's profitability.

Furthermore, AmerenUE totally ignores the Articles of Incorporation of EEInc. While the Majority Order cites the important provisions in the Articles, it fails to

discuss the most important provision, Article II, Section 6 Voting, which states in part:

In the event that any holder of voting capital stock of EEInc. (including, for these purposes, such holder's Affiliates) owns in excess of 50% of the voting capital stock of EEInc., then all corporate restructuring transactions and other major corporate actions shall be decided by the vote of the holders of 75% or more of the outstanding shares of the Corporation entitled to vote. Corporate restructuring transactions and other major corporate actions shall include: (a) ... (f) a material change in the business purpose or objectives of EEInc. (emphasis added)

It seems clear that the purpose of EEInc. changed significantly as a result of the Board of Directors decision to offer the Joppa Plant into the wholesale market, rather than using excess energy for the load of the partners. Such a change required a shareholder vote. Yet no such vote occurred. AmerenUE's failure to enforce its rights did not protect the interests of its customers. As a result, AmerenUE ratepayers are being asked to pay much more for energy from other higher cost sources. The OPC, Staff, the State, and others calculate the EEInc. issue to be worth \$65 to \$75 million in annual revenue requirement. Meanwhile AmerenUE treats its new revenues from its share of EEInc. off-system sales as though it were from a non-regulated source, dramatically increasing its overall profits without any benefit to ratepayers. At the same time, AmerenUE argues ratepayers should pay millions more in rates because of its decision. Ameren is a public utility company granted monopoly status by the State. Its duties and responsibilities are not the same as a private competitive business. This Commission has the responsibility to ensure that the "public" part of its function remains an important factor in the decisions of the company. AmerenUE's failure to enforce its legal rights in order to continue providing AmerenUE customers access to lower cost power and, instead, utilizing higher cost generation for which it asks its customers to pay, should be seen as imprudent by this Commission and the rates should reflect an appropriate adjustment.

SO2 Allowances

The SO2 analysis by the Majority in this case does not appear to be based on any position taken by a party in the record. The most reasonable approach based on the evidence would seem to be the position of the State, based upon historic sales.

MetroEast Transfer

The MetroEast transfer issue in this case is not very significant in terms of amount. However, the principle is important for purposes of setting precedent in future cases where the amount may be substantially greater. In the MetroEast case the Commission found there should be monitoring in rate cases to ensure that added environmental liability of plants, which would have been borne in part by the Illinois customers without the transfer, do not as a result of the transfer cause a detriment to Missouri ratepayers. It was determined that the Commission should analyze the net benefits to Missouri customers of the transfer of MetroEast and hold Missourians harmless if the liability exceeded the cost. The analysis of the Commission in this case sets the hurdle so low that it puts Missouri customers at significant risk of future liability that they did not cause and should not bear. The

Commission limits its inquiry as to benefits of the transfer to the amount of avoided fuel costs for generation that would have been avoided by not serving the MetroEast load. It does nothing to net the revenues from Illinois that were lost with the transfer. Obviously the revenues from serving the Illinois customers would have exceeded fuel costs. As a result no real analysis of net benefit / net cost has been conducted.

While the consequence in this case in dollars of liability may seem to make this issue of little importance, repeating this analysis in the future could have significant and detrimental impact on consumers if AmerenUE is liable for much more expensive cleanups.

Pinckneyville Kinmundy

The transfers of the units at Pinckneyville and Kinmundy to AmerenUE from its affiliate deserved more scrutiny. AmerenUE's argument that the Commission should not examine the amount of money involved in the transfer because FERC had approved the transfers flies in the face of assurances given in the past by Ameren and this Commission that a thorough prudence review would occur by the PSC. The difficulty in this case involves the evidence that would allow a determination of the correct value to be provided for ratemaking purposes – the lower of fair market value or book value. At the time of the transfer, gas combustion turbines were in high supply and low demand after a period of overbuilding. It seems clear that these gas turbines should have been transferred at a price less than that which was paid. However, Staff provided little assistance on this issue and while the analysis done by the Office of Public Counsel and the State was helpful, it needed expert testimony from a witness with experience in valuing these units. The lack of evidence is unfortunate for all hearing the case – but particularly for consumers who will be forced to pay higher rates as a result.²

*Note: At the time of publication, no other dissents have been issued.

² There were other matters in the majority's opinion with which this Commissioner did not concur, including certain depreciation matters. However, they will not be expounded in this opinion.

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OF THE

PUBLIC SERVICE COMMISSION

OF THE

STATE OF MISSOURI

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The Commission granted a fuel adjustment mechanism to Aquila. The Commission concluded that Aquila met the requirements of section 386.266, and it is reasonable and in the public interest to permit Aquila to use a fuel adjustment mechanism.—Aquila, Inc. 15 MPSC 3d 416.

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No headnotes in this volume involved the question of depreciation.

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- §11. Inequality of rates
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V. RATES AND CHARGES OF PARTICULAR UTILITIES

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- §25. Telecommunications
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- §31. Equipment, meters and instruments
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DISCRIMINATION

No headnotes in this volume involved the question of discrimination.

ELECTRIC

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- §2. Obligation of the utility
- §3. Certificate of convenience and necessity
- §4. Transfer, lease and sale
- §4.1. Change of suppliers
- §5. Charters and franchise
- §6. Territorial agreements

II. JURISDICTION AND POWERS

- §7. Jurisdiction and powers generally
- §8. Jurisdiction and powers of Federal Commissions
- §9. Jurisdiction and powers of the State Commission
- §10. Jurisdiction and powers of the local authorities
- §11. Territorial agreements
- §12. Unregulated service agreements

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- §14. Rules and regulations
- §15. Cooperatives
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- §21. Refunds
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- §28. Apportionment
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- §31. Equipment
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- §33. Maintenance

- §34. Additions and betterments
- §35. Extensions
- §36. Local service
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- §39. Costs and expenses
- §40. Reports, records and statements
- §41. Billing practices
- §42. Planning and management
- §43. Accounting Authority orders
- §44. Safety
- §45. Decommissioning costs

IV. RELATIONS BETWEEN CONNECTING COMPANIES

- §46. Relations between connecting companies generally
- §47. Physical connection
- §48. Contracts
- §48.1 Qualifying facilities
- §49. Records and statements

ELECTRIC

I. IN GENERAL

§ 1. Generally

The Commission concluded that the Staff's position on off-balance sheet obligations is reasonable an appropriate using the Standard and Poor's, Research Report dated May 18, 2006.—The Empire District Electric Company 15 MPSC 3d 199.

The Commission clarified that its' December 21, 2006 Report and Order is still in full force and effect besides the clarification to exclude Explorer Pipeline as a party in this case and as a party to the above-referenced stipulation.—Kansas City Power & Light Company 15 MPSC 3d 200.

On May 17, 2007, the Commission issued its Report and Order. In that order, at page 44, the Commission stated that "it would be improper to allow Aquila to flow hedging costs or demand costs associated with any purchased power contract through its fuel adjustment clause." Hedging costs and demand costs are also referred to collectively on page 43. In each instance the phrase "hedging costs" was inadvertently included.—Aquila, Inc. 15 MPSC 3d 463.

§3. Certificate of convenience and necessity

The Commission approved the Stipulation and Agreement and granted Aquila, Inc., a certificate of convenience or necessity to Acquire, construct, install, own, operate, and maintain a distribution substation and related facilities in Jackson County, near the city of Raymore.—Aquila, Inc. 15 MPSC 3d 60.

The Commission approved the Stipulation and Agreement and granted Aquila, Inc., a certificate of convenience or necessity to Acquire, construct, install, own, operate, and maintain a distribution substation and related facilities in St. Clair County, near the city of Osceola.—Aquila, Inc. 15 MPSC 3d 64.

II. JURISDICTION AND POWERS

§9. Jurisdiction and powers of the State Commission

The Commission ordered that the application filed by Aquila, Inc., on October 31, 2006, seeking an order authorizing it to execute, deliver and perform the agreements and instruments necessary to assume a lease and related documents pertaining to the Aries combustion turbine generator facility was dismissed pursuant to Sections 393.190 and 393.200 for lack of jurisdiction.—Aquila, Inc. 15 MPSC 3d 82.

§11. Territorial agreements

The Commission ordered that the proposed Territorial Agreement, although not detrimental to the public interest, not be approved since the Territorial Agreement was contingent upon the approval of a requested waiver of Chapter 14 of the Commission's rules, which was also denied.—The Empire District Electric Company 15 MPSC 3d 224.

III. OPERATIONS

§13. Operations generally

The Commission ordered that Staff's report describing the results of its management audit of Aquila, Inc. be accepted and that Aquila, Inc. is ordered to comply with the recommendations contained in the report.—Aquila, Inc. 15 MPSC 3d 336.

§20. Rates

The Commission ordered that the proposed electric service tariff sheets submitted under Tariff File No. YE-2006-0597 on Feb 1, 2006, by Empire District Electric

Company for the purpose of increasing rates for retail service to customers is rejected.—The Empire District Electric Company 15 MPSC 3d 99.

The Commission approved the stipulation and agreement concerning class cost of service and certain rate design issues, filed on March 22, 2007. This partial stipulation resolves many issues regarding class cost of service and rate design, but it specifically does not resolve three rate design and miscellaneous tariff issues: Ameren's proposal to implement economic development and retention riders, Ameren's proposed Industrial Response Pilot, and the "SafetyNet" proposal that customers be provided credits of \$25 per day for electric outages that extend beyond 48 hours.—Union Electric Company 15 MPSC 3d 377.

The Commission approved the parties' tier one partial stipulation and agreement. The issues settled were rate base adjustments, revenue and expense adjustments, production cost model, revenue and kWh sales.—Union Electric Company 15 MPSC 3d 379.

This order denies AmerenUE's request for a fuel adjustment clause. It allows AmerenUE to increase the revenue it may collect from its Missouri customers by approximately \$43 million. As a result, the average residential customer's monthly bill will increase by \$2.33, or approximately 3.26 percent.—Union Electric Company 15 MPSC 3d 470.

§22. Revenue

The Commission approved the parties' tier one partial stipulation and agreement. The issues settled were rate base adjustments, revenue and expense adjustments, production cost model, revenue and kWh sales.—Union Electric Company 15 MPSC 3d 379.

The Commission approved the parties' tier two partial stipulation and agreement. The revenue and expense issues settled between Company and Staff were resolved by Company agreeing to the Staff's positions for revenue requirement calculations for these revenue and expense issues in exchange for an additional \$5.5 million of revenue requirement to be imputed into the Staffs revenue requirement calculations.—Union Electric Company 15 MPSC 3d 381.

In the settlement of a variety of issues, the parties agree on the additional revenue of \$59,339,481, subject to possible adjustment as specified in depreciation, Sibley Accounting Authority Order, and Rate of Return Valuations.—Aquila, Inc. 15 MPSC 3d 385.

Based on its analysis of the expert testimony offered by the parties, and on its balancing of the interest of the company's ratepayers and shareholders

the Commission found that 10.25% was a fair and reasonable return on equity for Aquila. Based upon a 10.25% return on equity, Aquila's revenue requirement increase will be approximately \$13.6 million and \$45.1 million for its L&P and MPS Operating Divisions, respectively.—Aquila, Inc. 15 MPSC 3d 416.

§23. Return

Based on its analysis of the expert testimony offered by the parties, and on its balancing of the interest of the company's ratepayers and shareholders the Commission found that 10.25% was a fair and reasonable return on equity for Aquila. Based upon a 10.25% return on equity, Aquila's revenue requirement increase will be approximately \$13.6 million and \$45.1 million for its L&P and MPS Operating Divisions, respectively.—Aquila, Inc. 15 MPSC 3d 416.

§29. Rate of return

The Commission determined that the appropriate return on equity (ROE), for Kansas City Power & Light Company (KCPL), was 11% and that an 11% ROE was within the "zone of reasonableness". The Commission also considered a request by KCPL for an "adder" of 50 basis points due to the company's construction risk, the Commission found that evidence did not warrant an upward adjustment of 50 basis points, instead the Commission reduced the "adder" to 25 basis points resulting in a final Cost of Common Equity at 11.25%.—Kansas City Power & Light Company 15 MPSC 3d 138.

§39. Costs and expenses

The Commission approved the parties' tier one partial stipulation and agreement. The issues settled were rate base adjustments, revenue and expense adjustments, production cost model, revenue and kWh sales.—Union Electric Company 15 MPSC 3d 379.

The Commission approved the parties' tier two partial stipulation and agreement. The revenue and expense issues settled between Company and Staff were resolved by Company agreeing to the Staff's positions for revenue requirement calculations for these revenue and expense issues in exchange for an additional \$5.5 million of revenue requirement to be imputed into the Staff's revenue requirement calculations.—Union Electric Company 15 MPSC 3d 381.

The Commission granted a fuel adjustment mechanism to Aquila. The Commission concluded that Aquila met the requirements of section

386.266, and it is reasonable and in the public interest to permit Aquila to use a fuel adjustment mechanism.—Aquila, Inc. 15 MPSC 3d 416.

§40. Reports, records and statements

The Commission accepted the Stipulation and Agreement filed by Union Electric Company on January 5, 2007 outlining Union's integrated resource plan.—Union Electric Company 15 MPSC 3d 239.

EVIDENCE, PRACTICE AND PROCEDURE

I. IN GENERAL

- §1. Generally
- §2. Jurisdiction and powers
- §3. Judicial notice; matters outside the record
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- §9. Particular kinds of evidence generally
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- §11. Best and secondary evidence
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- §22. Parties
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- §28. Arbitration
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EVIDENCE, PRACTICE AND PROCEDURE

No headnotes in this volume involved the question of evidence, practice and procedure.

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- §1. Generally
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- §3. Financing practices
- §4. Apportionment
- §5. Valuation
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- §7. Jurisdiction and powers of the State Commission
- §8. Jurisdiction and powers of the Federal Commissions
- §9. Jurisdiction and powers of local authorities

III. EXPENSES OF PARTICULAR UTILITIES

- §10. Electric and power
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- §12. Heating
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- §15. Sewer

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- §16. Ascertainment of expenses generally

- §17. Extraordinary and unusual expenses
- §18. Comparisons in absence of evidence
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- §20. Methods of estimating
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- §22. Reasonableness generally
- §23. Comparisons to test reasonableness
- §24. Test year and true up

VI. PARTICULAR KIND OF EXPENSE

- §25. Particular kinds of expenses generally
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- §27. Additions and betterments
- §28. Advertising, promotion and publicity
- §29. Appraisal expense
- §30. Auditing and bookkeeping
- §31. Burglary loss
- §32. Casualty losses and expenses
- §33. Capital amortization
- §34. Collection fees
- §35. Construction
- §36. Consolidation expense
- §37. Depreciation
- §38. Deficits under rate schedules
- §39. Donations
- §40. Dues
- §41. Employee's pension and welfare
- §42. Expenses relating to property not owned
- §43. Expenses and losses of subsidiaries or other departments
- §44. Expenses of non-utility business
- §45. Expenses relating to unused property
- §46. Expenses of rate proceedings
- §47. Extensions
- §48. Financing costs and interest
- §49. Franchise and license expense
- §50. Insurance and surety premiums
- §51. Legal expense
- §52. Loss from unprofitable business
- §53. Losses in distribution
- §54. Maintenance and depreciation; repairs and replacements
- §55. Management, administration and financing fees

§56.	Materials and supplies
§57.	Purchases under contract
§58.	Office expense
§59.	Officers' expenses
§60.	Political and lobbying expenditures
§61.	Payments to affiliated interests
§62.	Rentals
§63.	Research
§64.	Salaries and wages
§65.	Savings in operation
§66.	Securities redemption or amortization
§67.	Taxes
§68.	Uncollectible accounts
§69.	Administrative expense
§70.	Engineering and superintendence expense
§71.	Interest expense
§72.	Preliminary and organization expense
§73.	Expenses incurred in acquisition of property
§74.	Demand charges
§75.	Expenses incidental to refunds for overcharges
§76.	Matching revenue/expense/rate base
§77.	Adjustments to test year levels
§78.	Isolated adjustments

EXPENSE

No headnotes in this volume involved the question of expense.

GAS

I. IN GENERAL

§1.	Generally
§2.	Obligation of the utility
§3.	Certificate of convenience and necessity
§4.	Abandonment or discontinuance
§5.	Liability for damages
§6.	Transfer, lease and sale

II. JURISDICTION AND POWERS

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§8.	Jurisdiction and powers of the Federal Commissions
§9.	Jurisdiction and powers of local authorities

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- §10. Construction and equipment generally
- §11. Leakage, shrinkage and waste
- §12. Location
- §13. Additions and betterments
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- §15. Maintenance
- §16. Safety

IV. OPERATION

- §17. Operation generally
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- §17.2. Purchased Gas-incentive mechanism
- §18. Rates
- §19. Revenue
- §20. Return
- §21. Service
- §22. Weatherization
- §23. Valuation
- §24. Accounting
- §25. Apportionment
- §26. Restriction of service
- §27. Depreciation
- §28. Discrimination
- §29. Costs and expenses
- §30. Reports, records and statements
- §31. Interstate operation
- §32. Financing practices
- §33. Billing practices
- §34. Accounting Authority orders
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- §36. Joint operations generally
- §37. Division of revenue
- §38. Division of expenses
- §39. Contracts
- §40. Transportation
- §41. Pipelines

VI. PARTICULAR KIND OF EXPENSES

- §42. Particular kinds of expenses generally
- §43. Accidents and damages
- §44. Additions and betterments
- §45. Advertising, promotion and publicity
- §46. Appraisal expense
- §47. Auditing and bookkeeping
- §48. Burglary loss
- §49. Casualty losses and expenses
- §50. Capital amortization
- §51. Collection fees
- §52. Construction
- §53. Consolidation expense
- §54. Depreciation
- §55. Deficits under rate schedules
- §56. Donations
- §57. Dues
- §58. Employee's pension and welfare
- §59. Expenses relating to property not owned
- §60. Expenses and losses of subsidiaries or other departments
- §61. Expenses of non-utility business
- §62. Expenses relating to unused property
- §63. Expenses of rate proceedings
- §64. Extensions
- §65. Financing costs and interest
- §66. Franchise and license expense
- §67. Insurance and surety premiums
- §68. Legal expense
- §69. Loss from unprofitable business
- §70. Losses in distribution
- §71. Maintenance and depreciation; repairs and replacements
- §72. Management, administration and financing fees
- §73. Materials and supplies
- §74. Purchases under contract
- §75. Office expense
- §76. Officers' expenses
- §77. Political and lobbying expenditures
- §78. Payments to affiliated interests
- §79. Rentals
- §80. Research
- §81. Salaries and wages
- §82. Savings in operation
- §83. Securities redemption or amortization
- §84. Taxes

- §85. Uncollectible accounts
- §86. Administrative expense
- §87. Engineering and superintendence expense
- §88. Interest expense
- §89. Preliminary and organization expense
- §90. Expenses incurred in acquisition of property
- §91. Demand charges
- §92. Expenses incidental to refunds for overcharges

GAS

I. IN GENERAL

§1. Generally

The Commission ordered that the Joint Recommendation Regarding Disconnection of Service Based on Unauthorized Consumption of Natural Gas at a Multi-Dwelling Unit Residential Building filed by Laclede Gas Company, Staff, and the Office of the Public Counsel is accepted. The Commission further stated that, if Laclede is unable to gain access to the meter after reasonable attempts to contact the landlord, it is to follow the procedures outlined in Commission Rule 4 CSR 240-13.050 and Sections 392.550 through 392.565, RSMo 2000.—Staff v. Laclede Gas Company 15 MPSC 3d 198.

III. CONSTRUCTION AND EQUIPMENT

§10. Construction and equipment generally

The Commission granted the requests Staff made regarding Laclede Gas Company's direct-buried copper service line replacement program and the effectiveness of Laclede's leak survey procedures. The current requirements of the previously approved Stipulation and Agreement will be continued.—Laclede Gas Company 15 MPSC 3d 45.

§11. Leakage, shrinkage and waste

Staff alleged that Laclede Gas Company has violated Commission regulations regarding notification to customers concerning the issuance of estimated bills. Also, Staff alleged that Laclede had not acted quickly enough to investigate and correct situations where it has shut off gas service at a meter or curb, but usage has continued to register on the meter. In other words, gas has continued to flow into the building under unknown conditions.—Laclede Gas Company 15 MPSC 3d 93.

IV. OPERATION

§17. Operation generally

The Commission granted Laclede Gas Company an Accounting Authority Order to defer for future recovery of the costs of complying with the Commission's January 1, 2006 emergency amendment to the cold weather rule.—Laclede Gas Company 15 MPSC 3d 89.

The Commission granted Laclede Gas Co. an Accounting Authority Order to defer for future recovery of the costs of complying with the Commission's January 1, 2006 emergency amendment to the cold weather rule.—Laclede Gas Company 15 MPSC 3d 91.

Office of Public Counsel alleges that Laclede has violated Commission regulations by billing customers for estimated gas usage for more than twelve months without obtaining an actual meter reading. The Commission approved Public Counsel's Stipulation and Agreement that required Laclede to provide at least \$500,000 in bill credits to residential customers who received a catch-up bill on or after November 1, 2004, for a period exceeding 12 consecutive months of estimated usage. The credit is to be equal to the amount of the catch-up bill that relates to under-billings for usage prior to the 12 consecutive months of estimated bills. The cost of such credits will be borne by Laclede's shareholders and will not be passed on to ratepayers.-- Laclede Gas Company 15 MPSC 3d 93.

§18. Rates

Missouri Gas Energy filed tariff sheets with the Missouri Public Service Commission to implement a general rate increase for natural gas service in the annual amount of \$41,651,345. The Commission approved the Partial Nonunanimous Stipulation and Agreement filed by Missouri Gas Energy on December 8, 2006.—Missouri Gas Energy 15 MPSC 3d 196.

The Commission approved the tariff sheets filed by Missouri Gas Energy to implement a general rate increase for natural gas service in the annual amount of \$41,651,345.—Missouri Gas Energy 15 MPSC 3d 223.

The Commission rejected the general rate increase originally requested by Atmos Energy Corporation and also authorized Atmos to file new tariff sheets in compliance with this order. The Commission reported that the status quo rate design was just and reasonable and that the volumetric rates encourage conservation. The Commission also clarified that if Atmos filed new tariff sheets with the new fixed monthly charge rate design, it shall also implement an efficiency and conservation program as set out within this report. Otherwise, the Commission found that Atmos shall

maintain its current rate structure with no additional revenue required.—
Atmos Energy Corporation 15 MPSC 3d 261.

The Commission ordered that the Stipulation and Agreement filed on March 8, 2007, be approved as a resolution of all issues in this case. Furthermore, the Commission ordered that the proposed gas service tariff sheets submitted on July 7, 2006, by Union Electric Company d/b/a AmerenUE be rejected and that Union Electric is authorized to file the tariff sheets agreed to as part of the Stipulation and Agreement and may request that the tariff sheets be allowed to become effective on April 1, 2007.—Union Electric Company 15 MPSC 3d 341.

The Commission ordered that the tariff sheets filed by Missouri Gas Energy, a division of Southern Union Company, on May 1, 2006 be rejected. The Commission also granted authorization to Missouri Gas Energy, to file a tariff sufficient to recover the revenues that were determined by the Commission in this order.—Missouri Gas Energy 15 MPSC 3d 350.

The Commission authorized Atmos Energy Corporations to file new tariffs with a Straight Fixed Variable rate design which was to be accompanied by a commitment to implement a substantial energy efficiency and conservation program.—Atmos Energy Corporation 15 MPSC 3d 376.

§35. Safety

The Commission found that the tariff of Laclede Gas Company as revised on June 10, 2005, provides for safe and adequate service and therefore the Complaint is dismissed with prejudice.—USW Local 11-6 v. Laclede Gas Company 15 MPSC 3d 67.

MANUFACTURED HOUSING

I. IN GENERAL

- §1. Generally**
- §2. Obligation of the manufacturers and dealers**
- §3. Jurisdiction and powers of Federal authorities**
- §4. Jurisdiction and powers of the State Commission**
- §5. Reports, records and statements**

II. WHEN A PERMIT IS REQUIRED

- §6. When a permit is required generally**
- §7. Operations and construction**

III. GRANT OR REFUSAL OF A PERMIT

- §8. Grant or refusal generally
- §9. Restrictions or conditions
- §10. Who may possess
- §11. Public safety

IV. OPERATION, TRANSFER, REVOCATION OR CANCELLATION

- §12. Operations under the permit generally
- §13. Duration of the permit
- §14. Modification and amendment of the permit generally
- §15. Transfer, mortgage or lease generally
- §16. Revocation, cancellation and forfeiture generally
- §17. Acts or omissions justifying revocation or forfeiture
- §18. Necessity of action by the Commission
- §19. Penalties

MANUFACTURED HOUSING

I. IN GENERAL

§1. Generally

The Commission directs the department of the General Counsel to seek civil penalties from Blakely Manufactured Homes for clearly violating the Commission rules and therefore violated statute §700.100.3(6) which told how to properly set up and install a modular unit.—Dir. of Manufactured Housing v. Blakely Manufactured Homes 15 MPSC 3d 296.

§2. Obligation of the manufacturers and dealers

The Commission approved the Stipulation and Agreement entered into between the Director of the Manufactured Housing and Modular Units Program of the Public Service Commission (“Director”) and A&G Commercial Trucking, Inc. with regard to the Director’s August 5, 2003 Complaint against A&G, which alleged that A&G had offered four manufactured homes it owned for sale at retail while not being registered with the Public Service Commission as a manufactured home dealer, as is required by law. Other allegations were included as well.—Dir. of Manufactured Housing v. A&G Commercial Trucking, Inc. 15 MPSC 3d 51.

The Commission approved the Stipulation and Agreement entered into between the Director of the Manufactured Housing and Modular Units

Program of the Public Service Commission (“Director”) and Amega Sales, Inc with regard to the Director’s August 5, 2003 Complaint against Amega, which alleged that Amega had improperly sold a 2000 Skyline Corporation manufactured home located on its sales lot in Ashland, Missouri. Prior to this, the Director had placed a prohibitive sale notice on this particular manufactured home and informed Amega that the home could not be sold as a new manufactured home. —Dir. of Manufactured Housing v. Amega Sales, Inc. 15 MPSC 3d 56.

PUBLIC UTILITIES

I. IN GENERAL

- §1. Generally
- §2. Nature of
- §3. Functions and powers
- §4. Termination of status
- §5. Obligation of the utility

II. JURISDICTION AND POWERS

- §6. Jurisdiction and powers generally
- §7. Jurisdiction and powers of the State Commission
- §8. Jurisdiction and powers of the Federal Commissions
- §9. Jurisdiction and powers of local authorities

III. FACTORS AFFECTING PUBLIC UTILITY CHARACTER

- §10. Tests in general
- §11. Franchises
- §12. Charters
- §13. Acquisition of public utility property
- §14. Compensation or profit
- §15. Eminent domain
- §16. Property sold or leased to a public utility
- §17. Restrictions on service, extent of use
- §18. Size of business
- §19. Solicitation of business
- §20. Submission to regulation
- §21. Sale of surplus
- §22. Use of streets or public places

IV. PARTICULAR ORGANIZATIONS-PUBLIC UTILITY CHARACTER

- §23. Particular organizations generally
- §24. Municipal plants
- §25. Municipal districts
- §26. Mutual companies; cooperatives
- §27. Corporations
- §28. Foreign corporations or companies
- §29. Unincorporated companies
- §30. State or federally owned or operated utility
- §31. Trustees

PUBLIC UTILITIES

No headnotes in this volume involved the question of public utilities.

RATES

I. JURISDICTION AND POWERS

- §1. Jurisdiction and powers generally
- §2. Jurisdiction and powers of Federal Commissions
- §3. Jurisdiction and powers of the State Commission
- §4. Jurisdiction and powers of the courts
- §5. Jurisdiction and powers of local authorities
- §6. Limitations on jurisdiction and power
- §7. Obligation of the utility

II. REASONABLENESS-FACTORS AFFECTING REASONABLENESS

- §8. Reasonableness generally
- §9. Right of utility to accept less than a reasonable rate
- §10. Ability to pay
- §11. Breach of contract
- §12. Capitalization and security prices
- §13. Character of the service
- §14. Temporary or emergency
- §15. Classification of customers
- §16. Comparisons
- §17. Competition

- §18. Consolidation or sale
- §19. Contract or franchise rate
- §20. Costs and expenses
- §21. Discrimination, partiality, or unfairness
- §22. Economic conditions
- §23. Efficiency of operation and management
- §24. Exemptions
- §25. Former rates; extent of change
- §26. Future prospects
- §27. Intercorporate relations
- §28. Large consumption
- §29. Liability of utility
- §30. Location
- §31. Maintenance of service
- §32. Ownership of facilities
- §33. Losses or profits
- §34. Effects on patronage and use of the service
- §35. Patron's profit from use of service
- §36. Public or industrial use
- §37. Refund and/or reduction
- §38. Reliance on rates by patrons
- §39. Restriction of service
- §40. Revenues
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- §42. Seasonal or irregular use
- §43. Substitute service
- §44. Taxes
- §45. Uniformity
- §46. Value of service
- §47. Value of cost of the property
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- §49. Voluntary rates
- §50. What the traffic will bear
- §51. Wishes of the utility or patrons

III. CONTRACTS AND FRANCHISES

- §52. Contracts and franchises generally
- §53. Validity of rate contract
- §54. Filing and Commission approval
- §55. Changing or terminating-contract rates
- §56. Franchise or public contract rates
- §57. Rates after expiration of franchise
- §58. Effect of filing new rates
- §59. Changes by action of the Commission

- §60. Changes or termination of franchise or public contract rate
- §61. Restoration after change

IV. SCHEDULES, FORMALITIES AND PROCEDURE RELATING TO

- §62. Initiation of rates and rate changes
- §63. Proper rates when existing rates are declared illegal
- §64. Reduction of rates
- §65. Refunds
- §66. Filing of schedules reports and records
- §67. Publication and notice
- §68. Establishment of rate base
- §69. Approval or rejection by the Commission
- §70. Legality pending Commission action
- §71. Suspension
- §72. Effective date
- §73. Period for which effective
- §74. Retroactive rates
- §75. Deviation from schedules
- §76. Form and contents
- §77. Billing methods and practices
- §78. Optional rate schedules
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VI. RATES AND CHARGES OF PARTICULAR UTILITIES

- §104. Electric and power
- §105. Demand, load and related factors
- §106. Special charges; amount and computation
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- §109. Heating
- §110. Telecommunications
- §111. Water
- §112. Sewers
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- §114. Emergency and temporary rates generally
- §115. What constitutes an emergency
- §116. Prices
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- §119. Rate design, class cost of service for electric utilities
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RATES

No headnotes in this volume involved the question of rates.

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- §2. Obligation of the utility
- §3. Authorization by a corporation
- §4. Conversion, redemption and purchase by a corporation
- §5. Decrease of capitalization
- §6. Sinking funds
- §7. Dividends
- §8. Revocation and suspension of Commission authorization
- §9. Fees and expenses
- §10. Purchase by utility
- §11. Accounting practices

II. JURISDICTION AND POWERS

- §12. Jurisdiction and powers in general
- §13. Jurisdiction and powers of Federal Commissions
- §14. Jurisdiction and powers of the State Commission
- §15. Jurisdiction and powers of local authorities

III. NECESSITY OF AUTHORIZATION BY THE COMMISSION

- §16. Necessity of authorization by the Commission generally
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- §21.1. Effect on bond rating
- §22. Equity capital
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- §26. Definite plans and purposes
- §27. Financial conditions and prospects
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- §29. Dividends and dividend restrictions
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- §32. Necessity of issuance
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- §43. Compensation for services and stockholders' contributions
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- §64. Bonds
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- §69. Financing methods and practices generally
- §70. Leases
- §71. Financing expense
- §72. Payment for securities
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IX. PARTICULAR UTILITIES

- §76. Telecommunications
- §77. Electric and power
- §78. Gas
- §79. Sewer
- §80. Water
- §81. Miscellaneous

SECURITY ISSUES

No headnotes in this volume involved the question of security issues.

SERVICE

I. IN GENERAL

- §1. Generally
- §2. What constitutes adequate service
- §3. Obligation of the utility
- §4. Abandonment, discontinuance and refusal of service
- §5. Contract, charter, franchise and ordinance provisions
- §6. Restoration or continuation of service
- §7. Substitution of service
- §7.1. Change of supplier
- §8. Discrimination

II. JURISDICTION AND POWERS

- §9. Jurisdiction and powers generally
- §10. Jurisdiction and powers of the Federal Commissions
- §11. Jurisdiction and powers of the State Commission
- §12. Jurisdiction and powers over service outside of the state
- §13. Jurisdiction and powers of the courts
- §14. Jurisdiction and powers of local authorities
- §15. Limitations on jurisdiction
- §16. Enforcement of duty to serve

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- §17. Duty to serve in general
- §18. Duty to render adequate service
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- §20. Duty to serve as affected by contract
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- §22. Duty to serve persons who are not patrons
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- §25. Operations generally
- §26. Extensions
- §27. Trial or experimental operation
- §28. Consent of local authorities
- §29. Service area
- §30. Rate of return
- §31. Rules and regulations
- §32. Use and ownership of property
- §33. Hours of service
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- §38. Standard service
- §39. Noncontinuous service

V. SERVICE BY PARTICULAR UTILITIES

- §40. Gas
- §41. Electric and power

- §42. Heating
- §43. Water
- §44. Sewer
- §45. Telecommunications

VI. CONNECTIONS, INSTRUMENTS AND EQUIPMENT

- §46. Connections, instruments and equipment in general
- §47. Duty to install, own and maintain
- §48. Protection, location and liability for damage
- §49. Restriction and control of connections, instruments and equipment

SERVICE

No headnotes in this volume involved the question of service.

SEWER

I. IN GENERAL

- §1. Generally
- §2. Certificate of convenience and necessity
- §3. Obligation of the utility
- §4. Transfer, lease and sale

II. JURISDICTION AND POWERS

- §5. Jurisdiction and powers generally
- §6. Jurisdiction and powers of the Federal Commissions
- §7. Jurisdiction and powers of the State Commission
- §8. Jurisdiction and powers of local authorities
- §9. Territorial agreements

III. OPERATIONS

- §10. Operation generally
- §11. Construction and equipment
- §12. Maintenance
- §13. Additions and betterments
- §14. Rates and revenues

§15.	Return
§16.	Costs and expenses
§17.	Service
§18.	Depreciation
§19.	Discrimination
§20.	Apportionment
§21.	Accounting
§22.	Valuation
§23.	Extensions
§24.	Abandonment or discontinuance
§25.	Reports, records and statements
§26.	Financing practices
§27.	Security issues
§28.	Rules and regulations
§29.	Billing practices
§30.	Eminent domain
§31.	Accounting Authority orders

SEWER

I. IN GENERAL

§4. Transfer, lease and sale

The Commission granted without prejudice Staff's recommendation to dismiss the complaint alleging that Hurricane Deck Holding Company violated §393.190.1 by transferring the water and sewer systems serving the Chelsea Rose Service Area from Hurricane Deck Holding Company to Chelsea Rose Land Owners Association without having obtained authorization from the Commission.—PSC Staff v. Hurricane Deck Holding Company 15 MPSC 3d 1.

The Commission ordered that the application of Central Jefferson County Utilities, Inc., for an order authorizing the transfer and assignment of certain water and sewer assets to Jefferson County Public Sewer District, filed on August 15, 2006, is approved.—Central Jefferson County Utilities, Inc. 15 MPSC 3d 241.

III. OPERATIONS

§10. Operation generally

The Commission ordered that L.W. Sewer Corporation, LLC, is granted authority to reorganize and convert to a nonprofit sewer company to be

known as L.W. Sewer Company.—L.W. Sewer Corporation, LLC 15 MPSC 3d 294.

The Commission ordered that the Metropolitan St. Louis Sewer District shall compensate Missouri –American Water Company, a private water company, for the data obtained by Missouri-American during meter readings under the authority of statute § 249.645.—Metropolitan St. Louis Sewer Dist. V. Missouri-American Water Company 15 MPSC 3d 464.

§14. Rates and revenues

The Commission ordered that the proposed sewer service tariff sheet submitted on May 5, 2006, by Algonquin Water Resources of Missouri, LLC for the purpose of increasing rates for retail sewer service to customers be rejected.—Algonquin Water Resources of Missouri, LLC 15 MPSC 3d 318.

STEAM

I. IN GENERAL

- §1. Generally
- §2. Obligation of the utility
- §3. Certificate of convenience and necessity
- §4. Transfer, lease and sale
- §4.1. Change of suppliers
- §5. Charters and franchise
- §6. Territorial agreements

II. JURISDICTION AND POWERS

- §7. Jurisdiction and powers generally
- §8. Jurisdiction and powers of Federal Commissions
- §9. Jurisdiction and powers of the State Commission
- §10. Jurisdiction and powers of the local authorities
- §11. Territorial agreements
- §12. Unregulated service agreements

III. OPERATIONS

- §13. Operations generally
- §14. Rules and regulations
- §15. Cooperatives
- §16. Public corporations
- §17. Abandonment and discontinuance
- §18. Depreciation
- §19. Discrimination
- §20. Rates
- §21. Refunds
- §22. Revenue
- §23. Return
- §24. Services generally
- §25. Competition
- §26. Valuation
- §27. Accounting
- §28. Apportionment
- §29. Rate of return
- §30. Construction
- §31. Equipment
- §32. Safety
- §33. Maintenance
- §34. Additions and betterments
- §35. Extensions
- §36. Local service
- §37. Liability for damage
- §38. Financing practices
- §39. Costs and expenses
- §40. Reports, records and statements
- §41. Billing practices
- §42. Planning and management
- §43. Accounting Authority orders
- §44. Safety
- §45. Decommissioning costs

IV. RELATIONS BETWEEN CONNECTING COMPANIES

- §46. Relations between connecting companies generally
- §47. Physical connection
- §48. Contracts
- §49. Records and statements

STEAM

No headnotes in this volume involved the question of steam.

TELECOMMUNICATIONS

I. IN GENERAL

- §1. Generally
- §2. Obligation of the utility
- §3. Certificate of convenience and necessity
- §3.1. Certificate of local exchange service authority
- §3.2. Certificate of interexchange service authority
- §3.3. Certificate of basic local exchange service authority
- §4. Transfer, lease and sale

II. JURISDICTION AND POWERS

- §5. Jurisdiction and powers of local authorities
- §6. Jurisdiction and powers of Federal Commissions
- §7. Jurisdiction and powers of the State Commission

III. OPERATIONS

- §8. Operations generally
- §9. Public corporations
- §10. Abandonment or discontinuance
- §11. Depreciation
- §12. Discrimination
- §13. Costs and expenses
- §13.1. Yellow Pages
- §14. Rates
- §14.1. Universal Service Fund
- §15. Establishment of a rate base
- §16. Revenue
- §17. Valuation
- §18. Accounting
- §19. Financing practices
- §20. Return
- §21. Construction
- §22. Maintenance
- §23. Rules and regulations

- §24. Equipment
- §25. Additions and betterments
- §26. Service generally
- §27. Invasion of adjacent service area
- §28. Extensions
- §29. Local service
- §30. Calling scope
- §31. Long distance service
- §32. Reports, records and statements
- §33. Billing practices
- §34. Pricing policies
- §35. Accounting Authority orders

IV. RELATIONS BETWEEN CONNECTING COMPANIES

- §36. Relations between connecting companies generally
- §37. Physical connection
- §38. Contracts
- §39. Division of revenue, expenses, etc.

V. ALTERNATIVE REGULATION AND COMPETITION

- §40. Classification of company or service as noncompetitive, transitionally, or competitive
- §41. Incentive regulation plans
- §42. Rate bands
- §43. Waiver of statutes and rules
- §44. Network modernization
- §45. Local exchange competition
- §46. Interconnection Agreements
- §46.1 Interconnection Agreements-Arbitrated
- §47. Price Cap

TELECOMMUNICATIONS

I. IN GENERAL

§1. Generally

The Commission ordered that Southwestern Bell Telephone, L.P. d/b/a AT&T Missouri's revision to its General Exchange Tariff, PSC Mo. No. 35, Regarding Provision of 811 Service is approved and is effective as of February 16, 2007.—Southwestern Bell Telephone, L.P. 15 MPSC 3d 229.

The Commission ordered that requests for reimbursement by telecommunications companies from the Missouri Universal Service Fund administrator shall be made no later than the 15th day of each month, and reimbursements shall be dispatched between the first and the fifth day of the following month.—Missouri Universal Service Fund 15 MPSC 3d 339.

The Commission ordered that requests for reimbursement by telecommunications companies from the Missouri Universal Service Fund administrator shall be made no later than the 15th day of each month, and reimbursements shall be dispatched between the first and the fifth day of the following month.—Missouri Universal Service Fund 15 MPSC 3d 387.

The Commission granted the United Way of Greater St. Louis, Inc.'s application for authorization to serve as a 211 Information and Referral Service Provider for a period of three years.—United Way of Greater St. Louis, Inc. 15 MPSC 3d 413.

III. OPERATIONS

§8. Operations generally

The Commission ordered that the Report and Order issued on September 21, 2006 be amended as set out in this order to redefine the service areas of Alltel Missouri, Inc., Grand River Mutual Telephone Corporation, Mark Twain Rural Telephone Corporation, and Spectra Communications Group, LLC, d/b/a CenturyTel.—Missouri RSA No. 5 Partnership 15 MPSC 3d 314.

Generally The Commission ordered that New Florence Telephone Company, Tiger Telephone, Inc. and Direct Communications Rockland, Inc. are authorized to enter into and perform in accordance with the terms of the Stock Purchase Agreement and that Leonard May, Garrin Bott, Kip Wilson, Jeremy Smith, Scott Hendrickson and Elizabeth Dunn are authorized to purchase or acquire, take or hold all of the total issued and outstanding capital stock of Tiger Telephone, Inc.—New Florence Telephone Company, Tiger Telephone, Inc., and Direct Communications Rockland, Inc. 15 MPSC 3d 345.

§14.1 Universal Service Fund

The Commission designated Northwest Missouri Cellular Limited Partnership as a Telecommunications Company Carrier Eligible for Federal Universal Service Fund purposes pursuant to § 254 of the Telecommunications Act of 1996.—Northwest Missouri Cellular Limited Partnership 15 MPSC 3d 3.

The Commission granted Missouri RSA No. 5 Partnership's (MO5) application for status as an eligible telecommunications carrier (ETC) for federal universal service fund (USF) purposes.—Missouri RSA No. 5 Partnership 15 MPSC 3d 23.

The Commission designated Northwest Missouri Cellular Limited Partnership as a Telecommunications Company Carrier Eligible for Federal Universal Service Fund purposes pursuant to § 254 of the Telecommunications Act of 1996.—Northwest Missouri Cellular Limited Partnership 15 MPSC 3d 310.

The Commission finds that U.S. Cellular has met all requirements of federal and state law and designates it as an eligible telecommunications carrier (ETC) throughout its Missouri service area. As an ETC, U.S. Cellular is designated as eligible to receive all available support from the federal Universal Service Fund, including support for rural, insular, and high-cost areas, and low-income customers.—USCOC of Greater Missouri, LLC 15 MPSC 3d 388.

V. ALTERNATIVE REGULATION AND COMPETITION

§40. Classification of company or service as noncompetitive, transitionally, or competitive

The Commission ordered that Southwestern Bell Telephone, L.P., d/b/a AT&T Missouri's; intraLATA toll service, intraLATA private line/dedicated services, Wide area Telecommunications Services (WATS) and 800 services, special access services and station-to-station, person-to-person and calling card operator services be classified as competitive in all of its Missouri exchanges.—Southwestern Bell Telephone Company 15 MPSC 3d 203.

VALUATION

I. IN GENERAL

- §1. Generally**
- §2. Constitutional limitations**
- §3. Necessity for**
- §4. Obligation of the utility**

II. JURISDICTION AND POWERS

- §5. Jurisdiction and powers generally
- §6. Jurisdiction and powers of the State Commission
- §7. Jurisdiction and powers of the Federal Commissions
- §8. Jurisdiction and powers of local authorities

III. METHODS OR THEORIES OF VALUATION

- §9. Methods or theories generally
- §10. Purpose of valuation as a factor
- §11. Rule, formula or judgment as a guide
- §12. Permanent and tentative valuation

IV. ASCERTAINMENT OF VALUE

- §13. Ascertainment of value generally
- §14. For rate making purposes
- §15. Purchase or sale price
- §16. For issuing securities

V. FACTORS AFFECTING VALUE OR COST

- §17. Factors affecting value or cost generally
- §18. Contributions from customers
- §19. Appreciation
- §20. Apportionment of investment or costs
- §21. Experimental or testing cost
- §22. Financing costs
- §23. Intercorporate relationships
- §24. Organization and promotion costs
- §25. Discounts on securities
- §26. Property not used or useful
- §27. Overheads in general
- §28. Direct labor
- §29. Material overheads
- §30. Accidents and damages
- §31. Engineering and superintendence
- §32. Preliminary and design
- §33. Interest during construction
- §34. Insurance during construction
- §35. Taxes during construction
- §36. Contingencies and omissions
- §37. Contractor's profit and loss
- §38. Administrative expense
- §39. Legal expense
- §40. Promotion expense

§41. Miscellaneous

VI. VALUATION OF TANGIBLE PROPERTY

§42. Buildings and structures
§43. Equipment and facilities
§44. Land
§45. Materials and supplies
§46. Second-hand property
§47. Property not used and useful

VII. VALUATION OF INTANGIBLE PROPERTY

§48. Good will
§49. Going value
§50. Contracts
§51. Equity of redemption
§52. Franchises
§53. Leases and leaseholds
§54. Certificates and permits
§55. Rights of way and easements
§56. Water rights

VIII. WORKING CAPITAL

§57. Working capital generally
§58. Necessity of allowance
§59. Factors affecting allowance
§60. Billing and payment for service
§61. Cash on hand
§62. Customers' deposit
§63. Expenses or revenues
§64. Prepaid expenses
§65. Materials and supplies
§66. Amount to be allowed
§67. Property not used or useful

IX. DEPRECIATION

§68. Depreciation generally
§69. Necessity of deduction for depreciation
§70. Factors affecting propriety thereof
§71. Methods of establishing rates or amounts
§72. Property subject to depreciation
§73. Deduction or addition of funds or reserve

X. VALUATION OF PARTICULAR UTILITIES

- §74. Electric and power
- §75. Gas
- §76. Heating
- §77. Telecommunications
- §78. Water
- §79. Sewer

VALUATION

No headnotes in this volume involved the question of valuation.

WATER

I. IN GENERAL

- §1. Generally
- §2. Certificate of convenience and necessity
- §3. Obligation of the utility
- §4. Transfer, lease and sale
- §5. Joint Municipal Utility Commissions

II. JURISDICTION AND POWERS

- §6. Jurisdiction and powers generally
- §7. Jurisdiction and powers of the Federal Commissions
- §8. Jurisdiction and powers of the State Commission
- §9. Jurisdiction and powers of local authorities
- §10. Receivership
- §11. Territorial Agreements

III. OPERATIONS

- §12. Operation generally
- §13. Construction and equipment
- §14. Maintenance
- §15. Additions and betterments
- §16. Rates and revenues
- §17. Return
- §18. Costs and expenses
- §19. Service
- §20. Depreciation

- §21. Discrimination
- §22. Apportionment
- §23. Accounting
- §24. Valuation
- §25. Extensions
- §26. Abandonment or discontinuance
- §27. Reports, records and statements
- §28. Financing practices
- §29. Security issues
- §30. Rules and regulations
- §31. Billing practices
- §32. Accounting Authority orders

WATER

I. IN GENERAL

§4. Transfer, lease and sale

The Commission granted without prejudice Staff's recommendation to dismiss the complaint alleging that Hurricane Deck Holding Company violated §393.190.1 by transferring the water and sewer systems serving the Chelsea Rose Service Area from Hurricane Deck Holding Company to Chelsea Rose Land Owners Association without having obtained authorization from the Commission.--PSC Staff v. Hurricane Deck Holding Company 15 MPSC 3d 1.

The Commission authorized White River Valley Company to sell its water system facilities and assets to the Public Water Supply District No. 2 of Taney County, Missouri, pursuant to the terms and conditions contained in the Facilities Purchase Agreement submitted to the Commission on September 28, 2006.—White River Valley Water Company 15 MPSC 3d 78.

The Commission granted a default judgment in favor of Staff's complaints because the Respondents failed to timely respond. Therefore, the Commission first found that Respondents are both a water corporation and a public utility which is subject to the Commission's jurisdiction. The Commission has also found that the Respondent's have violated §393.170 by providing water service to the Oakview Estates Subdivision in Warren County, Missouri without the requisite certificate of convenience and necessity, and that each day Respondents have done so constitutes a separate violation.—Staff v. Joe Hybl, Oakview Estates Homeowners Association 15 MPSC 3d 81.

The Commission ordered that the application of Central Jefferson County Utilities, Inc., for an order authorizing the transfer and assignment of certain water and sewer assets to Jefferson County Public Sewer District, filed on August 15, 2006, is approved.—Central Jefferson County Utilities, Inc. 15 MPSC 3d 241.

III. OPERATIONS

§16. Rates and revenues

The Commission ordered that the proposed water service tariff sheets submitted on May 5, 2006, by Algonquin Water Resources of Missouri, LLC for the purpose of increasing rates for water service to customers be rejected.—Algonquin Water Resources of Missouri, LLC 15 MPSC 3d 318.