Exhibit No.:	
Issue:	Conditions on Acquisition Approval
Witness:	Donald Johnstone
Type of Exhibit:	Direct Testimony
Sponsoring Party:	AGP
Case Number:	WA-2012-0066
Date Prepared:	March 27, 2012

Missouri American Water Company
WA-2012-0066

Direct Testimony of

Donald E. Johnstone

on behalf of

AG PROCESSING INC, A COOPERATIVE

March 27, 2012

Competitive Energy
DYNAMICS

Missouri American Water Company

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Direct Testimony of Donald E. Johnstone

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Direct Testimony of Donald E. Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A Donald E. Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, MO 65049.

Q BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A I am President of Competitive Energy Dynamics, L. L. C. My qualifications and experience are set forth in Schedule 1 attached to this testimony.

Q ON WHOSE BEHALF ARE YOU APPEARING?

A I am appearing on behalf of AG PROCESSING INC A COOPERATIVE ("AGP"). AGP is an industrial water customer of MAWC located in the St. Joseph District and served under industrial rates presently approved for the district.

INTRODUCTION

Q PLEASE PROVIDE AN OVERVIEW OF THE PLEADINGS IN THIS CASE.

A MAWC has made an application for a certificate of convenience and necessity to support of its acquisition of the Saddlebrooke water and sewer properties, although it is not entirely clear from its application and attached materials that this should not be considered more of acquisition than an initial application.

Staff has filed pleadings and a report that includes cost of service and rate

proposals. OPC has also filed pleadings and a report. Direct testimony is first being filed by MAWC on the same date as this testimony and there has been no testimony from the other parties. Thus, at the time this testimony is being drafted the positions have not been explained and supported by testimony. Necessarily, AGP reserves its right to fully respond, and the full AGP response must necessarily await a review of the testimony of the parties. My testimony at this time is intended to express the general areas of concern that AGP has with the MAWC acquisition and application, as apparently put forward, rather to than express a final position on the proposal.

Q PLEASE PROVIDE AN OVERVIEW OF YOUR TESTIMONY.

A The rates for MAWC water service in each district should reflect the cost of the water services provided in each district for each rate class. On its face this is a simple matter of equity. No doubt, each customer expects to pay for their own service, and not for the service of neighbors or customers that reside somewhere else in the state. Water rates that reflect cost are also important as a matter of efficiency since higher cost usages will be discouraged by the prices which reflect the higher costs while the relative advantage of lower cost service is also preserved in the rates charged. Certainly relatively low water rates that reflect the reasonable cost of service are important to my clients and to an environment in the St. Joseph District that supports a continuing manufacturing base and job creation.

I am advised by Mr. Conrad, attorney for AGP, that Missouri law supports this approach to water rates. To this end, the comments and brief of AGP that were filed in SW-2011-0103 are attached for the convenience of the Commission. Not being an attorney, I offer this document simply as a courtesy preview of the legal arguments that may come in due course.

In the context of this acquisition the matter of cost-based rates arises because anything less than cost-based rates for the acquired service area could give rise to a detriment to the current customers of MAWC, unless MAWC would agree up front to absorb the difference between rate revenue and actual costs. Otherwise, any shortfall would speed the onset of another general rate case, a detriment in itself, and in that case existing customers could be saddled with the cost of that shortfall – if, the historical course is not changed. I am again advised by Mr. Conrad that Missouri law supports the need to affirmatively take action to avoid the detriment. I am advised that the Commission may attach conditions to the requested certificate in such a way that cost shifting would be precluded. Alternatively, MAWC could agree to forego any future recovery of any difference between Saddlebrooke rate revenue and Saddlebrooke actual costs from customers in other districts. While the AGP case that I note below pertains more directly to a merger, the statutes that appear to be concerned (Sections 393.130 and Section 393.170) also appear to pertain to an acquisition. To this end, the October 28, 2003 ruling of the Supreme Court of Missouri in 120 S.W.3d 732;2003 Mo. LEXIS 142 is attached. Again, not being an attorney, I offer this document simply as a courtesy preview of the legal arguments that may come in due course.

In any event, as a policy matter, it is appropriate to resolve issues that arise in conjunction with potential detriments to existing customers in the context of this proceding.

Q PLEASE SUMMARIZE THE MAWC PROPOSAL FOR SADDLEBROOKE WATER AND SEWER RATES.

MAWC has provided work papers with water and sewer rates for the Saddlebrooke

service area under MAWC and Staff proposals. To the extent that rates do not fully recover costs, there could be detriment to existing MAWC customers. It is my understanding that MAWC's current position will be the subject of its direct testimony.

Q PLEASE SUMMARIZE THE STAFF PROPOSAL FOR SADDLEBROOKE WATER AND SEWER RATES.

Staff has issued a report that contains water and sewer rates for the proposed Saddlebrooke service area. It is not clear that these rates fully recover the costs.

To the extent that Staff rates do not fully recover costs, there could also be detriment to existing MAWC customers.

Q PLEASE SUMMARIZE THE OPC PROPOSAL FOR SADDLEBROOKE WATER AND SEWER RATES.

OPC has taken positions that would reduce the proposed water and sewer rates for customers in the proposed Saddlebrooke service area. It is not clear that these adjustments would lead to rates that fully recover the cost of service.

To the extent that OPC adjustments would not provide for full recovery of costs, there could be detriment to existing MAWC customers.

SUMMARY OF TESTIMONY AND RECOMMENDATIONS

Q GIVEN THE STAFF AND MAWC PROPOSED WATER AND SEWER RATES AND THE POTENTIAL FOR PROBLEMS YOU HAVE BRIEFLY DESCRIBED, WOULD YOU PLEASE PROVIDE A SUMMARY OF YOUR TESTIMONY AND RECOMMENDATIONS?

A

- Under present rates, AGP, like most other existing customers, contributes to a subsidy of the small utility properties that have been acquired by MAWC and now generally comprise District 8 and the sewer districts. It is important to ensure that the instant acquisitions do not increase and exacerbate this pattern of the detriment to existing ratepayers.

- Rates for Saddlebrooke water and sewer service should reflect the cost of the services to be provided, no more and no less. No less is necessary to reasonably ensure no present or future detriment to existing customers as a result of the acquisition while "no more" would protect Saddlebrooke customers

- Any potential cost-of-service adjustments should be considered fully in the context of policies that could produce or lead to detriments for existing customers.

- Any adjustment for excess capacity should be explicit and continuing in nature as long as the excess capacity exists, so as to avoid the possibility of inappropriate cost increases that could contribute to the need for a general rate increase and a detriment to existing customers.

- Valuation of the rate base in consideration of purchase price of the assets is a matter that must be decided. Proper and explicit valuation is important to avoid current and future detriment to existing customers as well as to the prospective Saddlebrooke customers.

- Approval of the requested certificate and proposed acquisition should be conditioned on adjustments and procedures necessary to avoid detriment to existing customers. The point is to provide the protections necessary to avoid, to the maximum reasonable extent, an acquisition that would operate to the detriment of existing customers.

COMPARISON OF EXISTING DISTRICT REVENUES AND COST OF SERVICE

Q IS DETRIMENT TO EXISTING MAWC CUSTOMERS A REAL PROBLEM?

Yes. AGP has been a party to all recent MAWC general rate proceedings, and the detriment, in the form of subsidies arising from MAWC's acquisitions of small

utility properties, has been an issue in each case. Detriment arises because the rates applied in the acquired small districts have not been sufficient to recover their cost of service. While the most recent water and sewer general rate increase (consolidated) was settled, AGP's agreement was limited, as is typical, to that case. No policy matters were resolved as a precedent or in a way that would bind any party in any other proceeding. That said, the detriment to existing customers due to the acquisitions amounts to roughly a 1% tax on the existing customers. That is a real problem.

Q HAVE YOU COMPARED THE RATE REVENUE TO THE COST OF SERVICE FOR THE EXISTING MAWC DISTRICTS?

A Yes. The small sewer districts do not provide revenues sufficient to meet the cost of service. Similarly, the small water districts that comprise District 8 do not provide revenues sufficient to meet the cost of service.

While the rates were the product of a settlement that was supported by AGP, the fact remains that the small districts are not providing revenues sufficient to recover their cost. The Saddlebrooke acquisition under inappropriate rates and conditions would simply exacerbate this problem. Consequently, the detriment to existing customers would increase if proper rates, procedures, and protections are not a condition of the acquisition. Indeed, in the absence of necessary protections there would be detriment to existing customers. I am advised by counsel that such detriment, if unresolved could preclude a legally sustainable approval of the proposed acquisitions.

Q WHAT IS THE MAGNITUDE OF THE SHORTFALL IN REVENUES PROVIDED BY THE EXISTING SMALL WATER AND SEWER DISTRICTS?

A The small water districts comprise District 8. According to information from Docket No. WR-2011-0337 (the last MAWC rate case) the District 8 shortfall is $1,008,143. The shortfall for the small sewer districts as a group is $1,401,302. Thus, taken together the shortfall is approximately $2,409,445 per year under currently effective rates. This is premised on the Staff's February 6 update in WR-2011-0337 and assumes a 7.58% rate of return and the rates approved in that case. I will set aside for the moment that water districts are subsidizing sewer districts -- an entirely different service, and which raises a different set of issues.

Q HAVE MAWC, STAFF, OR OPC PROPOSED TO SHIELD EXISTING CUSTOMERS FROM THIS ONGOING DETRIMENT?

A There has been no proposal by MAWC to reduce its revenue requirement by any amount in response to this problem. In the recent rate case neither Staff nor OPC has proposed an adjustment to shield existing customers from the detriment of these acquisitions. AGP, with only limited success, has recommended cost-based rates to resolve the issue. As a consequence, roughly a $2.4 million detrimental effect of MAWC acquisitions continues to fall to existing customers. MAWC's acquired service areas are currently being subsidized by existing customers and, in effect, MAWC's acquisitions are being subsidized by existing customers.

CONDITIONS TO AVOID DETRIMENT

Q WHAT SPECIFIC RATES, PROCEDURES, AND PROTECTIONS ARE NECESSARY TO AVOID A DETRIMENT TO EXISTING CUSTOMERS?

A I cannot be specific at this stage of case because there has been no testimony on the relevant matters. Hence, this testimony is necessarily preliminary in nature and based on what I have gleaned from various filings and data request responses. Subject to this caveat:

- In a general sense, the Saddlebrooke rates should be set at the cost of service. While this is not a general rate case, as a practical matter rates for the Saddlebrooke water and sewer customers are a necessary result. Moreover, rates set at cost-of-service levels will convey accurate cost information to the Saddlebrooke customers. Otherwise there is a serious potential that they could be misled. Of course the rates must be just and reasonable.

- If there is to be an excess capacity adjustment, then a process should be defined for resolving the excess capacity over time. There must either be an explicit voluntary agreement to the process or the Commission should establish the process as a condition of approval of the acquisition.

- It is my understanding that MAWC and Staff will be supporting a rate base valuation that exceeds the price to be paid by MAWC for the assets. This is an issue that will have immediate as well as ongoing rate implications. In due course I may address the matter further.

- Another concern is an expense of roughly $31,000 that I understand to be required by DNR as a condition of the acquisition. It is difficult to comprehend why rates for Saddlebrooke customers should not reflect this expense and why the existing customers should be at risk for the detrimental effect.

- MAWC corporate overheads are another concern. An appropriate level should be included in the cost of service used to design the rates. Staff expressed concern about the allocations of these costs in its testimony

in the recent MAWC rate case. Certainly the initial rates should reflect an appropriate level consistent with the cost of service for existing customers. Anything less would be a preference for Saddlebrooke customers and a disadvantage for existing MAWC water customers in different localities.

- The MAWC return on rate base and taxes are also important. Assuming the acquisition is approved, the return and income taxes that flow from it should be even with return and taxes for existing customers.

Q IS IT YOUR INTENT TO INFLATE THE RATES FOR SADDLEBROOKE CUSTOMERS, TO THEIR DETRIMENT?

A Not at all. Instead, the intent is to identify and resolve any proposal that would hold Saddlebrooke rates to an artificially low level that would set up the potential of a detriment to existing customers. To the extent possible, the point is to deal with the issues forthrightly as a part of this proceeding so as to avoid detriment to existing customers now and in the future. With detriments resolved, other relevant considerations would govern the Commission's consideration of the application.

CONCLUSIONS

Q PLEASE SUMMARIZE YOUR CONCLUSIONS AT THIS TIME.

A There is a history of detrimental subsidies being provided at the expense of existing customers as a result of MAWC's acquisitions of smaller utility properties that now generally comprise District 8 and the sewer districts. I cannot prejudge the proposals of the parties, but suffice it to say the goal on behalf of AGP will be to support an approach that avoids detriment to existing customers as a consequence of MAWC's acquisition of the Saddlebrooke water and sewer properties.

Q CAN THE DETRIMENT TO EXISTING CUSTOMERS BE AVOIDED?

Yes. The purpose of this direct testimony identify the possibility of detriment to existing customers due to the proposed acquisitions and to define some of the issues to the extent possible at this early date.

As a threshold matter, rates set here should be at the cost of service, no more and no less. Proposals that would depress initial rates to a level below cost should not simply be viewed as a benefit that is extracted from MAWC. In fact, time and again, in the general rate proceedings, there is no accommodation (except to perhaps make some limited progress towards cost-based rates) while continuing to extract the shortfalls from existing customers.

In addition, any cost-of-service proposals that have ongoing implications, for example, the excess capacity adjustment of Staff, need to be resolved in a way that binds parties for an extended period. Otherwise existing customers could be called upon to subsidize and protect Saddlebrooke customers from potentially large increases dictated by the Saddlebrooke cost of service should the adjustment not be extended.

In due course I expect to have more specific recommendations that would identify conditions on the approval of the acquisition that would be necessary to resolve any detriment to existing customers. I would recommend that MAWC would then have the option to accept the conditions or to not make the acquisition. While the decision to proceed would be theirs, I would hope that such conditions would be acceptable so that the acquisition would continue to be in the interest of the public and MAWC and no party need suffer a detriment as a result.

Q DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A Yes it does.

Qualifications of Donald E. Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A Donald E. Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, MO 65049.

Q PLEASE STATE YOUR OCCUPATION.

A I am President of Competitive Energy Dynamics, L.L.C. and a consultant in the field of public utility regulation.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A In 1968, I received a Bachelor of Science Degree in Electrical Engineering from the University of Missouri at Rolla. After graduation, I worked in the customer engineering division of a computer manufacturer. From 1969 to 1973, I was an officer in the Air Force, where most of my work was related to the Aircraft Structural Integrity Program in the areas of economic cost analysis, data base design and data processing. Also in 1973, I received a Master of Business Administration Degree from Oklahoma City University.

From 1973 through 1981, I was employed by a large Midwestern utility and worked in the Power Operations and Corporate Planning Functions. While in the Power Operations Function, I had assignments relating to the peak demand and net output forecasts and load behavior studies which included such factors as weather, conservation and seasonality. I also analyzed the cost of replacement energy associated with forced outages of generation facilities. In the Corporate Planning Function, my assignments included developmental work on a generation expansion planning program and work on the peak demand and sales forecasts. From 1977

through 1981, I was Supervisor of the Load Forecasting Group where my responsibilities included the Company's sales and peak demand forecasts and the weather normalization of sales.

In 1981, I began consulting, and in 2000, I created the firm Competitive Energy Dynamics, L.L.C. As a part of my thirty years of consulting practice, I have participated in the analysis of various electric, gas, water, and sewer utility matters, including the analysis and preparation of cost-of-service studies and rate analyses. In addition to general rate cases, I have participated in electric fuel and gas cost reviews and planning proceedings, policy proceedings, market price surveys, generation capacity evaluations, and assorted matters related to the restructuring of the electric and gas industries. I have also assisted companies seeking locations for new manufacturing facilities.

I have testified before the state regulatory commissions of Delaware, Hawaii, Illinois, Iowa, Kansas, Massachusetts, Missouri, Montana, New Hampshire, Ohio, Pennsylvania, Tennessee, Virginia and West Virginia, and the Rate Commission of the Metropolitan St. Louis Sewer District.

BEFORE THE

PUBLIC SERVICE COMMISSION OF MISSOURI

In the Matter of Missouri-American Water Company for a Certificate of Convenience and Necessity Authorizing it to Install, Own, Acquire, Construct, Operate, Control, Manage and Maintain Water and Sewer Systems in Christian and Taney Counties, Missouri.	)))))))	WA-2012-0066

Affidavit of Donald E. Johnstone

State of Missouri)
) SS
County of CAMDEN)

Donald E. Johnstone, being first duly sworn, on his oath states:

1. My name is Donald E. Johnstone. I am a consultant and President of Competitive Energy Dynamics, L. L. C. I reside at 384 Black Hawk Drive, Lake Ozark, MO 65049. I have been retained by AG PROCESSING INC, A COOPERATIVE.

2. Attached hereto and made a part hereof for all purposes are my testimony and schedules in written form for introduction into evidence in the above captioned proceeding.

3. I hereby swear and affirm that my testimony is true and correct and show the matters and things they purport to show.

Donald E. Johnstone

Subscribed and sworn to this 27th day of March, 2012.

CYNTHIA E. BALLIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Camden County
My Commission Expires: July 18, 2012
Commission Number: 08379951

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Review of Economic, Legal and Policy Considerations of District-Specific Pricing and Single Tariff Pricing	))))	**SW-2011-0103**

COMMENTS AND BRIEF
OF AG PROCESSING INC A COOPERATIVE

I. INTRODUCTION.

First, Ag Processing Inc a Cooperative (AGP) would like to thank the Commission for considering this question. As this brief will make clear, we do not agree that single-tariff pricing should be re-adopted, but we nevertheless appreciate the opportunity to comment on the suggestion.

Second, AGP is a large industrial customer in St. Joseph, Missouri and uses significant quantities of water supplied by Missouri-American Water Company (MAWC). AGP has participated in numerous MAWC rate cases and, in particular, participated in the 2000 rate case (WR-2000-281) that concerned the inclusion of the large new water plant to serve St. Joseph.

There, along with other industrials, AGP argued that, even though single-tariff pricing (STP) might save on the level of rates in St. Joseph as compared to district specific pricing (DSP), STP was incorrect as an approach and would lead to greater problems in the future if it continued to be followed. We urged a careful look at whether MAWC's construction of the new water plant was justified and prudent.

In that case the Commission determined to move away from STP toward DSP and, as a result, charged the value of the new St. Joseph plant to the St. Joseph district.[1/] That plant continues to be paid for by the St. Joseph customers and, based on our understanding, no others.

Having paid and continuing to pay for the new St. Joseph plant, AGP understands that in this proceeding the Commission is taking another look at STP as against the DSP approach. Although it might conceivably reduce AGP's water costs to some degree, STP remains no less incorrect now than it did ten years ago. AGP respectfully recommends to the Commission that the existing approach - district specific pricing -- be retained.

II. ARGUMENT.

A. STP Remains As Wrong Now As It Was 10 Years Ago.

The STP proposal is nothing more complicated than taking the costs of a utility's districts, combining them, then developing essentially uniform tariffs that recover those costs across the separate districts. This mechanism, of course, disregards costs that are specific to each district, especially the district specific capital costs necessary to supply service to each separate district.

[1/] There was, as we recall, a small disallowance for excess capacity. We are uncertain as to the current status of this disallowance.

Instead of directly charging each district for its unique costs, STP simply "averages" those costs and distributes them to all the districts with the result being that company customers in any of the districts only accidentally pay the actual costs that the company incurs to provide them with service. While this may be more convenient and expedient for the Company in preparing rate cases, the Courts of this state have often cited an axiom that aptly fits this situation:

> [N]either convenience, expediency or necessity are proper matters for consideration in the determination of whether or not an act of the commission is authorized by the statute.

See, *State ex rel. Kansas City v. Public Service Commission*,[2/]; *State ex rel. Util. Consumers Council v. Public Service Commission*,[3/]; *State ex rel. Missouri Cable Telecommunications Ass'n v. Public Service Commission*,[4/].

AGP respectfully encourages the Commission to keep this guiding principle in mind as it re-evaluates STP as compared to the more appropriate DSP approach.

B. Rate Discrimination Generally.

[2/] 257 S.W. 462 (Mo. *en banc* 1923).

[3/] 585 S.W. 41, 49 (Mo. *en banc* 1979).

[4/] 929 S.W. 2d 768, 772 (Mo. App. W.D. 1996).

The legal requirement is that the rate approved by the Commission must be lawful, reasonable, nondiscriminatory and non-preferential.[5/]

1. The General Assembly Has Circumscribed the Commission's Ability to Create Subsidized Rates.

The Commission's jurisdiction is determined by the General Assembly's statutory delegation of regulatory power to the Commission. Section 393.130 RSMo 2000[6/] limits the Commission's power in this particular case. Single Tariff Pricing (STP) violates Section 393.130, which provides in pertinent part:

> 1. . . . . ***All charges*** made or demanded by any . . . water corporation . . . ***for water . . . service rendered or to be rendered shall be just and reasonable*** . . . . ***Every unjust or unreasonable charge made or demanded for . . . water . . . service***, or in connection therewith . . . ***is prohibited***.

The previously commenting parties appear to have focused on this provision in the statute. But they overlook a later portion of the same statute.

> 3. ***No . . . water corporation*** . . . ***shall make or grant any undue or unreasonable preference or advantage to any . . . locality***, or to any particular description of service in any respect whatsoever, or ***subject any . . . locality*** or any particular description of service ***to any undue or unreasonable preju-***

[5/] Most of the discussion on this topic has focused on the lack of "undue" discrimination. Section 393.130 has, however, a broader scope which does not appear to have been addressed.

[6/] All statutory citations are to RSMo 2000.

dice or disadvantage in any respect whatsoever. [Emphasis Added]

Subsection 1 requires rates to be just and reasonable for the "***water . . . service rendered***." The setting of rates for service in a district, which are higher than the reasonable cost to render the water service in such district violates this subsection. When none of the utility districts are interconnected, and none of the customers in any one of the districts is provided service by any of the other districts, any attempt to impute or include in the rates of one district, the costs of providing service to another district, is prohibited by Subsections 1 and 3 of Section 393.130.

Subsection 3 expands on the anti-discrimination and anti-preference provision of the law relating to water companies. The General Assembly added this provision and, we believe, went beyond the "undue discrimination" prescriptions contained in subsection 1 by adding additional language directed to "localities." This provision is written in the disjunctive: not only is it unlawful to subject a ***locality*** to "any undue or unreasonable prejudice or disadvantage in any respect whatsoever"; it is equally unlawful to grant a ***locality*** "any undue or unreasonable preference or advantage . . . in any respect whatsoever." *See*, *Alexander v. Chicago, M. & St. P. R. Co.*[7/], interpreting what is now Section 387.110, which includes virtually identical language pertaining to common carriers.

[7/] 147 S.W. 217 (Mo. 1912).

2. The Legislature's Choices Should Be Respected.

The legislature's choice of wording has significance. We do not believe that the General Assembly acted precipitously nor do we believe that the words that were chosen were mere surplusage. Instead they draw a distinction between (a) prohibiting "undue" discrimination between ***individual*** customers by putting them into a class with other ***individual*** customers sharing common load and usage characteristics, and (b) prohibiting an undue or unreasonable "preference or advantage" or an undue or unreasonable "prejudice or disadvantage" "in ***any*** respect whatsoever" to a ***locality***. These language choices deserve respect, and they highlight a distinction.

A utility could not rationally set a rate for each individual customer, but must group customers by common load and usage characteristics. Doing so is not "undue discrimination." But to attempt to unify physically separate and unconnected districts by averaging their rates violates introduces "undue" discrimination and an "undue" preference or disadvantage.

In the case of Single Tariff Pricing for non-interconnected districts with substantially different district specific costs of service, both prohibitions in Section 3 are broken. Not only does STP violate the law by granting undue or unreasonable preference or advantage to those localities (districts), whose resulting rates are lower than the cost of rendering such districts with water service, but STP also violates the law by subjecting other localities (districts) to undue or unreasonable

prejudice or disadvantage, by requiring them to pay higher rates than justified by the cost of rendering those districts with water service. Under STP, it is only happenstance and chance that the rates in any one locality (district) recover no more or no less than the cost of rendering such district's water service.

3. The General Assembly Is Presumed to Know Existing Judicial Construction.

Legislative selection of terms such as "undue preference" and "unreasonable discrimination" as limitations on a utility's authority were intentional. They are declarative of the common law rule, founded on public policy requiring one engaged in a public calling to charge a reasonable rate without discrimination. *State ex rel. Laundry, Inc. v. Public Service Commission*.[8/] Use of these terms sets clear limits on the grant of authority to the Commission. The terms "discrimination" and "preference," qualified with the additional terms "undue" and "unreasonable" have been construed by our courts to foreclose

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[8/] 34 S.W. 2d 37 (Mo. 1931). The *Laundry* case should be required reading for anyone interested in understanding the anti-discrimination provisions of Section 393.130.2 and 3. There is a very scholarly discussion of the purpose of the law prohibiting undue discrimination and undue preference found there. In *Laundry*, the Court determined that there was undue and unlawful discrimination for failure to give the same rate to all who used water under the same or substantially similar circumstances. In that case the company had a manufacturers rate and refused to give it to laundries, who were not manufacturers but used water the same as manufacturers. Quite obviously, the converse, where one locality is charged the same rate as another locality but the costs to serve each locality are substantially different, is also discrimination.

severance of the close relationship between cost-causers and cost-payers.

The parties heretofore have commented that there appears to be no precedent one way or the other on this issue. We think they may have overlooked several of the important cases in addition to *Laundry, supra*. For example:

In *State ex rel. City of Cape Girardeau v. Public Service Commission*,[9/] the court confirmed rejection of a rate proposal that would have "pass[ed] on to all residential customers within the city the benefits derived from the consumption of one user; it would [have] establish[ed] residential rates which would not reflect the true cost to those individual customers.

In *State ex rel. City of West Plains v. Public Service Commission*,[10/] the Supreme Court noted that a telephone utility's prior tariffs that passed through several individual municipal franchise taxes to ratepayers in other communities that did not impose such taxes was an "unjust discrimination" and upheld tariffs that limited charges for municipal taxes ***only*** to the utility customers ***living within those municipalities***.

And, in *State ex rel. City of Grain Valley v. Public Service Commission*,[11/] the Missouri Court of Appeals held that Southwestern Bell was in violation of Section 392.200, the anti-discrimination statute applicable to telephone companies, for

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[9/] 567 S.W.2d 450, 454 (Mo.App., 1978).

[10/] 310 S.W.2d 925 (Mo. en banc 1958).

[11/] 778 S.W.2d 287 (Mo. App. W.D. 1989)

providing the same service under the same conditions to two localities but charging one locality a different rate than the other locality. This, of course, is the converse to STP, which is the providing of a different service under different conditions to differing localities but charging all localities the ***same*** rates, thereby subjecting some utility service territories (localities) to undue or unreasonable prejudice or disadvantage while granting undue or unreasonable preference or advantage to the other utility service territories (localities) in violation of Subsection 3 of Section 393.130.

C. Operationally Separate Service Districts Have Different Costs.

Most of the water and sewer districts, existing and proposed, are operationally separate. There is no physical connection between these districts. For example, there is no possibility that the water treatment plant, mains or distribution facilities in St. Joseph may be used by the ratepayers in St. Charles, nor can the wells that provide a source of supply in Joplin provide service to customers in Warrensburg. The separate districts are discrete operating entities that have their own unique treatment plants, and their own ***unique*** sources of supply. Costs that are imposed by the provision of service to customers in one district simply do not benefit customers in another district. Utility plant that is used and useful in providing service to customers in St. Charles is not used and useful in providing service to customers in Joplin.

Staff has referenced the cost of water processing as being different. St. Joseph draws supplies from a Rainey well situated alongside the Missouri River (essentially as it did from its old plant although benefiting from the alluvial filtration of the Rainey well).

Joplin draws from wells as does Warrensburg but even those sources differ. Competent hydrogeologists would inform the Commission of the differences in well water from wells that are in the Ozark mountains than from those just south of the Missouri River, with the southern wells drawing water that is far less brackish and requiring less treatment to eliminate sulphur odors. There are other problems with surface water, and each separate district and source requires analysis and different treatment options -- and costs -- to bring the raw water to a finished state. The difference results, among other things, from the extent of glaciation during the most recent ice age.

The touchstone of public utility rate regulation is the rule that one group or class of consumers shall not be burdened with costs created by another group or class. *Coffelt v. Ark. Power & Light Co.*[12]; *Utilities Comm. v. Consumers Council*[13], *Jones v. Kansas Gas & Elect. Co.*[14]

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[12] 248 Ark. 313, 451 S.W. 2d 881 (1970).

[13] 18 N.C. App. 717, 198 S.E. 2d 98 (1973).

[14] 222 Kan. 390, 401, 565 P.2d 597, 606 (1977).

D. When Cost Are Shifted From Cost-Causers, Discrimination Results.

Under Section 393.130.3, an undue or unreasonable preference or advantage is given some districts while other districts are subjected to undue or unreasonable prejudice or disadvantage when the cost recovery is separated from cost causation. Transferring a significant portion of the cost responsibility caused by the use of a physically discrete utility plant and necessitated and caused by the usage of one group of customers in the served to another group of customers in different localities who have or derive no benefit whatever from that utility plant violates Section 393.013.3. Under STP, depending upon the district in which they are located, utility customers are either being subjected to an undue or unreasonable prejudice or disadvantage or are given an undue preference or advantage.

At its most basic, the justification for ignoring these undisputed cost differences is that it will allow the utility Company to spread the costs of its operations over more customers. Just as obviously, those who would otherwise have to pay the costs are given an unreasonable preference; those who have to pay costs that they did not cause are unduly prejudiced.

Spreading one district's discrete costs to the other districts unquestionably will reduce the rate impact on the customer in the ***benefited*** district. Both the common law and Section 393.130 are barriers to discrimination between cost-causers and cost-payers.

There is a useful (though imperfect) analogy in the electric field. Several years ago, the citizens of the State of Missouri, through an initiative Proposition, amended the Public Service Commission statutes to deny the Commission the authority to pass through costs associated with electric plant that was not used and useful. *See*, Section 393.135. Although applicable explicitly only to electric utilities, the section, and the fact that it was passed by an initiative, strongly hints that public sentiment would preclude the use of regulatory devices to charge ratepayers costs that are associated with utility investment that is not used and useful to them.

E. Single Tariff Pricing Is Poor Public Policy and Inconsistent With Objectives of Regulation.

We have noted above the inappropriate nature of STP based on its preferential treatment for some districts and its prejudicial treatment against other districts via its complete and undisputed departure from district by district cost of service. STP is also unreasonable on the same basis. Approaching the question from this perspective reveals an entirely different analysis.

As held in the *Jones* case, *supra*, the relationship between costs and rates is the essence of public utility regulation. Consider for a moment how this relationship came to be recognized.

Public utility regulation was established because the people, through their elected representatives, recognized that

public utility operations were capital intensive and that duplication of competing facilities within a geographical territory was economically inefficient. Accordingly, public utilities were permitted to have a monopoly in a given service territory. Recognizing, however, that monopoly powers were destined to result in abuses, the legislature established a regulatory commission to counterbalance what would otherwise be the unrestrained exercise of monopoly power. The regulatory commission was established as the substitute for competition and was intended to establish, through regulation, a close approximation of the pricing structure that would result if competition were permitted. Thus the *quid pro quo* for the monopolistic rights granted the utility was its submission to regulation and its commitment to safe, adequate and non-discriminatory service to all requesting that service within its monopoly territory.

One of the typical abuses of monopoly power that the regulators were to prevent was the monopolist's ability to enhance or protect its market dominance by overcharging customers for services as to which there was no effective competition, while using the excess monopoly rents gained thereby to subsidize below-cost operations in other areas. Thus was born the companion principle that each separate utility service should, to the maximum extent possible, be priced based on its cost including an approximately equal rate of return for the utility on the value of its investment used to provide that service. To say it in another way, the question was posed: What rate would likely

result if robust competition were permitted? The answer is that no service would be provided at much above or much below cost, because, in either case, and in a competitive environment, either the below-cost supplier would be forced out of business, or competitors would undercut the prices of the above-cost supplier. In all cases, after several iterations, rates that represented a return of the cost to provide the particular service, including a reasonable rate of return on the needed investment, would develop.

Thus approached, the concept of "cost of service" is not limited to the aggregate revenue requirement of the utility, but extends to cover the appropriate pricing of service to customers and groups of customers that are reasonably related as to cost and usage characteristics. Regulation that does not achieve this objective is failing its basic mission and purpose. Regulation that achieves control only of the **aggregate** level of utility revenues is doing an incomplete job. After all, regulation does not exist to benefit the monopoly utility; it exists to protect the public from the abuses of monopoly.

This case demonstrates the effect of abandoning these basic principles of public utility regulation. Cost differences between physically discrete service districts are acknowledged as present, but then dismissed or ignored under STP.

There are other practical reasons behind cost-based rates, including:

- ***Cost based DSP rates send proper price signals to utility customers***. They permit appropriate evaluation

of alternatives such as housing insulation, electric appliances, selection of manufacturing equipment on efficiencies, and (in this case) the evaluation of the cost of the use of scarce resources such as water, whether to install more efficient plumbing fixtures or engage in "zero-scaping" to reduce lawn-watering. They promote wise use of resources and meaningful comparison of available alternatives. In some instances, they may even cause previously unexplored alternatives to become economic.

- ***Cost based DSP rates provide appropriate public feedback for the utility regarding its investment and encourage prudence in making that investment***. If rates do not track costs, or if ratepayers are over-charged or under-charged, customer reaction to the costs associated with utility investment will be misdirected and inappropriate. Excessive investment will be inhibited by the fear of public scrutiny and wrath.

  There is an example of this available in Missouri-American's construction of the new St. Joseph plant. Well-documented in the record of the WR-2000-281 case, MAWC urged community support of the construction, arguing that St. Joseph would only bear one-third of the new plant's cost, with the remainder spread to other districts. When a 80%-250% increase in rates arrived (depending on the meter size), there was much outcry. Assurance of district specific pricing would prevent a recurrence and avoid overbuilding when district service parameters do not support the size of a construction project.

- ***Cost based DSP rates do not mask the true costs of an acquisition by one utility of another district.*** A utility business plan to acquire another service district (or several) should be similar to that involved in a main extension question: Does the additional business justify the investment? An up-front loss may be required in order to earn future returns.[15/]

- ***Cost based DSP rates provide earnings stability for the utility***. When customer usage patterns shift, utility revenues will shift. If rates are tied to costs, costs will also shift in synchrony with changes in usage patterns; utility earnings will remain stable. Conversely, if rates and costs are not related, customer

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[15/] It is occasionally forgotten that utilities are only guaranteed an ***opportunity*** to earn a reasonable return. Prudent management is still required.

> usage shifts will still change revenues, but underlying costs may not change with resultant instability and unpredictability in utility earnings.

In *In re Gas Service Company*,[16/] this Commission ruled:

> Above all, in the opinion of the Commission, *the **touchstone** of rate design is that the rates must and should reflect the cost to serve that particular customer or group of customers*. To depart from this basic principle will place the regulator in a never-never land wherein he can design rates to suit his own particular whim or caprice, or satisfy his own preconceived ideas of how society should be charged for services. [Emphasis added].

III. CONCLUSION.

The Commission of today should recognize the validity of these well-established principles. By promoting STP, utilities seek to ignore costs, how costs are incurred, and for whose benefit costs are incurred. STP should not enjoy a resurgence.

AGP has listened to several arguments that attempt to justify socialization of utility costs. But AGP picked up and continues to pick up its tab for the new St. Joseph plant. We did not ask for a subsidy from another MAWC district. Though more costly, we advocated DSP because that was the proper approach. Having once paid its dues, AGP does now not wish to pay those of another. We respectfully urge that DSP be retained and that STP be rejected.

Respectfully submitted,

[16/] 21 Mo. P.S.C. (N.S.) 262 (1976).

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ATTORNEYS FOR AG PROCESSING INC A COOPERATIVE

SERVICE CERTIFICATE

I certify that I have caused a true copy of the foregoing pleading to be provided to parties of record in this proceeding through electronic service upon the addresses provided by the EFIS.

December 22, 2010

An attorney for Ag Processing Inc a Cooperative

1 of 2 DOCUMENTS

Positive
As of: May 30, 2008

STATE ex rel. AG PROCESSING, INC., Appellant, v. PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI and AQUILA, INC., f/k/a/ UtiliCorp United, Inc., Respondents.

No. SC85352

SUPREME COURT OF MISSOURI

120 S.W.3d 732*; *2003 Mo. LEXIS 142

October 28, 2003, Filed

PRIOR HISTORY: **[**1]** APPEAL FROM THE CIRCUIT COURT OF COLE COUNTY. The Honorable Byron L. Kinder, Judge.
State ex rel. AG Processing v. PSC of Mo., 2003 Mo. App. LEXIS 764 (Mo. Ct. App., Apr. 22, 2003)

DISPOSITION: Reversed and remanded.

CASE SUMMARY:

PROCEDURAL POSTURE: Respondent applicants entered into a merger agreement and applied for approval of the merger with respondent public service commission. Appellant corporation intervened and sought disapproval of the merger. The commission approved the merger, but rejected the proposed regulatory plan. On appeal, the Circuit Court of Cole County (Missouri) affirmed the commission's order. The intervenor sought further review.

OVERVIEW: The applicants were regulated public utilities. The public service commission (PSC) staff opposed the merger and recommended its rejection as being against the public interest, because the proposed recovery of the acquisition adjustment required that customers paid costs that were properly assignable to the applicants' shareholders. The Missouri Supreme Court reversed the PSC order approving the merger, because the PSC erred when determining whether to approve the merger when it failed to consider and decide all the necessary and essential issues, primarily the issue of recoupment of an acquisition premium. With respect to the other issues, (1) the corporation failed to show by clear and satisfactory evidence that the applicants were required to submit a market power study, (2) the credit rating issue was without merit, because it depended on the regulatory plan, which was not approved, and (3) the PSC findings and conclusions on the issue of the risk of an increased cost of debt were not unreasonable.

OUTCOME: The circuit court's judgment was reversed, and the case was remanded with instructions to remand the case to the public service commission for consideration of the issue of recoupment of the acquisition premium in conjunction with the other issues raised by commission's staff and the intervenors in making its determination of whether the merger was detrimental to the public.

LexisNexis(R) Headnotes

Administrative Law* > *Judicial Review* > *General Overview
***Energy & Utilities Law* > *Administrative Proceedings* >**

General Overview
Evidence > Inferences & Presumptions > Presumption of Regularity
[HN1] Pursuant to *Mo. Rev. Stat. § 386.510* (2000), the appellate standard of review of a public service commission (PSC) order is two-pronged: first, the reviewing court must determine whether the PSC order is lawful; and second, the reviewing court must determine whether the order is reasonable. The burden of proof is upon an appellant to show that the order or decision of the PSC is unlawful or unreasonable. The lawfulness of a PSC order is determined by whether statutory authority for its issuance exists, and all legal issues are reviewed de novo. An order's reasonableness depends on whether it is supported by substantial and competent evidence on the whole record, and the reviewing court considers the evidence together with all reasonable supporting inferences in the light most favorable to the PSC order. The PSC factual findings are presumptively correct, and if substantial evidence supports either of two conflicting factual conclusions, the reviewing court is bound by the findings of the administrative tribunal. The procedure provided for judicial review in *§ 386.510* is exclusive and jurisdictional.

Business & Corporate Law > Mergers & Acquisitions > General Overview
Energy & Utilities Law > Administrative Proceedings > Public Utility Commissions > Authority
Energy & Utilities Law > Administrative Proceedings > Public Utility Commissions > Judicial Review
[HN2] *Mo. Rev. Stat. § 393.190.1* (2000) requiring the issuance of a merger approval order from the public service commission (PSC), provides the lawful authority for the PSC decision. *Mo. Rev. Stat. §§ 386.040, 393.190* (2000). Once the PSC decision is found to be lawful, the reviewing court must examine its reasonableness. Reasonableness turns on the standard used to evaluate a merger subject to approval by the PSC, which is whether or not the merger would be detrimental to the public. *Mo. Code Regs. Ann. tit. 4, §§ 240-2.060(7)(D), 240-2.060(8)(D), 240-3.115*.

Business & Corporate Law > Mergers & Acquisitions > General Overview
Energy & Utilities Law > Administrative Proceedings > Public Utility Commissions > Authority
Energy & Utilities Law > Utility Companies > Rates > General Overview
[HN3] The fact that an acquisition premium recoupment issue can be addressed in a subsequent ratemaking case does not relieve the public service commission (PSC) of the duty of deciding it as a relevant and critical issue when ruling on a proposed merger. While the PSC may be unable to speculate about future merger-related rate increases, it can determine whether the acquisition premium is reasonable, and it should consider it as part of the cost analysis when evaluating whether a proposed merger would be detrimental to the public. The PSC refusal to consider this issue in conjunction with the other issues raised by the PSC staff might substantially impact the weight of the evidence evaluated to approve the merger. The PSC errs when determining whether to approve a merger where it fails to consider and decide all the necessary and essential issues, primarily the issue of recoupment of an acquisition premium.

Business & Corporate Law > Mergers & Acquisitions > General Overview
Energy & Utilities Law > Administrative Proceedings > Public Utility Commissions > Authority
Energy & Utilities Law > Utility Companies > Rates > General Overview
[HN4] The burden of proof outlined in *Mo. Rev. Stat. § 393.150.2* (2000) pertains to ratemaking cases and not mergers. In the context of a merger, it is an appellant's burden to show that the public service commission errs by failing to order applicants to submit a market power study as part of their application for approval of a merger. *Mo. Rev. Stat. § 386.430* (2000).

Energy & Utilities Law > Administrative Proceedings > Public Utility Commissions > General Overview
Governments > Courts > Judicial Precedents
[HN5] An administrative agency is not bound by stare decisis, nor are public service commission decisions binding precedent on the Missouri Supreme Court.

COUNSEL: Stuart W. Conrad and Jeremiah D. Finnegan, Kansas City, Missouri for APPELLANT

Steven Dottheim, Dana K. Joyce, Missouri Public Service Commission, Paul A. Boudreau and Sondra B. Morgan, Jefferson City, Missouri, for RESPONDENTS.

JUDGES: Ronnie L. White, Chief Justice. Wolff, Benton, Stith, Teitelman and Limbaugh, JJ., And Draper, Sp.J., concur. Price, J., not participating.

OPINION BY: Ronnie L. White

OPINION

[*733] I.

AG Processing, Inc. ("AGP"), appeals the judgment of the circuit court affirming the decision of the Missouri Public Service Commission ("PSC" or "Commission") approving the merger of UtiliCorp United, Inc. ("UtiliCorp," now renamed Aquila, Inc.) and St. Joseph Light & Power Company ("SJLP"). [1] Reversed and remanded.

1 UtiliCorp, a Delaware corporation with its principal office and place of business in Kansas City, Missouri, provides electrical and natural gas utility services in Missouri through its Missouri Public Service (MPS) operating division. SJLP, a Missouri corporation with its principal office and place of business located in St. Joseph, Missouri, provides electricity, natural gas, and industrial steam to a number of industrial customers. AGP, an agricultural cooperative and manufacturer and processor of soy-related and other grain products, is a major purchaser of electricity and industrial steam from SJLP.

[2]** UtiliCorp and SJLP (collectively "Applicants") entered into a merger agreement and, with shareholder consent, filed a joint application with the PSC seeking approval. [2] The Applicants submitted a five-year regulatory plan providing, *inter alia*, a five-year rate moratorium on rate increases, barring catastrophic circumstances, in return for which the PSC would order no rate decreases during the same five years. The plan also addressed recovery of the $ 92,000,000 acquisition premium associated with the merger.

2 The agreement provided that SJLP shareholders were to receive a fixed value of $ 23 per share for their SJLP common stock, which was to be converted into shares of UtiliCorp common stock. The equity that UtiliCorp was required to issue to exchange shares of its stock for SJLP's stock totaled $ 190,000,000 and, with the SJLP indebtedness assumed by UtiliCorp, brought the total cost of the merger to approximately $ 270,000,000.

The PSC conducted an evidentiary hearing on the proposed merger and regulatory **[**3]** plan. AGP intervened seeking disapproval of the merger or conditional approval **[*734]** assuring that the ratepayers of SJLP would be shielded from any possible detriment and would receive the full benefit of the merger's resulting savings as opposed to having those benefits retained by the surviving corporate entity during the rate moratorium. [3]

3 Other intervenors included the City of Springfield, Missouri, Union Electric Company, d/b/a AmerenUE, and the Missouri Department of Natural Resources.

In addition to the evidence offered by AGP at the hearing, PSC staff testified that they opposed the merger and recommended its rejection as being against the public interest. Staff members testified that the proposed recovery of the acquisition adjustment would require customers to inappropriately pay for costs properly assignable to the shareholders and that the ratepayers would receive an insignificant portion of total merger savings with the majority of the savings being retained by UtiliCorp.

Other objections raised **[**4]** by the PSC staff and the intervenors included claims that the merger would result in UtiliCorp acquiring an undue and anti-competitive concentration of market power detrimental to ratepayers. It was also asserted that the credit rating of the surviving entity would be the lower triple-B rating of UtiliCorp as opposed to the A rating of SJLP, resulting in higher interest rates on the debt held by the merging corporations, a financial risk for SJLP ratepayers. A further objection concerned Applicants' Exhibit 503, a worksheet prepared by the Applicants in response to a data request from AGP, pursuant to *4 CSR 240-2.090(2)*, asking that UtiliCorp provide a description of the method used for the allocation of the acquisition premium. Exhibit 503's allocation of costs and premiums from the merger projected an annual detriment of $ 34,000 to SJLP's steam customers and $ 35,000 to its natural gas customers.

PSC approved the merger, but rejected Utilicorp's proposed regulatory plan. On appeal, the circuit court affirmed, finding the PSC's approval order to be both lawful and reasonable. Transfer was granted after opinion by the Court of Appeals, Western District, **[**5]** *Mo. Const. art. V, section 10.* [4]

4 Portions of this opinion follow the legal analysis of Court of Appeals' opinion authored the Honorable Judge Edwin H. Smith and are incorporated without further attribution.

II.

[HN1] Pursuant to *section 386.510*, the appellate standard of review of a PSC order is two-pronged: "first, the reviewing court must determine whether the PSC's order is lawful; and second, the court must determine whether the order is reasonable." [5] The burden of proof is upon the appellant to show that the order or decision of the PSC is unlawful or unreasonable. [6] The lawfulness of a PSC order is determined by whether statutory authority for its issuance exists, and all legal issues are reviewed *de novo*. [7] An order's **[*735]** reasonableness depends on whether it is supported by substantial and competent evidence on the whole record, and the appellate court considers the evidence together with all reasonable supporting inferences in the light most favorable to the Commission's **[**6]** order. [8] The Commission's factual findings are presumptively correct, and if substantial evidence supports either of two conflicting factual conclusions, the Court is bound by the findings of the administrative tribunal." [9] The procedure provided for judicial review in *section 386.510* is exclusive and jurisdictional. [10]

5 *Section 386.510* (all statutory references are to RSMo 2000 unless otherwise noted); *State ex rel. Atmos Energy Corp. v. PSC, 103 S.W.3d 753, 759* (Mo. banc 2003); *Love 1979 Partners v. Public Service Com'n of Missouri, 715 S.W.2d 482, 485-486* (Mo. banc 1986). See also *Mo. Const. art. 5, section 18*; *Union Electric Company v. Clark, 511 S.W.2d 822, 824-825 (Mo. 1974)*.

6 *Section 386.430*; *State ex rel. Associated Natural Gas Co. v. Public Service Com'n of State of Mo., 37 S.W.3d 287, 292 (Mo. App. 2000)*; *State ex rel. City of St. Louis v. Public Service Com'n of Missouri, 335 Mo. 448, 73 S.W.2d 393, 397* (Mo. banc 1934).

[7]**

7 *State ex rel. Alma Telephone Co. v. Public Service Com'n, 40 S.W.3d 381, 387 (Mo. App. 2001)*; *Atmos, 103 S.W.3d at 759*.

8 *Alma, 40 S.W.3d at 387*.

9 *Atmos, 103 S.W.3d at 759*; *Amway Corp. Inc. v. Director of Revenue, 794 S.W.2d 666, 668* (Mo. banc 1990).

10 *Clark, 511 S.W.2d at 825*.

III.

There is no dispute that the Applicants are regulated utilities under *chapter 393*. [11]

11 See also *sections 386.020(15), (18), and (20)*.

Section 393.190.1, [HN2] requiring the issuance of a merger approval order from the PSC, provides the lawful authority for the PSC's decision. [12] Having found the PSC's decision to be lawful, the Court must examine its reasonableness. Reasonableness turns on the standard used to evaluate a merger subject to approval by the PSC, **[**8]** which is whether or not the merger would be "detrimental to the public." [13]

12 *Sections 386.040 & 393.190*; *Atmos, 103 S.W.3d at 756*.

13 *City of St. Louis, 73 S.W.2d at 400*; *4 CSR 240-2.060(7)(D)* & *(8)(D)*, effective April 30, 2000 through April 29, 2003; and *4 CSR 240-3.115* effective since April 30, 2003.

AGP raises three points on appeal in its attempt to establish that the merger is a detriment to the public. AGP claims that the PSC's approval of the merger was not supported by competent and substantial evidence upon the whole record because: (1) when determining that the merger was not detrimental to the public, the PSC rejected the unrefuted and contrary evidence of its own staff and refused to consider the recoupment of the acquisition premium; (2) the PSC impermissibly shifted the burden of proof of *section 393.150* from the applicants to the intervenors **[**9]** by failing to require the applicants to prepare and submit a market power study; and (3) the applicant's own evidence established the merger was a public detriment because UtiliCorp's Exhibit 503 demonstrated an annual increased cost allocation of $ 34,000 to SJLP's steam customers and $ 35,000 to its natural gas customers, and the merger would result in a drop in SJLP's credit rating, increasing the interest rate on the corporation's debt.

Applicants respond by arguing that the decision to approve the merger was supported by substantial evidence, that all contrary evidence presented at the hearing was refuted, and that the burden of proof did not shift as a result of not having to produce a market power

survey. [14] The PSC also maintains that considering recoupment of the $ 92,000,000 acquisition premium while considering approval of the **[*736]** merger amounts to prejudging a ratemaking factor outside a ratemaking case.

14 The reasons cited for the approval included: (1) continued provision of quality day-to-day utility service at reasonable rates; (2) strengthening of the competitive position and financial condition of the combined entity would support an investment grade bond rating; (3) expanded asset base, increased revenues and improved cash flows would increase access to capital markets on more reasonable terms; and (4) the merger would result in significant synergies from generation, economies of scale, and efficiencies realized from the elimination of duplicate corporate and administrative services, ultimately resulting in lower operational costs translating into lower rates for utility service.

[10]** [HN3] The fact that the acquisition premium recoupment issue could be addressed in a subsequent ratemaking case did not relieve the PSC of the duty of deciding it as a relevant and critical issue when ruling on the proposed merger. While PSC may be unable to speculate about future merger-related rate increases, it can determine whether the acquisition premium was reasonable, and it should have considered it as part of the cost analysis when evaluating whether the proposed merger would be detrimental to the public. [15] The PSC's refusal to consider this issue in conjunction with the other issues raised by the PSC staff may have substantially impacted the weight of the evidence evaluated to approve the merger. [16] The PSC erred when determining whether to approve the merger because it failed to consider and decide all the necessary and essential issues, primarily the issue of UtiliCorp's being allowed to recoup the acquisition premium.

15 See *State ex rel. Martigney Creek Sewer Co. v. Pub. Serv. Comm'n, 537 S.W.2d 388, 399* (Mo. banc 1976) (stating that, for ratemaking purposes, recovery of the cost of an asset acquired from another utility depends on the reasonableness of the acquisition, considering the factors of whether the transaction was at arm's length, if it resulted in operating efficiencies, and if it made possible a desirable integration of facilities).

[11]**

16 PSC staff had also testified that their analysis of the merger demonstrated that the expected rate impact on SJLP and MPS customers would be negative. Merger costs potentially assignable to the ratepayers included transaction costs, transition costs and administrative costs. Ninety-three percent of the projected merger savings could have been achieved on a "stand alone" basis without the merger, and there was no plan to assign these savings to the customers. Projected merger savings were, in fact, illusory and PSC staff calculated costs exceeding savings by $ 68.9 million during the ten-year period following the merger.

With regard to AGP's second point, burden shifting in relation to producing a market power study, [HN4] the burden of proof outlined in *section 393.150.2* as cited by AGP pertains to ratemaking cases and not mergers. In proper context, it is AGP's burden as the appellant to show on appeal that the PSC erred by failing to order the Applicants to submit a market power study as part of their application for approval of the merger. [17] In support of its claim **[**12]** that the Applicants were required to submit a market power study, AGP cites several prior PSC decisions in which the PSC required merger applicants to file market power studies. However, [HN5] an administrative agency is not bound by *stare decisis*, nor are PSC decisions binding precedent on this Court. [18] AGP fails in its burden to show by clear and satisfactory evidence that Applicants were required to submit a market power study. [19]

17 See footnote 6.

18 *State ex rel. GTE N. Inc. v. Mo. Pub. Serv. Comm'n, 835 S.W.2d 356, 371 (Mo. App. 1992)*; *Cent Hardware Co., Inc. v. Dir. Of Revenue, 887 S.W.2d 593, 596* (Mo. banc 1994).

19 *Section 386.430*; *State ex rel. Midwest Gas Users' Ass'n v. Public Service Com'n of State, 976 S.W.2d 485, 492 (Mo. App. 1998)*.

AGP's final allegation of public detriment from the merger involves UtiliCorp's Exhibit 503, which according to AGP establishes detrimental cost allocations to SJLP's steam **[**13]** and natural gas customers. Additionally, AGP claims the merger will lower SJLP's credit rating resulting in higher interest rates on debt, raising costs for the ratepayers. With regard to the first part of this point,

the cost allocations in question were dependent on the rejected five-year regulatory plan, and, consequently, this claim is without merit.

[*737] Addressing the second part of this point, UtiliCorp's credit rating of BBB, while lower than SJLP's current rating, is still considered to be investment grade. No evidence was presented that would quantify how the cost of debt attributable to SJLP would increase, and even if it is assumed that the merger will increase the cost of debt for SJLP's ratepayers, that fact alone does not require the Commission to reject the merger. The risk of an increased cost of debt is just one factor for the Commission to weigh when deciding whether or not to approve the merger, and based on the evidence in the record, the PSC's findings and conclusions were not unreasonable concerning this issue.

IV.

The judgment is reversed, and the case is remanded. The circuit court shall remand the case to the PSC to consider and decide the issue of **[**14]** recoupment of the acquisition premium in conjunction with the other issues raised by PSC staff and the intervenors in making its determination of whether the merger is detrimental to the public. Upon remand the Commission will have the opportunity to reconsider the totality of all of the necessary evidence to evaluate the reasonableness of a decision to approve a merger between UtiliCorp and SJLP.

Ronnie L. White, Chief Justice

Wolff, Benton, Stith, Teitelman and Limbaugh, JJ., And Draper, Sp.J., concur. Price, J., not participating.