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C.A. TURNER UTILITY REPORTS

THE INVESTOR'S EDGE

ELECTRIC COMPANIES

NATURAL GAS COMPANIES

TELEPHONE COMPANIES

WATER COMPANIES

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Attachment 1

TELEPHONE COMPANIES

COMPANY	OPER REV $ MILL (1)	% TEL REV LOCAL OR CLEC	NET PLANT $ MILL	NET PLANT PER $ REV (1)	S&P BOND RATING	MOODY'S BOND RATING	COMMON EQUITY RATIO (3)	% RETURN ON BOOK VALUE COMMON EQUITY (4)	% RETURN ON BOOK VALUE TOTAL CAPITAL	REGULATION ALLOWED ROE	REGULATION ORDER DATE
ALLTEL Corporation (NYSE-AT)	8,109.9	43	7,581.7	0.93	A	A2	54	15.0	10.6	-	-
AT&T Corp. (NYSE-T)	35,720.0	72	24,719.0	0.69	BBB	Baa2	44	3.2	3.5	-	-
BCE, Inc. (NYSE-BCE)	13,923.4	32	15,683.0	1.13	A	A3	36	20.4	10.9		
BellSouth Corporation (NYSE-BLS)	22,585.0	82	23,765.0	1.05	A+	Aa3	57	18.3	12.9	-	-
CenturyTel, Inc. (NYSE-CTL)	2,360.3	88	3,455.2	1.46	BBB+	Baa2	51	9.5	7.9	-	-
Cincinnati Bell Inc. (NYSE- CBB)	1,749.7	53	923.2	0.53	B+	Ba2	NM	NM	NM	13.00	01/99
Citizens Communications (NYSE-CZN)	2,540.6	81	3,568.8	1.40	BBB	Baa2	24	5.3	8.0	-	-
Commonwealth Telephone Ent. (NDQ-CTCO)	332.7	65	410.8	1.23	NR	NR	42	25.8	19.8	-	05/02
General Communication, Inc. (NDQ-GNCMA)	379.3	10	394.5	1.04	NR	B2	34	6.2	7.7		
Qwest Communications International (NYSE-Q)	14,504.0	97	18,363.0	1.27	CCC	B1	NM	4.1	3.7	11.11	-
RCN Corporation (NDQ-RCNC)	396.0	37	1,097.5	2.77	NR	Ca	NM	17.0	NM		
SBC Communications Inc. (NYSE-SBC)	41,993.0	87	51,983.0	1.24	A+	Aa3	67	21.1	15.5	11.99	-
Sprint Corporation (NYSE-FON)	14,308.0	43	16,159.0	1.13	BBB+	A3	82	4.4	4.6	12.27	-
Telephone & Data Systems, Inc. (ASE-TDS)	3,349.1	24	3,248.6	0.97	A-	A3	42	0.7	2.9	-	-
Verizon Communications (NYSE-VZ)	67,477.0	58	75,098.0	1.11	A+	A1	34	21.2	8.6	12.25	-
AVERAGE							47	12.3	9.0	12.12	

SMALL TELEPHONE COMPANIES

COMPANY	OPER REV $ MILL (1)	% TEL REV LOCAL OR CLEC	NET PLANT $ MILL	NET PLANT PER $ REV (1)	S&P BOND RATING	MOODY'S BOND RATING	COMMON EQUITY RATIO (3)	% RETURN ON BOOK VALUE COMMON EQUITY (4)	% RETURN ON BOOK VALUE TOTAL CAPITAL	REGULATION ALLOWED ROE	REGULATION ORDER DATE
Atlantic Tele-Network, Inc. (ASE-ANK)	77.2	41	87.1	1.13	NR	NR	79	17.0	12.3		
CT Communications, Inc. (NDQ-CTCI)	157.4	60	209.4	1.33	NR	NR	67	11.7	8.5	-	-
D&E Communications, Inc. (NDQ-DECC)	178.0	79	192.9	1.08	NR	NR	45	NM	3.8	-	-
Hector Communications Corp. (ASE-HCT)	38.8	72	44.0	1.13	NR	NR	42	9.5	7.0	-	-
Hickory Tech Corporation (NDQ-HTCO)	104.2	55	111.2	1.07	NR	NR	25	NM	NM	-	-
North Pittsburgh Systems, Inc. (NDQ-NPSI)	103.7	24	88.1	0.85	NR	NR	68	17.2	13.1	-	-
SureWest Communications (NDQ-SURW)	195.4	60	333.7	1.71	NR	NR	72	1.9	2.6	-	-
US LEC Corp. (NDQ-CLEC)	301.3	64	166.0	0.55	NR	NR	NM	12.0	NM		
Warwick Valley Telephone Co. (NDQ-WWVY)	28.6	48	39.4	1.38	NR	NR	83	23.0	19.3	-	-
AVERAGE							60	13.2	9.5		

recent opportunity to file additional evidence leads me to believe that a hearing should be held to elicit adequate evidence to make findings on those issues. For this reason, I respectfully dissent.

In the matter of St. Joseph Light & Power Company's proposed tariffs to increase rates for electric service provided to customers in the Missouri service area of the Company.

The Staff of the Missouri Public Service Commission, Complainant, vs. St. Joseph Light & Power Company, a Missouri corporation, Respondent.

Case Nos. ER-93-41 & EC-93-252
Decided June 25, 1993

Electric §1. SJLP had submitted tariffs designed to increase its revenue requirement on an annual basis by $6.1 million. Staff subsequently filed a complaint alleging that SJLP's revenues should be reduced by approximately $7 million. The Commission ordered SJLP to file tariffs designed to reduce revenues by $875,880.

Return §§4, 5. The Commission adopted Public Counsel's capital structure because SJLP's actual capital structure contained an equity ratio higher than normal for a regulated utility. SJLP's capital structure included 58 percent common equity while Public Counsel's hypothetical capital structure included 52 percent common equity. The Commission may adopt a hypothetical capital structure when the actual capital structure is outside a reasonable range.

Return §§17, 32. The Commission, in adopting Staff's rate of return on equity, adjusted it upward by 40 basis points to 11.67 percent. The upward adjustment was made to recognize SJLP's increased risk from its smaller size, components of capital structure adopted by the Commission and other factors.

Expense §17. The Commission denied SJLP's request to include $755,700 for complying with the Commission's Integrated Resource Planning Rule in its cost of service as being projected costs outside the test year thus not known and measurable.

APPEARANCES:

Gary Meyers, General Counsel & Secretary, 520 Francis Street, P.O. Box 998, St. Joseph, Missouri 64502, for St. Joseph Light & Power Company.

James C. Swearengen and *Gary W. Duffy*, Attorneys at Law, Brydon, Swearengen & England, 312 E. Capitol Avenue, P.O. Box 456, Jefferson City, Missouri 65102, for St. Joseph Light & Power Company.

David A. Baird, Attorney at Law, 1226 Parkdale Road, Maryville, Missouri 64468, for the City of Maryville, Missouri.

William M. Barvick, Attorney at Law, 231 Madison Street, Suite 301, Jefferson City, Missouri 65101, for AG Processing, Inc.

Attachment 2

Lewis R. Mills, Jr., First Assistant Public Counsel, P.O. Box 7800, Jefferson City, Missouri 65102, for Office of the Public Counsel and the Public.

Robert J. Hack, Deputy General Counsel, *Steven R. Dottheim*, Deputy General Counsel, *William M. Shansey*, Assistant General Counsel, *Eric B. Witte*, Assistant General Counsel, *Thomas R. Schwarz*, Assistant General Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

HEARING EXAMINER: Janet L. Sievert

REPORT AND ORDER

Procedural History

On August 7, 1992, St. Joseph Light & Power Company (SJLPC) submitted to this Commission tariffs reflecting increased rates for electric service provided to customers in the Missouri service area of the company. The proposed tariffs bear a requested effective date of September 7, 1992. The proposed tariffs are designed to produce an increase of approximately 8.8 percent ($6.1 million) in charges for electric service. On September 1, 1992, the Commission suspended the tariffs to July 5, 1993, and established a procedural schedule. On February 24, 1993, the Staff of the Missouri Public Service Commission (Staff) filed a complaint against SJLPC alleging that SJLPC's current rates are excessive and are not just and reasonable. Staff alleged in its complaint that SJLPC's revenues should be reduced by approximately $7 million in order to produce a fair and reasonable rate of return for SJLPC.

Pursuant to the procedural schedule, prefiled testimony was filed. The hearings in this matter were held on April 19-23, 1993, as scheduled. Briefs were filed pursuant to the briefing schedule.

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.

Capital Structure/Return on Equity

Capital structure is the relationship between a company's debt and equity. Capital structure generally influences the overall cost of capital. It is assumed that there is an optimum structure that will produce the minimum cost. A utility must meet its obligations and maintain a flexible capital structure so that it can raise capital whenever necessary. Additionally, the capital structure should result in the ability to generate the needed financing at a reasonable cost. Capital structure is based on the relationship between a company's debt and equity percentages. The most difficult and most important issue in the determination of a company's revenue requirement is that of finding the appropriate return on common stock equity. Common stock equity is the foundation of the capital structure and makes it possible for a company to borrow funds or to sell debt securities. Each of the parties in this proceeding has developed proxy groups to validate the capital structure it is supporting. Each has used different criteria to select and to develop its proxy group.

SJLPC proposes that the actual capital structure as of September 30, 1992, updated to December 31, 1992, including a capital lease obligation related to the Cooper-Fairport-St. Joseph (CFSJ) line, be used to establish its rate of return. SJLPC, therefore, is recommending a capital structure of 40.10% long-term debt, 57.93% common equity and 1.97% capital lease obligation. SJLPC has no preferred stock or short-term debt. SJLPC states that its proxy group's capital structure has an average of 46.7% long-term debt with a range of 38.9% to 52.4%, an average of 53.3% equity component which includes preferred as well as common stock, with a range of 47.6% to 61.1% and no preferred stock or short-term debt. SJLPC argues that the average capital structure of its proxy group demonstrates that its capital structure is reasonable.

Staff proposes to use a hypothetical capital structure in determining SJLPC's capital structure. Staff contends that its review of SJLPC's capital structure has disclosed an equity ratio that, in Staff's assessment, is higher than normal for a regulated utility. Staff states that its proxy group's long-term debt ranges from 47.15% to 50.32% with an average of 48.80%, preferred stock ranges from 4.47% to 10.96% with an average of 6.91%, common equity ranges from 39.30% to 47.5% with an average of 44.29% and no short-term debt. Based on the proxy group, Staff proposes a hypothetical capital structure of 49.47% long-term debt, 5.71% preferred stock, 44.82% common equity and no short-term debt. Staff states that it included preferred stock in its capital structure, even though SJLPC has no preferred stock, because its use is prevalent among similar companies in the electric utility industry and it is a less expensive form of capital (on a pre-tax basis) than either debt or common equity. Furthermore, Staff states that it is proposing the hypothetical capital structure because it does not appear to be detrimental to SJLPC's credit rating and it will lower capital costs, benefiting ratepayers through lower rates. Staff, in the alternative, proposes that if the Commission does not adopt its hypothetical capital structure, that SJLPC's actual capital structure without any adjustments, as of December 31, 1992, of 40.90% long-term debt and 59.10% common equity (SJLPC has no preferred stock or short-term debt) be used to establish a return on equity for SJLPC. Staff does not include a capital lease component in SJLPC's actual capital structure.

Even though AGP did not actually propose a hypothetical capital structure for SJLPC, its proxy group resulted in an average long-term debt of 48.6%, an average preferred stock of 6.6% and an average common stock of 44.8%. AGP used these percentages in its discount cash flow calculations to determine its proposed return on equity, which is discussed below.

Public Counsel proposes a hypothetical capital structure consisting of 48.29% long-term debt and 51.71% common equity. Public Counsel did not make an adjustment for the CFSI lease line. Public Counsel's proxy group has a capital structure of 48.29% long-term debt, which incudes 5.76% preferred stock, 47.903% common equity, which is the average range for the years 1989-1992, and no short-term debt. The standard deviation of Public Counsel's proxy group is 3.78% and the interval about the mean that falls within plus or minus one standard deviation is 44.15% to 51.71% equity. Public Counsel advocates that the equity ratio of 44.15% to 51.71% represents the appropriate "zone of reasonableness" for utilities with operating characteristics similar to SJLPC.

Public Counsel states it established the following criteria upon which to develop its proxy: (1) publicly traded, (2) no Missouri regulated operations, (3) percentage of electric revenues greater than seventy (70) percent, (4) covered by Value Line, (5) no diversified or non-regulated operations, (6) total capital less than $6 million, total revenues less than $3.5 million, and (8) a Standards and Poor's bond rating BBB+ or greater. Public Counsel states that from this criteria it established its eleven (11) company proxy group composed of mid-sized, non-diversified, non-nuclear, mid-western electric and electric/gas utilities which are a fair and reasonable characterization of the operations of SJLPC.

Public Counsel states that in calculating the long-term debt it included 5.76% of preferred stock, the average level of preferred stock contained in the capital structures of the comparable companies. Public Counsel reasoned that it is appropriate to allocate all of the preferred stock to long-term debt in the hypothetical capital structure because the average cost of the preferred stock issued by the eleven (11) comparable companies is actually below the cost of long-term debt for SJLPC and preferred stock possesses more characteristics of long-term bonds than common equity. Public Counsel's evidence showed that preferred stock is considered a hybrid security, but is more similar to long-term debt than preferred stock. Public Counsel asserts preferred stock, like bonds: (1) provides investors with prior claims on income and assets, (2) the level of current income is usually fixed for the life of the issue, (3) can carry call features and sinking fund provisions, (4) a firm can have more than one issue of preferred stock outstanding at any point in time, and (5) it usually trades on the basis of its yield and is, in fact, priced in the marketplace like fixed-income obligations and, as a result, is considered by many investors to be competitive with bonds.

The portion of common equity in a company's capital structure is important for ratemaking purposes because common equity is the most expensive form of capital. The cost differential between common equity and debt is even greater when the income tax treatment of debt is considered. Interest expense or the cost of debt is tax-deductible, while dividends to shareholders are not. The evidence clearly demonstrates that Staff, Public Counsel and AGP support the position that SJLPC's capital structure is too heavily weighted with common equity. The Commission agrees that SJLPC's capital structure is too heavily weighted with equity. In comparing SJLPC's own assessment of its capital structure with that of its proxy group's average capital structure, the Commission cannot find that SJLPC's capital structure is even in line with its own proxy group. SJLPC's long-term debt ratio of 40.10% is nowhere near the proxy group's long-term debt average of 46.7% which includes only one company with long-term debt lower than that of SJLPC. Similarly, SJLPC's proxy group contains only one company with a common equity ratio higher than its own. The second highest common equity ratio in its proxy group is 51.2%, which is not even close to SJLPC's own equity level of 57.93%. The average common equity of the proxy group is 53.3%, which the Commission, unlike SJLPC, does not believe places SJLPC's common equity of 57.93% reasonably close to its proxy group's average. The Commission cannot support a capital structure for a company such as SJLPC that is so heavily weighted with common equity. The Commission, in its duty to protect the ratepayers, cannot establish rates based on this skewed capital structure. The Commission is of the opinion that if SJLPC chooses to continue with its current debt/equity ratio then its stockholders should bear the burden of its management's decisions and not the ratepayers.

Therefore, the Commission finds that the hypothetical capital structure as proposed by Public Counsel should be used in setting rates in this proceeding. The Commission is aware that each party in this proceeding developed its proxy group with the criteria it believes to be the most relevant. The Commission finds Public Counsel's hypothetical capital structure the more reasonable alternative to the other proposals. The evidence shows that the eleven (11) companies which comprise Public Counsel's proxy group are representative of SJLPC's operations. The Commission finds it particularly relevant that none of the companies in Public Counsel's proxy group have any nuclear facilities, as nuclear facilities tend to have a higher risk factor than non-nuclear facilities. The Commission also finds, in developing a hypothetical capital structure for SJLPC, it is more appropriate in this instance to include a ratio for preferred stock in long-term debt than to establish a ratio for preferred stock as a separate component of the capital structure. The evidence demonstrated that preferred stock is considered a hybrid stock classified between long-term debt and common equity. However, based on the evidence presented, in this case preferred stock more closely resembles long-term debt (bonds) than common equity. The Commission determines that in establishing a hypothetical capital structure for SJLPC, including preferred stock in the ratio for long-term debt results in a capital structure that most closely resembles the composition of SJLPC's capital structure. Furthermore, Public Counsel's approach is reasonable because it advocates that companies with similar risk characteristics actually exist within a range of debt versus equity trade-offs. The adoption of Public Counsel's structure is further supported since the Commission is adopting the high end of Public Counsel's equity range, thereby, placing SJLPC in the zone of reasonableness for utilities with operating characteristics similar to SJLPC.

By adopting a hypothetical capital structure for SJLPC, the Commission is not indicating a preference for hypothetical capital structures in establishing revenue requirements for a company. The Commission, in other cases, has utilized the actual capital structure whenever the debt equity ratio has not been shown to be outside a zone of reasonableness. However, when as in this case, the actual capital structure is so entirely out of line with what the Commission considers to be a reasonable range, a hypothetical capital structure must be adopted to balance properly the interests of the shareholders and ratepayers.

The Commission, therefore, determines that the hypothetical capital structure as proposed by Public Counsel should be adopted in this proceeding.

Return on Equity

The rate of return on equity for a company is established by estimating its cost of common equity and combining it with its costs for debt and preferred stock. All parties in this proceeding used the discounted cash flow (DCF) method for estimating the cost of common equity. The purpose of the DCF analysis is to estimate the return on equity necessary to attract investors to a company given the future value of the stock based upon its projected price and expected dividend per share. The DCF model is a market-oriented approach that uses three variables to determine the cost of equity of a company. These variables are the expected dividend, the current stock price and the growth factor. Under the formula for the DCF, the return on equity is obtained by dividing the expected dividend by the current stock price and adding a growth factor. Normally a difference occurs in the DCF calculations due to differences in factors used to develop the growth rate. In this proceeding, not only were different growth factors employed, but also the parties used different expected dividend prices. SJLPC proposes that a 12.78% cost of equity be adopted in this proceeding. SJLPC used growth in dividends per share, earnings per share, book value and market value as growth factors in its DCF calculation. Additionally, SJLPC used $1.82 for the annual expected dividend rate as of January, 1993. SJLPC arrived at this figure by rounding the current dividend of $1.72 to the nearest 1/2 cent on a quarterly basis.