STATE OF MISSOURI
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of the Joint Application of Missouri-American Water Company, St. Louis County Water Company d/b/a Missouri-American Water Company and Jefferson City Water Works Company d/b/a Missouri-American Water Company for an accounting authority order relating to security costs.	))))))))	WO-2002-273

INITIAL BRIEF OF CITY OF RIVERSIDE, MISSOURI AND ST. JOSEPH INDUSTRIAL INTERVENORS

Jeremiah D. Finnegan 18416
Stuart W. Conrad 23966

FINNEGAN, CONRAD & PETERSON, L.C.
1209 Penntower Office Center
3100 Broadway
Kansas City, Missouri 64111
(816) 753-1122
Fax: (816) 756-0373
Internet: jfinnegan@fcplaw.com

ATTORNEYS FOR CITY OF RIVERSIDE, MISSOURI AND ST. JOSEPH INDUSTRIAL INTERVENORS

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I. INTRODUCTION AND SUMMARY.

At the outset, let us seek to be absolutely clear: Had a Missouri utility suffered some damage to its physical facilities as a result of the horrific 9/11 terrorist attacks on the United States, these intervenors would have no difficulty with that utility seeking appropriate specialized accounting treatment for the expenses incurred to replace damaged physical plant or facilities and to expeditiously restore customer service.

Fortunately, that is not this case.

To the contrary, this case presents a rather shameless attempt by an already highly profitable monopoly utility to exploit the national tragedy of 9/11 and increase its already substantial profit, by improving its financial position through an accounting authority order or "AAO."

A resounding "No" is the appropriate response to this opportunistic utility's attempt to profit from the terrorist

attacks of 9/11. Missouri-American ("MAWC") meets none of the tests for an AAO, neither the traditional tests applied by this Commission, nor the restated and clarified tests recommended by the Staff in this proceeding. MAWC's application for an AAO should be soundly rejected by this Commission.

II. ARGUMENT.

A. The Standards for Issuance of An AAO.

An Accounting Authority Order or "AAO" is an order from the appropriate regulatory authority (here the Missouri Public Service Commission or "Commission" that permits a utility (here MAWC) to depart from normal accounting practice and treatment and defer recognition of the expenses that are claimed to be associated with some extraordinary event. Normal accounting treatment requires recognition in the period the expenses are incurred resulting in a reduction in the current year's net income. Deferring recognition of an expense results in the creation of a "regulatory asset" on the utility's balance sheet for both regulatory and financial reporting purposes.[1/]

Typical examples where AAOs have been grated involve "acts of God," such as the repair of significant and disruptive system damage from an natural occurrence such as an ice or wind storm. These are typical unanticipated events that are not

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[1/] Conditions under which such deferrals are allowed are discussed by the Financial Accounting Standards Board (FASB) in Statement of Financial Accounting Standards No. 71, entitled *Accounting for the Effects of Certain Types of Regulation (FAS 71).*

planned for in the usual ratemaking process because they are nonrecurring and are outside the scope of the usual business and operations of the utility.

The AAO is a variance from the usual ratemaking procedure that employs a test year and adjustments that "normalize" or seek to make the selected test year representative of the conditions that are likely to occur during the future period that the rates to be established are expected to be effective. Because the usual ratemaking process involves the consideration of all relevant factors, variances from that process properly should be allowed on only a carefully limited basis -- the path that this Commission has historically chosen.

> [D]eferral of costs from one period to another . . . violates the traditional method of setting rates [and] should be allowed only on a limited basis.[2/]
>
> The items deferred are booked as an asset rather than as an expense, thus improving the financial picture of the utility in question during the deferral period. Id. AAO's should be used sparingly because they permit ratemaking consideration of items from outside the test year.[3/]

These parties believe that the obvious and salutary reluctance of the Commission to depart from normal accounting and regulatory treatment is particularly appropriate in today's

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[2/] *In the Matter of the Application of Missouri Public Service*, 1 M.P.S.C. (N.S.) 200, Case Nos. EO-91-358 and EO-91-360 (December 20, 1991) ("Sibley").

[3/] *In re Missouri-American Water Company, Order Concerning Non-Unanimous Stipulation and Agreement, and Denying Motion to Modify*, WO-2000-281, p. 8.

climate where many privately-held companies have been forced to recast or "restate" their operating results because of overly-aggressive accounting techniques that result in possible over-statement of income.

Accounting authority orders ("AAOs") such as that MAWC requests attempt to address the problem of regulatory lag for utilities, and are not intended to allow a utility to stockpile ongoing costs indefinitely, until it should file a rate case. *Missouri Gas Energy v. Public Serv. Comm'n*, 978 S.W.2d 434, 438 (Mo.App. W.D. 1998); *State ex rel. Office of Public Counsel v. Public Serv. Comm'n*, 858 S.W.2d 806, 812-13 (Mo.App. W.D. 1993).

An AAO accords special treatment to the utility so that its authorized earnings do not suffer as a result of an unusual and extraordinary occurrence. The Commission normally places a condition on the AAOs it issues, requiring the utility in question to file a rate proceeding within a specific period of time. If the utility's earnings are not suffering, it will presumably elect not to file a rate case within the specified time frame, and, accordingly, there is no longer a need to be concerned about the adverse impact on earnings of costs subject to the AAO. At that point, the very terms of the AAO, as well as concerns about single-issue and retroactive ratemaking, govern the final disposition of the costs: the utility absorbs them through routine channels.

In this case, MAWC has not fulfilled the Commission's traditional AAO test, as the expenses MAWC seeks to defer through

the AAO are standard, ongoing business expenses that are included in every rate case, and the mere fact that the expenses may be higher than normal does not entitle MAWC to special AAO treatment.

In *Sibley*, the Commission described the limited basis on which AAOs should be allowed by specifying three basic standards to govern review of such applications.

> 1. The primary focus of the inquiry should be on whether or not the event was extraordinary, which the Commission further defined as being unusual and unique, and not recurring.
>
> 2. FERC's 5% income materiality test, while not case dispositive, is relevant to whether the event is extraordinary.
>
> 3. Determination of extraordinary matters will be made on a case-by-case basis.[4/]

Although not directly referenced by any of the witnesses in this proceeding, the Accounting Principles Board made a relevant issuance in 1966 through APB 9 and ABP 30 in 1973. In APB 30, extraordinary items were distinguished by their unusual nature and by the infrequency of their occurrence in the following terminology:

> *Unusual Nature* - the underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates. Unusual

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[4/] *Sibley, supra.*

> nature is not established by the fact that an event or transaction is beyond the control of management.
>
> *Infrequency of occurrence* - the underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates. By definition, extraordinary items occur infrequently. However, more infrequency of occurrence of a particular event or transaction does not alone imply that its effects should be classified as extraordinary. An event or transaction in which the entity operates cannot, by definition, be considered as extraordinary, regardless of its financial effect.

Further clarifications of these standards may be found in the relevant financial literature. While not binding on this or any other regulatory commission, these standards provide explanatory power for the regulator regarding the application of a consistent and reviewable standard and the need to avoid decisions that otherwise might smack of arbitrariness.

The Staff witness suggested informative standards that, to be "extraordinary," an event must possess a "high degree of abnormality" and be clearly unrelated or only incidental to the ordinary and typical activities of the business entity that is involved. These standards also make clear that an event does not become "extraordinary" merely because it may be beyond the immediate control of entity management. Implicit within that explanation lies the concept that if the event is within the control of the business entity's managers to "manage," it is not extraordinary.

An additional factor noted in the literature is that the event is not likely to recur in the foreseeable future. Intuitively, an "extraordinary" item cannot be something that frequently occurs. The "annual winter ice storm" faced by utilities in other parts of this country would not be considered "extraordinary" either by the utility management or by the utility's customers. FERC uses the concept of an event that is of "unusual nature and infrequent occurrence" and of "significant effect" to describe an "extraordinary" occurrence such that might merit the unusual accounting treatment of an AAO.

B. The Terrorist Attacks of 9/11/01 Caused No Damage Whatever To This Utility and Are Not Extraordinary Events from Its Perspective.

It is our sense that no participant in this case would contend that the events of 9/11/01 and the cowardly attack on America was anything other than "extraordinary," and that all that reasonably can be done has and is being done to prevent a recurrence. It does not, however, follow that because buildings were destroyed or damaged in New York City and Washington (and even thousands of lives lost), that a water utility in Missouri is entitled to an AAO for otherwise ordinary costs associated with providing security for its plants and facilities.

It was not disputed by MAWC personnel that no MAWC facilities were damaged in any regard by the 9/11/01 attacks. Kartmann, Tr. 113; Grubb, Tr. 295. Prior to and on 9/11/01, MAWC witnesses stated that the utility was providing safe and adequate service to its customers. Kartmann, Tr. 149. MAWC continued to

provide this service after 9/11/01. Kartmann, Tr. 149. Absent further terrorist attacks, the pre-9/11 security level was judged by Mr. Kartmann to be adequate. Kartmann, Tr. 150. No security concerns or alerts were raised specific to MAWC operations. Kartmann, Tr. 158. No legislation has been enacted that requires any of these measures to be taken. Kartmann, Tr. 171. No law enforcement agencies have directed MAWC to take any specific security measures. Kartmann, Tr. 171. **

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Company witnesses sought to make out threats where there were none. Mr. Kartmann testified:

> 12 Q. Were any of your company's facilities in
> 13 Missouri damaged in that attack?
> 14 A. No, but they were ***threatened*** by it.
> 15 Q. Were any of your company's facilities in
> 16 Missouri damaged by that attack?
> 17 A. No, sir.

Kartmann, Tr. 113 (emphasis added).

> 8 Q. On September 11th, was there an attack on any
> 9 of Missouri-American's facilities?
> 10 A. No.
> 11 Q. Was there any damage to any of
> 12 Missouri-American's facilities?
> 13 A. No.

Kartmann, Tr. 185.

Mr. Kartmann had to admit that there had ***not*** been any specific threats to Missouri-American facilities. Kartmann, Tr. 158. Nor could he testify that public authorities in Missouri were aware of any specific threats to Missouri water utilities. Kartmann, Tr. 160. Moreover, Mr. Kartmann had to acknowledge

that national authorities, including the American Waterworks Association, characterized any threat to water utilities as "remote." Kartmann, Tr. 153; Ex. 10. No directives related to Missouri-American have been issued by any responsible public agency. Kartmann, Tr. 144-47.

While the attacks in New York and in Washington were unquestionably serious and caused great turmoil and loss of life and property, no damage occurred to Missouri-American facilities.

Because the typical case of a proper application of an AAO is to address a major ice storm that damages an electric utility's property, a useful analogy might be drawn. This past spring, Kansas City Power & Light ("KCPL") suffered severe damage to its system as the result of a major ice storm in its service territory. Perhaps as many as 300,000 customers were knocked off line by the storm and possibly several thousand lines were damaged by the weight of the ice on the lines directly, by associated wind or by broken limbs falling and breaking already over-stretched lines. Few would question the appropriateness of an AAO to allow KCPL to defer the significant expenses of repair for future consideration and to begin their amortization. But KCPL's damage would not justify Ameren-UE seeking an AAO to defer an incremental increase in tree-trimming expense because it felt "threatened" by the Kansas City ice storm.

Careful and reasoned analysis is needed. For AAO purposes, there seem to be at least three senses to the term "extraordinary."

First, there is certainly an extraordinary event that occurs and causes damage to the utility property. Additionally, the event is unusual and infrequent.[5/]

Second, the "extraordinary" event, if not causing actual physical damage to the utility's property, must be some externally operating compulsive force such as a command from a regulatory agency or a governmental organization that forces compliance action by the utility.

Obvious examples are changes in accounting conventions, pension rules or tax law that are externally generated and to which the utility must -- either by law or required practice -- react and as to which it is truly denied discretion to respond. These "events" are distinguishable, however, by their broad generic nature and that they are emanating from some public or quasi-public body that makes compliance a legal requirement. Here MAWC witnesses have acknowledged that there was no such operative compulsion. They clearly ***could*** have chosen to "do nothing," in response to 9/11 and it was management discretion

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[5/] The Staff would define "extraordinary event" as an event that is distinguished both by its unusual nature and by the infrequency of its occurrence. To be classified as extraordinary, the event should possess a high degree of abnormality and it should be a type of event that is clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the utility. Further, the event should be of a type that would not reasonably be expected to recur in the foreseeable future.

Fischer, Ex. 6, pp. 4-5.

and decision that was the operative event causing these expenditures.

It seems that this is the most applicable sense in which MAWC would like to press its case, claiming that the events of 9/11, while not causing damage to its facilities, nevertheless "required" reaction by the utility. But this is easily distinguishable from an edict or order by a governmental or quasi-governmental agency that denies a utility the option to react. Here, management had to make an initial evaluation of the perceived risk or threat to its facilities. Management had, however, **

** We submit that this management saw in this horrendous event an opportunity that they had missed before, namely to seek to recover additional funds from captive ratepayers in the name of security where there had been no actual damage, no actual threat and no governmental directive. This is the proverbial "bridge too far."

Third, the responding expenditures themselves must be extraordinary in amount and must not be of a character that are likely to recur and thus be eligible for potential inclusion in test year expenses in a rate case.

While the events of 9/11 may be extraordinary, they are not extraordinary in the same sense as an ice storm or a flood that operate to directly cause damage to the utility's physical plant that it must repair or restore to provide safe and adequate

service. MAWC grossly misperceives the purpose of an AAO and opportunistically seeks to twist a legitimate regulatory tool to an improper and flawed purpose.

C. Changes In Utility Risk Perceptions Do Not Justify an Accounting Authority Order.

An important distinction between a proper circumstance for an AAO and MAWC's circumstances is the degree of management discussion. Throughout the hearing, MAWC witnesses contended that they could not have ignored the 9/11 attacks. That they had to do "something" and could -- using a double negative -- not do "nothing." Kartmann, Tr. 166-67; Grubb, Tr. 306. That is really not, however, the question. It is clear that MAWC management decided to respond (since none of their facilities were damaged or threatened). Mr. Grubb finally had to acknowledge that management decisions were involved.

> Q. So it is your testimony, then, that the decision to beef up the security was beyond the control of the Company's management?
> A. We had to do it. It was a management -- it was a management decision, but it was a decision that we had to do.
> Q. But it was a decision?
> A. It was a decision, yes.
> Q. The Company decided that?
> A. The Company decided, yes.

Grubb, Tr. 306.

In questions from Commissioner Gaw, MAWC Witness Grubb acknowledged that what had occurred was a change in the risk that MAWC management ***perceived*** and to which management reacted.

> Q. In essence, aren't we talking about in this case a change in the policy of your company in regard to the amount of security expenses that you intend to incur in the future?
> A. It's probably an unwritten policy right now; conscious decisions have been made to heighten the security

level. I guess, yes, you could say it is a policy now that we have decided to take the management decisions and make these additional security measures or take these additional measures.
Q. I mean, Mr. Grubb, you really don't expect that this heightened risk that you've been testifying about and that the whole world knows about, except for some who seem to want to argue the point, that we're now in a position where there is more risk involved in the United States that, at least from a perception standpoint, most of

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us believe exist. You agree with that, don't you?
A. I believe the world is more aware of and we are at a certain level of heightened -- heightened awareness of the risk.
Q. I mean, you -- we don't know whether or not there actually exists more risk now than existed before September the 11th, do we? We don't know that to be the case?
A. I guess what we don't know is, I will say, if and when another attack will occur. I think --
Q. We are more aware --
A. We are more aware.
Q. -- of the fact that the risk exists than we were before September 11th; isn't that true?
A. That's correct.
Q. It's a perception and awareness question, in essence?
A. I believe that's correct.

Grubb, Tr. 342-43.

This colloquy confirms that only MAWC's perception and awareness of risk changed and that this new "perception" is likely to continue. The question is how did management respond? Clearly, had management evaluation resulted in a determination that security was adequate, then doing nothing would have been the proper step. Ms. Fischer has it right:

A. I don't believe we would expect any company, any utility company in the state of Missouri to not make some change in their procedures after 9/11. The level at which they would choose to make those changes or when they would implement those changes, that's what we're saying -- or what I'm saying in my rebuttal, is that ***they had the***

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options as to when to put those things in place and to what level to put them in place. I would not assume that they should have done nothing.
Q. Okay. So when we talk about management choice, it's not the choice between doing nothing and doing something, but between what level of something to do, correct?
A. Right.

Fischer, Tr. 437-38 (emphasis added).

Security costs are standard expenses for a utility and are generally included in its cost of service for ratemaking purposes. Fisher, Ex. 6, p. 13. Security costs are also recurring. *Id.*, p. 14. For example, Witness Kartmann testified that **

** He continued to describe these **

**

Thoughtful and careful analysis of Mr. Kartmann's testimony again demonstrates that the "risk" that existed prior to 9/11 and the "risk" that existed the day after were ***exactly the same***; it was simply ***management's perception of that risk that changed***, and that does not make that change in perception into an extraordinary event for purposes of an AAO.

"Changes in the level of security-related costs between rate filings are no different in concept that changes in the

level of salary expense or maintenance items." Fisher, Ex. 6, p. 14.

Thus, as in the case of an electric utility whose system is damaged by an ice storm, it is not management's decision to invite the ice storm that causes the damage, here there was no damage to repair. It was clearly management's decision to react to changes in its perception of risk but not actual changes in risk in a situation that did not present any damage to MAWC facilities and presented (based on MAWC's own witnesses) no threat to MAWC. 9/11 was not an ice storm or tornado for MAWC.

D. The Expenditures Claimed to Justify an AAO Are Principally Capital Expenditures Which Will Be Recovered Through Usual Rate Processes or Are Recurring Expenses.

Almost by definition, an AAO should not be used to defer capital expenditures that are going to be included in rate base in some relatively current period. Rate base items will be included in a rate case which this utility indicates will be filed in the spring of 2003, perhaps only some six or seven months hence. At that time, if the expenditures are determined prudent, they can be included in rate base and a rate of return allowed as well as related depreciation included in test year expenses.

Analysis of the claimed expenditures of MAWC reveals that a substantial part of these claims relate to what would be rate base additions. For example, on Schedule KKB-2.5 attached

to Ms. Bolin's Cross-Surrebuttal testimony (Ex. 8HC), fully **

** There is simply no reason to include these items as part of an AAO.

As Staff Witness Fischer testified, "deferral of capital costs under the AAO . . . should only include depreciation and carrying cost calculations, not the gross plant dollar amount included in Kartmann Schedule FLK-3 and above in this testimony." Fischer, Ex. 6, p. 8.

To again analogize from the ice storm example, it is as though the electric utility decided to expand part of its distribution system at the same time it was attempting to repair damage from the ice storm, then sought to blend these amounts with expenses for damage repair and seek an AAO for all these amounts. Such an attempt would be well beyond the purpose of an AAO.

As revealed by the same Schedule, and again acknowledged by MAWC witnesses, another **

** is identified as recurring expenses. By definition, recurring expenses are not properly recovered through an AAO, which exists to tee-up recovery of non-recurring expenses. Recurring expenses will recur in a test period for a rate case and will be subject to inclusion in test period expenses at that time.

In fact, as was developed through cross-examination, with the utility planning a rate case in the Spring of 2003, the only recurring expenses that might not be included in the test year are those **

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This creates an obviously distorted situation, namely that all but about **

** is what this case is about and which concerns this multi-million dollar operation. **

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The utility understands how to treat security costs in other circumstances. **

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And yet MAWC was unable to identify many of its expenditures to particular plant or plant sites. Expenditures in St. Joseph are an example. In St. Joseph, a new plant was constructed in 1999-2000, supposedly as "state of the art."

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Section 393.150.2 RSMo assigns the utility the burden of proof of these issues. MAWC fails this test. Its materials are sketchy and could be disaggregated only under the prodding of one of the Commissioners.

E. The Expenditures Are Not Material to This Utility's Ability to Earn Its Rate of Return And No Showing Has Been Made to The Contrary.

A requirement of materiality flows from the usual regulatory process. The utility times its rate filings, often to seek to capture increased expenses or large capital investments as soon as they come on line. The utility controls the content of its rate filing; increases in one expense item may be more than offset by decreases in another expense category so that the cumulative effect on the utility is minimal, non-existent or even favorable. Given that the utility has control of this process, and that Missouri law mandates the consideration of all relevant factors, it is appropriate that expenditures, even though caused by an unanticipated event beyond the control of company management, must be of significance if they are to be accorded special treatment. As noted by this Commission, turning an expense into a regulatory asset affects the financial community's perception of the utility's operations. Certainly such a process should be reserved only for items of significance that are "material" to the financial operations of the utility.

As noted earlier, the third sense in which "extraordinary" appears to be used in an AAO proceeding concerns the size of the expenditures that are otherwise eligible. Eliminated are capital expenditures and recurring expenses since those are addressed by other mechanisms. Remaining for consideration are non-recurring expenses that, because of exigency or timing, are

unlikely to be recaptured in a test year associated with a rate case.

In this context, "extraordinary" appears in the sense of significance or materiality and operates in conjunction with the ability of the utility to earn its allowed rate of return. It deserves stress that there is no guarantee to the utility that it will earn its allowed -- or any other -- rate of return. It is simply provided an ***opportunity*** to earn that rate of return. Realization of that return and, indeed, maximization of any return, is most often the result of utility management doing what they are paid to do -- manage the operations of the utility intelligently and with foresight gained from experience.

In this sense, "extraordinary" becomes shorthand for an expenditure that is of such an amount -- and beyond the ability of the management to "manage" -- that it will deny the utility any reasonable ability to earn its allowed rate of return. Our sense is that this is why the term "materiality" often comes into play.

The FERC standard employs a 5% test pertinent to eligible expenses and compares those expenses to the net income of the utility. We sense that Staff is suggesting something of that standard here, not in the arbitrary sense that 5.0000% qualifies and that 4.99999% does not, but rather in the sense that there needs be some order of magnitude "yardstick" by which these questions may be quickly evaluated.

As a result, the remaining non-recurring expenditures are clearly not material. An AAO is properly issued only to address extraordinary circumstances that are material to the utility's operations.

F. Staff's Four Factor Analysis Representations An Analytical Framework, Not A "Rule".

This Commission has utilized the "traditional test" - extraordinary, unusual, unique and nonrecurring - for accounting authority order applications since approximately December 20, 1991, the date of its decision in *Sibley*.[6/] Staff's four-part test reflects nothing more than a distillation of these cases to provide a more precise analytical framework for decisions.

We expect MAWC to rail against this proposal, asserting that "Staff is trying to create a new rule." Nothing could be further from the case. Section 536.010(4), RSMo defines "rule" as an "agency statement of general applicability that implements, interprets, or prescribes law or policy, or that describes the organization, procedure or practice requirements of any agency." The Missouri Supreme Court has stated that "[f]ailure to follow rule making procedures renders void purported changes in state-wide policy." *NME Hospitals, Inc. v. Department of Social Services*, 850 S.W.2d 71, 74 (Mo. *en banc* 1993). Staff's proposal is not a "change in statewide policy" nor is it a statement of general applicability that it intends to mindlessly apply to all future

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[6/] *In the Matter of the Application of Missouri Public Service*, 1 M.P.S.C. (N.S.) 200, Case Nos. EO-91-358 and EO-91-360 (December 20, 1991).

accounting authority order applications. These criteria are merely articulations or restatements of prior Commission decisions in *Sibley* and in other cases. Indeed, it is ironic that MAWC seems impelled to challenge Staff's proposal as a "Rule," while failing to recognize that *Sibley* was not a rulemaking proceeding but, rather, was a contested case proceeding. Moreover, the traditional test in one way or another is derived from the language of the uniform system of accounts. The Commission described the basis for its authority related to accounting authority orders as follows:

> The Commission by authority pursuant to Section 393.140(4) promulgated rule 4 CSR 240-20.030, which prescribes the use of the USOA adopted by the Federal Power Commission, now the Federal Energy Regulatory Commission (FERC), for use by electric utilities subject to its jurisdiction. As stated in the Commission rule, the USOA contains definitions, general instructions, electric plant instructions, operating expense instructions and accounts that comprise the balance sheet, electric plant, income, operating revenues, and operation and maintenance expenses. Costs incurred by the utility during a period are off set against revenues from that same period in determining a company's profitability. The USOA provides for the treatment of extraordinary items in Account 186. The account was created to include "all debits not elsewhere provided for, such as miscellaneous work in progress, and unusual or extraordinary expenses, not included in other accounts, which are in the process of amortization and items the proper final disposition of which is uncertain."[7/]

[7/] *In the Matter of the Application of Missouri Public Service*, 1 M.P.S.C. (N.S.) 200, 202-203, Case Nos. EO-91-358 and EO-91-360 (December 20, 1991) (emphasis added).

FERC's definition, though directly pertinent only to natural gas pipelines and the electric operations that it regulates, is not far from this mark. The FERC definition is found in its Uniform System of Accounts (USOA) general instructions dealing with Extraordinary Items and, per the April 1, 1996 revised USOC states:

> Those items related to the effects of events and transactions which have occurred during the current period and which are not typical or customary business activities of the company shall be considered extraordinary items. Accordingly, they will be events and transactions of significant effect which would not be expected to recur frequently and which would not be considered as recurring factors in any evaluation of the ordinary operation processes of business.

As Staff Witness Fischer went on to state:

> Accounting and ratemaking rules and conventions are presumed to be capable of adequately reflecting the ongoing and normal changes to revenues, expenses and rate base which a utility will experience over time. Only infrequently do extraordinary events occur which justify changes to normal utility accounting and ratemaking practices and procedures. Only truly extraordinary items and events justify extraordinary accounting and ratemaking treatment, such as the deferral and amortization of items that would normally be charged to expense when they are incurred.

Fischer, Ex. 6, p. 4.

G. Exhibits 12 and 13 Demonstrate from MAWC's Own Records That the Request Does Not Deal With Amounts That Are Material.

Staff Witness Fischer testified that the Staff had **

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Staff's concerns were borne out by late-filed Exhibit 13 which when properly analyzed and laid against Exhibit 12 shows a de minimis impact on MAWC.

First, given that MAWC intends to file for rate relief in June, 2003 using a test year of 2002, **

** These break down as follows:

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** While more than pocket change to most of us as indi-

viduals, this amount is hardly material compared to the operations of MAWC.

Turning for a moment to the capital side, Exhibit 12 identifies by ** ** a total of **

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In short, MAWC's eligible expenditures, whether considered as outright expenses that are non-recurring, or calculated based on a rough fixed charge rate representing a revenue requirement calculation (which would include return on investment as well as depreciation effect and taxes) are ***well*** below the ** ** that Witness Fischer indicated would be a threshold requirement to even achieve a 5% level compared to net income for the utility. MAWC's expenditures, whether capital or outright expense, are not material and are not extraordinary,

particularly for a utility that is earning 11.2 percent at a time that passbook savings accounts are perhaps earning 2%. As to "materiality," the following exchange is relevant:

Q. Okay. At the time you do your fiscal -- your financial statements, do you review your rate of return as a part of the analysis?
A. Sometimes we do.
Q. Did you at the close of this last fiscal year?
A. I think I can remember looking at it. It was in the range of about 11 percent, 11.2, in that range.
Q. Is that the last time that you can recall that you've looked at your rate of return?
A. Yes.
Q. So that's not a calculation you-all keep up with on a regular basis?
A. No. We normally look at earnings, dollar earnings.
Q. As a per share?
A. No, just dollar earnings.
Q. Okay. Do you recall what your dollar earnings were for the last fiscal year?
A. I'm going to say $22.38 million, I believe. I can doublecheck that.

Grubb, Tr. 267.

It is also important to recall that MAWC has recently merged with other water utilities. Mr. Grubb testified that the basic reason to do so was to achieve savings; savings that have not been passed back to the ratepayers, which the utility has continued to receive revenue at the previously established levels of rates. Mr. Grubb testified:

Q. Why did you do a merger?
A. One is the American system has a -- has a policy of, when they have operations in one state, to merge it into one entity so that you're not dealing with three -- or two or three separate companies, three in this case. Companies become more efficient. You only have to go to the capital markets one time if you need financing. You only have one line of credit. You only have one set of officers and board of directors. It makes -- and with a bigger organization, you can capture a lower cost on capital.
Q. All savings, right?

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A. There are savings.
Q. Efficiency?
A. There are, yes.
Q. Fewer number of officers, elimination of duplication, duplicative positionings; would you agree?
A. That's right.
Q. You mentioned efficiencies of purchasing?
A. Uh-huh.

9 Q. Efficiencies of going to the capital market,
10 be more efficient there, lower cost of borrowing?
11 A. That's correct.
12 Q. Has Missouri-American Water Company, since
13 that merger occurred, filed to reduce its rates?
14 A. No. We will be filing next June of 2003.

Grubb, Tr. 275-76.

There is simply no basis that can support a finding of materiality for this utility. The amounts realistically involved are small and doubtless well overshadowed by merger savings.

III. CONCLUSION.

MAWC's Application for an AAO should be rejected. MAWC has failed to meet its burden of proof and has completely failed do demonstrate any damage to its facilities or anything other than a change in perception by management of its risks following on the 9/11 terrorist attacks. MAWC may certainly seek to include new plant investment and prudent expenses in its next rate case, but has no basis on which to claim that special and

extraordinary accounting treatment should be given these activities.

Respectfully submitted,

FINNEGAN, CONRAD & PETERSON, L.C.

/s/ Jeremiah D. Finnegan_____
Jeremiah D. Finnegan 18416

/s/ Stuart W. Conrad_____
Stuart W. Conrad 23966
1209 Penntower Office Center
3100 Broadway
Kansas City, Missouri 64111
(816) 753-1122
Fax: (816) 756-0373
Internet: stucon@fcplaw.com

ATTORNEYS FOR CITY OF RIVERSIDE, MISSOURI AND ST. JOSEPH INDUSTRIAL INTERVENORS

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing Initial Brief to be served upon each party of record in these proceedings based on the Commission's service listing by either electronic means or by First Class Mail, Postage Prepaid, all on the date last below written.

/s/ Stuart W. Conrad_____
Stuart W. Conrad

August 20, 2002