BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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.	)))))))	**Case No. WO-2002-273**

STAFF'S INITIAL BRIEF

DANA K. JOYCE
General Counsel

Keith R. Krueger
Deputy General Counsel
Missouri Bar No. 23857

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-4140 (Telephone)
(573) 751-9285 (Fax)
kkrueg01@mail.state.mo.us

August 20, 2002

NP

TABLE OF CONTENTS

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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	))))))))	**Case No. WO-2002-273**

STAFF'S INITIAL BRIEF

COMES NOW the Staff of the Missouri Public Service Commission and, for its Initial Brief, states to the Missouri Public Service Commission as follows:

INTRODUCTION AND OVERVIEW

On September 11, 2001, terrorists carried out massive suicide attacks against the World Trade Center in New York City and against the Pentagon in Washington, D.C., and an aborted attack on the White House in Washington, D.C. Besides causing tremendous death and destruction, the terrorists rendered the American populace fearful.

In the aftermath of these attacks, a consensus developed that the United States in general and infrastructure, including utility plant, in particular, are vulnerable to similar attacks by terrorist organizations in the future. Various government agencies and *ad hoc* groups met to formulate plans to prepare for such attacks and to respond to any future attacks. The federal government proposed to form a new Department of Homeland Security to guard against and prepare for other terrorist attacks in the future.

Partly in response to the urgings of certain government entities, Missouri-American Water Company ("MAWC" or "Company") undertook a program of evaluating and upgrading its security procedures at its facilities throughout the state. The Company claims that it has incurred costs totaling ** HC---------- ---------- HC---------- HC---------- ---------- HC---------- --**

On December 10, 2001, the Company filed an Application for an Accounting Authority Order ("AAO"), claiming that the expenses that it incurred in response to "The Events of September 11" were extraordinary. The Company claimed that the Commission should authorize this special accounting treatment to enable the Company to seek recovery in rates of some of the costs that it incurred in its response to The Events of September 11.

The Commission has occasionally granted AAOs to utilities to allow them to defer costs on their balance sheets that would otherwise be charged to expense in the period the costs were incurred. The normal basis on which the Commission finds that the AAOs are appropriate involves a finding that the costs in question are "extraordinary, unusual, unique and non-recurring." Most of the AAOs that the Commission has authorized involve either so-called "acts of God" or expenditures that the Commission has mandated that utilities undertake.

The Staff urges the Commission to adopt, and apply in this case, a new four-part test to determine whether an AAO application should be granted. This new four-part test is consistent with recent Commission decisions in AAO cases and would serve to expand and clarify the Commission's standards for granting AAOs.

The Company's Application in this case fails this four-part test and should be rejected.

Even if the Commission does not accept this new four-part test, it should still reject the Company's Application, because the costs the Company seeks to defer are not "extraordinary, unusual, unique and nonrecurring," as required by longstanding Commission practice.

ARGUMENT

THE ISSUES THE COMPANY CONFRONTED

Stated most broadly, this case revolves around two major decisions that the Company had to make. First, what should the Company do to protect its facilities, its customers and its shareholders from the risks associated with a possible terrorist attack on its facilities? And second, how should the expenses that the Company incurs in providing this protection be reflected in the rates that it charges for the services it provides to its customers?

The Company's Response to The Terrorist Threat

The threat of terrorism is not new. It has been a fact of daily life in Israel for many years, and it exists in many other locations throughout the world. There have been attacks on American aircraft and American facilities abroad in recent years, such as the attack on the Khobar Towers in 1997[1] and on American embassy buildings in Africa in 1998.[2] There have also been attacks on facilities within the United States prior to The Events of September 11, including the first attack on the World Trade Center in 1993, and the attack on the Murrah Federal Office Building in Oklahoma City in 1995.

[1] Tr. 138, lines 3-9. Although the name of the building is spelled "Cobar" in the transcript, counsel for the Staff believes the correct spelling is "Khobar."
[2] Tr. 138, line 16 – Tr. 139, line 1.

Although the threat of terrorism is not new, The Events of September 11 are properly regarded much more seriously, because those attacks were different in degree and different in kind from the previous attacks. First, these attacks used a different kind of weapon than any of the previous attacks. Although suicide bombings using trucks and other land vehicles are common in the Middle East, the September 11 attack consisted of suicide bombings using commercial airplanes. And second, this attack occurred on a much more massive scale than previous attacks. Two of America's best-known landmarks were destroyed and about 3,000 lives were lost in the attack upon the World Trade Center, and there was serious damage and loss of life at another of America's best-known landmarks in the attack upon the Pentagon.

But although The Events of September 11 were far more massive that prior attacks and utilized a different kind of weapon, Missouri utilities, including the Company, have always had to be concerned about security, whether it be to merely protect against vandalism, graffiti and the unauthorized dumping of trash, or the protection of their facilities against terrorist attacks. MAWC witness Frank Kartmann conceded at the hearing that the Company's security measures had taken into account the possibility of terrorist events for some period of time prior to The Events of September 11.[3]

The Company has therefore routinely made decisions about how to protect its facilities. Prior to September 11, the Company elected to do little to protect against terrorist attacks. Since September 11, the Company has responded in a different way. It claims it has expended about ** HC----------HC----------**

[3] Tr. 191, lines 6-24.

The Company was not directly attacked on September 11. Nor, to the best knowledge of the Staff, was any other utility. The Company suffered no interruption of service on September 11. The Company has received no specific threats of direct attacks since September 11. And no government agency has mandated that the Company take any particular action to protect its facilities or the general public against future terrorist actions.

The Company contends, however, that "doing nothing" was not an option.[4] It claims that although there was no direct mandate to act, as a practical matter, it had no choice but to act.[5] The Staff does not disagree. The Staff believes it was entirely proper for the Company to review its security procedures and to make appropriate modifications to improve its security. And the Staff does not, at this time, question whether the Company's actions were prudent or not – that issue will be preserved, and may be presented in the Company's next rate case.

The critical fact in this case, however, is that the Company's decisions about when and how to take action to protect its facilities from attack are now, and have always been, entirely within the control of the Company's management.

Recovery of Security-Related Expenditures

The Company also has control over the second major issue in this case, namely how and when to seek recovery of its security-related expenditures from its ratepayers. The two main options available to the Company were to seek an accounting authority order, which would address only these expenditures, as the Company has done, or to file a general rate case, in which all relevant factors would be considered.

[4] Tr. 305, line 18 – Tr. 306, line 16.
[5] Tr. 71, lines 12-16; Tr. 223, line 18 – Tr. 224, line 1.

The General Rate Case Option

The normal practice of utilities that are faced with increasing expenses is to file for a general rate increase, if the increased expenses are of a significant nature. The Company filed its Application for Accounting Authority Order on December 10, 2001. It is reasonable to assume that it made its decision to do so by December 1, 2001, at the latest. The Company contends that it would need six months to prepare and file a rate case. If that is true, and if the Company had decided to file a rate case on December 1, the case could have been filed by May 1, 2002. The operation of law date for a rate case filed on May 1, 2002 would have been about April 1, 2003. The Company believes that the expenditures for which it seeks deferral will be completed ** HC-HC---------- -** If the Company had filed a rate case on May 1, 2002, the true-up date for that rate case could easily have been August 31, 2002, or later. Accordingly, rates that would take into account all relevant factors, including the Company's expenditures in response to The Events of September 11, as well as offsetting efficiencies achieved as a result of the Company's recent merger, would go into effect by about April 1, 2003. The Company elected, however, not to file a rate case.

The Accounting Authority Order Option

The Company elected, instead, to file an Application for an Accounting Authority Order. In such a case, the Commission will not consider "all relevant factors." Nor will it adjust any rates; that will have to wait until approximately May 2004 – eleven months after the Company files its *next* rate case, which it promises to file in June 2003. What the Commission will consider in this case, instead, is whether the Company's expenditures in response to The Events of September 11 were "extraordinary." The Commission will not decide whether the Company's expenditures were prudent, nor how much the expenditures actually amounted to, nor how they

should be classified, nor whether and how the prudently incurred expenditures should be recovered from ratepayers. The briefing in this case will be complete on September 4, 2002. If the Commission issues its Report and Order very promptly after the conclusion of the briefing, the order could become effective about October 1, 2002 – just six months before the Report and Order in a rate case could have become effective, if the Company had filed a rate case instead of seeking an accounting authority order.

The Staff asserts that the appropriate course of action for the Company to take was to file a rate case to capture the financial impact of its increased security costs, if those costs had the effect of significantly reducing the Company's earnings when all relevant facts are taken into consideration.

ISSUES FOR COMMISSION RESOLUTION

In the List of Issues that they filed with the Commission, the parties to this case identified three issues and several sub-issues for resolution by the Commission. The remainder of this brief will address each of those issues in the order that they are presented in the List of Issues.

Issue No. 1: Should the Commission expressly adopt the four criteria proposed by the Staff for this Accounting Authority Order application?

The Staff is recommending that the Commission expand its traditional criteria for the granting of an AAO, by requiring the Company to show that four conditions have been met. Those four conditions, as applied to this case, may be briefly stated as follows:

(1) The Company must show that the costs resulting from the event must be extraordinary and material. The Staff recommends that the costs that are to be deferred should be at least five percent of the Company's regulated Missouri net income over the most recent 12 months, without reflecting the alleged extraordinary event;

(2) The Company's current rates must be inadequate to cover the event;

(3) The extraordinary expenses that the Company seeks to defer must result *from either* an extraordinary capital addition that is required to maintain safe and adequate service, in which unique conditions preclude recovery of the costs through a rate filing; *or from* an extraordinary event that is beyond the control of the utility's management, such as a major flood or an ice storm; and

(4) There must be a sufficient reason why the Company could not file a rate case to recover the costs resulting from the extraordinary event. Alternatively, if an AAO is granted, the Commission should require the Company to begin amortizing the deferred items upon the effective date of the order approving the AAO.[6]

It is important to note that under this proposal, the Company would be required to satisfy *all four criteria* before an AAO should be granted.

Although these new criteria would, as Staff witness Janis Fischer testified "expand [the Commission's] traditional criteria for the approval of deferred cost recognition under an AAO,"[7] they might also be likened to a restatement of the principles that the Commission has strived to apply, on a case-by-case basis, in deciding upon applications for AAOs over the past ten years or so. These proposed criteria would merely offer additional clarification on the issue of when an event may properly be considered as "extraordinary," and would elaborate upon it. Although the Staff continues to recommend that the Commission consider each application on a case-by-case

[6] Fischer Rebuttal, Ex. 6, p. 10, line 3 – p. 12, line 13, and Tr. 476, line 17 – Tr. 477, line 16. Because of the fact that the Company has changed its position on when the amortization of deferred items should begin, the fourth criterion, as applied in this case, has changed from that which is stated in Ms. Fischer's Rebuttal Testimony. See the discussion at pp. 23-24, below.

[7] Fischer Rebuttal, Ex. 6, p. 9, lines 27-30.

basis, Staff suggests that these proposed criteria offer a more precise framework for the Commission to decide whether an application for an AAO has merit.

In the past, the Commission has granted AAOs if the utility has incurred extraordinary and nonrecurring expenses as a result of some event that was beyond the control of the utility. As the Commission stated in *In Re Missouri Public Service*, 1 Mo. P.S.C. 3d, 200, 205: "the primary focus is on the uniqueness of the event, either through its occurrence or its size." The kinds of extraordinary events for which utilities have incurred costs that led to the issuance of AAOs in the past include "acts of God," such as snow and ice storms[8] or floods,[9] or actions ordered by the Commission or other government entities, such as a gas service line replacement program.

It may be said that AAOs have been authorized in the past when the utility was required to expend extraordinary sums of money in order to lawfully continue to provide service to its customers.

AAOs have been granted in cases where the utility has had to act very promptly, to prevent or mitigate an interruption of service (such as the "act of God" cases), and also in cases where the utility has had to carry out construction programs over an extraordinarily long period of time, such as the fuel conversion project in Case Nos. EO-90-114 and EO-91-358 and the gas service line replacement program. In both of these types of cases where AAOs have been issued, however, the utility had been required to expend extraordinary sums that it could not then recover through the normal rate case process.

The Staff's proposed criteria would serve as a useful statement of the tests that will be applied, on a case-by-case basis, to applications for accounting authority orders. This would

[8] See Case No. EO-95-193.
[9] See Case No. EO-94-35.

enable utilities to have a better idea, in advance, when their situation meets the requirements for an AAO, and would discourage utilities from filing applications that have no merit.

The Commission should apply the Staff's four criteria in this case.

A. Do Staff's proposed criteria constitute an unlawful change in statewide policy because such change would not be made through a rule making proceeding?

The Staff's proposed criteria do not constitute a change in statewide policy, which may only be effected through a rulemaking proceeding. The Staff is, rather, asking the Commission to apply these four criteria, on a case-by-case basis, to this and future applications for accounting authority orders. In each such case, the applicant for the AAO would have the opportunity to present evidence and argument to attempt to persuade the Commission to apply these criteria or to reject them and apply other criteria.

Section 536.010(4)[10] defines a rule as: "each 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." (Emphasis supplied). As mentioned above, the Staff proposes that the Commission would apply these criteria on a case-by-case basis. The Staff has not alleged that it would be appropriate to apply these four criteria to every AAO request that may be filed in the future, regardless of the specific circumstances surrounding the AAO application.

In a 1994 case, the Missouri Supreme Court stated:

> Not every generally applicable statement or "announcement" of intent by a state agency is a rule. Implicit in the concept of the word "rule" is that the agency declaration has a potential, however, slight, of impacting the substantive or procedural rights of some member of the public. Rulemaking, by its nature, involves an agency statement that affects the rights of individuals in the abstract. Bonfield, State Administrative Rule Making, § 3.3.1 (1986).[11]

[10] All statutory references are to RSMo 2000, unless otherwise indicated.
[11] *Baugus v. Director of Revenue*, 878 S.W.2d 39, 42 (Mo. 1994).

The Staff is not advocating that the Commission engage in rulemaking in this case. In support of this position, the Staff points out that prior decisions of this Commission have no *stare decisis* effect, *i.e.*, the prior decisions do not limit proper exercise of the Commission's discretion. See *State ex rel. GTE North Inc. v. Public Service Comm'n of State of Mo.*,[12] where the Western District stated:

> An administrative agency is not bound by *stare decisis. State ex rel. Churchill Truck Lines, Inc. v. Public Serv. Comm'n,* 734 S.W.2d 586 (Mo. App. 1987). "Courts are not concerned with alleged inconsistency between current and prior decisions of an administrative agency so long as the action taken is not otherwise arbitrary or unreasonable." *Columbia v. Missouri State Bd. Of Mediation,* 605 S.W.2d 192, 195 (Mo. App. 1980). …

The Commission has both the discretion and the authority to modify or discard any test it has applied in the past. Acceptable reasons to do so include refining or improving the test, addressing a new factual situation, and meeting changed circumstances and/or changed views of the commissioners.

In the instant case, as in future cases, the Commission will continue to have the right to apply case-specific, appropriate standards to review AAO applications. In doing so, the Commission will be acting as an adjudicatory body under the principles of § 536.010(2), which provides that proceedings in which "legal rights, duties or privileges of specific parties are required by law to be determined after hearing."

B. If the Commission adopts the Staff's four criteria, then:

(1) Are the costs incurred and which are sought to be deferred in this proceeding at least 5% of MAWC's regulated Missouri income, computed before extraordinary items?

The Staff believes that the Company's evidence fails to show that the costs incurred by the Company are at least five percent of the Company's regulated Missouri income before

[12] 835 S.W.2d 356, 371 (Mo. App. W.D. 1992).

extraordinary items; however it is difficult to reach this conclusion with certainty. The Staff's analysis of this issue is complicated by two factors: first, the Company's revision and updating of the cost data that the Staff initially used to analyze the materiality of the Company's expenditures; and second, the Company's confusing use of the term "ongoing expenses" to refer to expenditures which are, as the Company now claims, actually nonrecurring expenditures.

The Staff will discuss each of these three complicating factors in turn. Before doing so, however, it will be helpful to briefly explain the three categories into which the Company has placed each of the expenditures that, according to the Company, The Events of September 11 required it to make.

Capital Expenditures. The first category of expenditures has been referred to in this case as "Capital Expenditures." This includes money expended for the design, purchase and installation of items that will become part of the Company's plant at such time as they are placed in service and are "used and useful." Under normal accounting practice, the carrying cost on the Company's investment in these assets (allowance for funds used during construction, or "AFUDC") is included in the cost of the assets until the assets are placed in service. When the item is placed in service, the Company may no longer book the carrying cost as an asset. The Company must also begin depreciating it as soon as the item is placed in service. By seeking an accounting authority order, the Company is requesting permission from the Commission to deviate from the normal accounting practice by not depreciating these assets between the date they are placed in service and the effective date of the order in the Company's next rate case,[13] and by continuing to accrue a carrying cost on the asset in question to the same point in time.

[13] Or, until the effective date of the requested accounting authority order.

On Going Expenses. The second category of expenditures has been referred to in this case as "On Going Monthly." Although these expenses were referred to as "ongoing," it would appear that the Company contends that they are *not recurring*, and that the expenditures will end at such time as certain Capital Expenditures are placed in service.[14] These expenditures were apparently "ongoing" only in the sense that the Company incurred them repeatedly, until a capital asset eliminated the need for them, much like a person might pay rent for an apartment on an "ongoing" basis only until the house the renter is buying is available for occupancy. As the Staff understands it, these "On Going Monthly" expenses will all end **- HC---------- HC----**, when the Capital Expenditures are all complete. Under normal accounting practice, these expenses would have to be recorded on the Company's books as an expense during the period in which they are incurred, and the Company might not be able to recover them in rates. By requesting this accounting authority order, however, the Company seeks permission to record these expenses as a regulatory asset, and to begin to amortize them upon the effective date of the requested AAO.

Deferred Expenditures – One Time. The third category of expenditures has been referred to in this case as the "Deferred Expenditures – One Time." These are expenditures that will occur only once during the year after September 11, and the Company will not have to incur them again. Under normal accounting practice, these expenses would have to be recorded on the Company's books as an expense during the period in which they are incurred, and the Company might not be able to recover them in rates. By requesting this accounting authority

[14] Tr. 392, lines 4-21 (HC).

order, however, the Company seeks permission to record these expenses as a regulatory asset, and to begin to amortize them upon the effective date of the requested AAO.

If deferral is appropriate for any costs in this case, it would only be appropriate for costs that the Company had not incurred prior to The Events of September 11, and that would be in the nature of one-time, nonrecurring costs. Neither costs associated with capital additions related to security concerns nor any security expenses that will be incurred on an ongoing basis should be included in a deferral under any circumstances, because both categories of costs can be adequately handled through the normal rate case process on a timely basis.

The Revision and Updating of Cost Data. Prior to the time that she filed her Rebuttal Testimony in this case, Staff witness Fischer calculated the Company's "total net deferral" to be ** HC------- -**[15]. As the Company's net income is approximately $22 million per year,[16] that "total net deferral" is less that five percent of the net income, and Ms. Fischer determined that the Company's expenditures failed to pass the materiality test.[17]

After Ms. Fischer filed her Rebuttal Testimony, however, the Company provided updated information on its expenditures. Ms. Fischer then recalculated the "total net deferral" to be ** HC------- -**, as shown on Exhibit 14, in which Ms. Fischer utilized the same format as she utilized in Schedule JEF-3 to her Rebuttal Testimony. This figure is more than five percent of the Company's annual net income. If all of these data are accepted, this would suggest that the Company's expenditures are material, according to the Staff's first criterion. However, not all of these expenses would be valid for deferral, even if an AAO were to be granted by the Commission.

[15] Fischer Rebuttal, Ex. 6, HC Schedule JEF-3, p. 1.
[16] Tr. 279, lines 21-24; Tr. 281, lines 11-15.
[17] Fischer Rebuttal, Ex. 6, p. 16, line 27 – p. 17, line 2.

"*Ongoing Expenses.*" Ms. Fischer testified that when she noticed that her original determination of the materiality showed the net deferral to be less than five percent, she decided not to do a further analysis of the expenses that went into the listing of "ongoing" expenses, for there was no need to do so.[18] Ms. Fischer also testified, however, that when she recalculated the materiality, based upon updated information that the Company supplied (as described above), and found that the total net deferral was above five percent of net income, she analyzed the different components that go into the schedule. After doing so, she said, she "would back off of including the expenses that are ongoing in this schedule. And when you would back out those numbers, then I believe the total would fall below the 5 percent range."[19] Among the costs that would need to be "backed out" are the carrying costs and depreciation expense associated with normal capital additions associated with security, and any other expenses that would be of an ongoing nature.

The Staff submits that the Company has failed to satisfy the Staff's proposed materiality criterion.

(2) Are MAWC's current rates inadequate to cover the event (i.e., are MAWC's existing rates sufficient to cover the extraordinary cost and still provide MAWC with a reasonable expectation of earning its authorized rate of return)?

The information and evidence available to the Staff in this case is not sufficient to enable the Staff to form a judgment as to whether the Company is able to cover the alleged extraordinary cost and yet earn its authorized rate of return. Accordingly, the Staff does not contend that MAWC's current rates are adequate to cover the costs it has incurred in responding to The Events of September 11.

[18] Tr. 412, line 21 – Tr. 413, line 6.
[19] Tr. 413, lines 11-14.

This alone does not support the granting of an accounting authority order, however, because, as noted above[20], under the Staff's proposal the Company must show that it satisfies all four of the proposed criteria.

(3) (a) [Did the expenses result from] an extraordinary capital addition that is required to insure the continuation of safe and adequate service in which unique conditions preclude recovery of these costs through a rate case filing?

There are no unique conditions present in this case that would preclude MAWC from recovering its prudently incurred security-related capital addition costs through a traditional rate case filing. The Company is not presently subject to a rate moratorium that would prevent it from filing a rate case at any time of its choosing. Nor does any division of the Company have its rates frozen or indexed.[21]

As pointed out above[22], the Company could have decided, on December 1, 2001, to file a rate case on May 1, 2002, using a test year trued up to ** HC---------- -**, to reflect all expenditures that the Company will incur in its response to The Events of September 11. If it had done so, new rates reflecting any prudently incurred expenditures and taking into account all relevant factors could have become effective about April 1, 2003.

(3) (b) [Did the expenses result from] an extraordinary event that is beyond the control of the utility's management?

The Events of September 11 were certainly "extraordinary," according to any reasonable understanding of the term. With the destruction of two 105-story office buildings where 50,000 people were employed, serious damage to the Pentagon, the deaths of more than 3,000 people, and the destruction of four commercial airliners in an unprecedented attack, it probably qualifies as the most extraordinary day the United States has experienced in the last half century.

[20] See p. 8.
[21] Tr. 199, line 22 – Tr. 200, line 4.
[22] See pp. 5-6.

The critical question in this case, however, is not whether The Events of September 11 were extraordinary in some general sense, but whether, as a result of those events, MAWC in particular was compelled to incur extraordinary expenses in order to continue to lawfully provide safe and adequate water service to its customers. Viewed from this perspective, the expenses that MAWC incurred did not result from an extraordinary event that is beyond the control of the Company's management. It is striking that no other utility in Missouri has requested an AAO associated with security costs after The Events of September 11.

The Vietnam War was an extraordinary event; but it did not cause MAWC to incur an extraordinary expense. To use a more germane example cited by OPC attorney Ruth O'Neill[23], a flood in Fargo, North Dakota, is also an extraordinary event; but it is unlikely that it would cause MAWC to incur an extraordinary expense. And the attack on the Khobar Towers, the first attack on the World Trade Center in 1993, and the destruction of the Murrah Federal Office Building in Oklahoma City, all mentioned during the hearing in this case, were obviously extraordinary events as well, for they were all extensively covered by the national news media. But again, they did not cause MAWC to incur an extraordinary expense, even though each of them involved violent physical attacks upon property of the United States that were motivated by political goals, as were The Events of September 11. MAWC apparently took little action in response to any of these attacks, even though each of them was probably a terrorist attack.

Obviously, The Events of September 11 were far more serious than the earlier attacks. National, state and local leaders responded to them by placing a new emphasis on "homeland security." And the Company properly responded to the perceived new threats to the security of its facilities by re-evaluating its security procedures and making capital improvements. The Staff

does not here challenge the prudency of the Company's expenditures for those improvements. But that does not mean the expenditures were extraordinary, in the ratemaking sense.

Security expenses are an ongoing expense of any utility company. But the decision as to whether, how, when, and at what cost to upgrade the utility's security generally rests entirely within the discretion of the utility's management.

MAWC was not directly attacked on September 11. None of its facilities were damaged or destroyed. There was no interruption of the Company's service to its customers as a result of the terrorist attacks. And there was no need to repair any facilities in order to restore service to the Company's customers.

Furthermore, the Company has not received a mandate from this Commission, or from any other agency of the State of Missouri or of the federal government. The Company has said that it "could not do nothing,"[24] and that there was a "social mandate."[25] That may be true, and it may also be true that all of the Company's expenditures on improved security were prudent.

However, MAWC's decision to upgrade security rested entirely with the Company's management. Consequently, the Company's expenditures did not result from an extraordinary event that is beyond the control of the utility's management.

(4) Is there a sufficient reason why MAWC cannot recover the costs resulting from these expenditures through the normal rate case process?

In this case, there is not a sufficient reason why MAWC could not recover the costs that it incurred in response to The Events of September 11 through the normal rate case process.

---

[23] Tr. 84, lines 2-7.
[24] Tr. 305, line 18 – Tr. 306, line 16.
[25] Tr. 307, lines 21-25.

In its Report and Order in *In Re St. Joseph Light and Power Company*, Case No. EO-2000-845, the Commission emphasized the importance of utilizing the normal rate case process to recover costs, where that is feasible. The Commission there stated:

> However, the simple fact that an expense is extraordinary and nonrecurring is not enough to justify the deferral of that expense. Implicit in the Commission's previous orders regarding requests for AAOs is a requirement that *there must be some reason why the expense to be deferred could not be immediately included for recovery in a rate case.* (Emphasis added).

The Company has cited no reason, and the Staff knows of no reason, why the Company could not have sought recovery of its expenditures by filing a rate case "immediately" – or at least within six months after it decided that the expenses were significant enough to require recovery, which would have given the Company the time it needed to prepare its case. The fact that MAWC did not do so suggests that the Company did not believe the costs associated with its security upgrades were significant enough to justify filing a rate case in and of themselves. Company witness Grubb's testimony supports this conclusion. He testified that the Company's earnings are currently "around the authorized level," but that they would begin to erode next year, and that is why the Company plans to file its next rate case in June 2003.[26]

In some important respects, the Company's situation with regard to these security-related expenses is similar to that which it faces with regard to many of the other construction projects that it regularly undertakes in the conduct of its business. When the Company makes improvements to its treatment facilities or distribution system, it usually does so without an urgent timetable, and it can choose the optimum time to perform the design and construction and

[26] Tr. 275, line 15 – Tr. 277, line 23; see especially Tr. 276, lines 19-25. It should be noted that Mr. Grubb's testimony about the level of earnings was based upon the deferral of the expenditures that the Company seeks, in this case, to defer.

can then file a rate case to coincide with the conclusion of the project, if it so desires. Such is also the case here. The design and construction of the capital projects associated with enhanced security has been spread over nearly one year's time, and the Company was equally free to file a rate case to coincide with the conclusion of the project.

The Commission should not allow the Company to do, through the short-cut mechanism of an AAO case, what it ought to do in a normal rate case, where the Commission could consider all relevant factors.

C. If the Commission does not adopt Staff's four criteria as requirements to granting an AAO, are the costs incurred by MAWC to increase security measures subsequent to the events of September 11, 2001, "extraordinary, unusual, unique and non-recurring"?

Even if the Commission does not adopt the Staff's four proposed criteria as the basis for deciding whether an AAO should be granted, the Commission should nonetheless reject the Company's application for an AAO in this case. This is because, as noted above, at pages 8-9, the Staff's criteria do not significantly change the standard for granting an AAO, but rather summarize the standards that the Commission has strived to apply in deciding AAO cases in recent years. The Staff's proposed criteria expand and elaborate upon the issue of when an event may properly be considered as "extraordinary." The discussion in the foregoing pages therefore adequately addresses the question of whether the costs MAWC incurred in its response to The Events of September 11 were "extraordinary, unusual, unique and non-recurring." See especially the discussion under Issue 1.B.(3)(b), at pages 17-19, above.

Issue No. 2: In light of the above, should the commission grant to MAWC an Accounting Authority Order to defer recognition of the costs it incurred and attributed to increased security needs after the terrorist attacks of September 11, 2001 in New York City and Washington, D.C.?

The Commission should not grant an AAO in this case to allow MAWC to defer the costs it incurred in response to The Events of September 11.

The terrorist attacks in New York City and Washington, D.C. did not have *any* direct effect on MAWC. The Company was not required to incur any expense to restore service, repair its facilities, or upgrade its security as a direct result of the terrorist attacks. The only effect upon the Company was indirect. They affected the Company's perception of what it must do to discharge a duty that it has always had – to secure its premises.

The Company understandably perceives a greater risk of attack now than it saw prior to September 11, and it has acted to protect itself. The Company has not attempted to protect itself from the type of attack that we all learned about on September 11 – a suicide attack by a hijacked commercial airplane. But the Company did attempt to guard against another kind of attack that had been feared in the past, even though never carried out – the poisoning of our drinking water.

It has been often said that AAOs may properly be granted to alleviate the effects of damage to a utility's facilities by ice storms or floods. The Company's expenditures in this case are more akin to what a utility would do to protect against a *future* flood (for which, to Staff's knowledge, an AAO has never been granted) than it is to what a utility would do to repair the damage caused by a *past* flood (for which AAOs *have* been granted).

Assuming that the Company's expenditures in this case were wise or prudent, wisdom and prudence alone are not sufficient to warrant the grant of an AAO. The Company's

expenditures must still be extraordinary – generally as a result of some compulsion, such as a government mandate or an "act of God."[27]

A utility's decision to construct a new water treatment plant or replace some part of its existing plant, even at considerable expense, is usually not sufficient to justify the granting of an AAO, even if the decision is wise and prudent and the expenditure is necessary. Instead, the customary relief is for the utility to file a rate case that is timed so that the true-up period can include the conclusion of the project. The same thing could have been done here.

The Company's request for an AAO should be denied.

Issue No. 3: If the Commission grants MAWC an Accounting Authority Order:

A. What conditions, if any, should be reflected in the Commission's order?

If the Commission grants MAWC an accounting authority order, it should require the Company to begin amortizing the full amount of the deferrals immediately.

In its Application in this case, the Company requested that it be authorized to defer these expenditures until the effective date of a Report and Order in its next rate case, but not for longer than four years after the issuance of the requested AAO.[28] The Company also requested that the Commission state that it intends that the deferred expenses be included in the rates that are authorized in the next rate case, and that, if amortized, the amortization would continue for not more than three years.[29]

[27] Why God has traditionally been blamed for natural disasters has never been satisfactorily explained.
[28] *Application for Accounting Authority Order Requested to be Issued Prior to January 4, 2002 and Motion for Expedited Treatment,* ¶ 17 (a), pp. 6-7.
[29] *Application for Accounting Authority Order Requested to be Issued Prior to January 4, 2002 and Motion for Expedited Treatment,* ¶ 17 (b), pp. 6-7

Based upon this provision in the Application, and on Mr. Grubb's direct testimony[30], Ms. Fischer stated that the Staff's proposed fourth criterion would require that the Company show that there is a sufficient reason why it could not file a rate case to recover the costs resulting from the extraordinary event. Alternatively, if the request for AAO were approved, the Commission should require the Company to file a rate case within 90 days after the effective date of the AAO.[31] However, Ms. Fischer also informed the Company, in her response to a data request, that the Staff would change requirement 4 in the case of any AAO request that includes a prescribed amortization period.[32]

However the Company subsequently filed a Supplemental Statement of Position, in which it stated that the Commission should direct the Company to begin to amortize the deferred amounts over a 20-year period, beginning with the effective date of an order granting the requested AAO.[33]

Consequently, the Staff's Criterion No. 4, as applied to this new position, is also changed. The Staff still contends that the Company should provide a sufficient reason why it could not file a rate case to recover the costs of the extraordinary event. If the Commission grants the AAO, the Company should not be required to file a rate case within 90 days, as previously requested, but should instead be required to begin the amortization of the deferred amounts immediately.

The Commission should not make a rate decision, about the length of the amortization period, as a part of its decision in this AAO case. That decision should be postponed until the next rate case, when the Commission can consider all relevant factors.[34] If the Commission does

[30] Grubb Direct, Ex. 3, p. 4, line 16 – p. 5, line 8.
[31] Fischer Rebuttal, Ex. 6, p. 11, lines 17-23.
[32] See Ex. 15.
[33] *MAWC's Supplemental Statement of Position*, ¶ 2.
[34] Fischer Rebuttal, Ex. 6, p. 25, lines 1-3.

establish an amortization period, however, the Staff recommends that it be only 10 years, instead of the 20 years that the Company has requested.[35] This would serve the useful function of amortizing the deferred costs at a time that is more nearly contemporaneous with the time when the ratepayers receive the benefits of the expenditures that are being amortized. A 10-year amortization period is also consistent with the Commission's decision in *In Re Missouri Gas Energy*, Case No. GR-98-140, and *In Re St. Louis County Water Company, Case* No. WR-2000-844, regarding the amortization of AAO deferrals in those proceedings.

B. Should the Commission make any indications regarding future ratemaking treatment of the deferred expenditures in the Commission's order? If so, what indications should the Commission make?

The Commission's order in this case should not include any indications regarding future ratemaking treatment. On the basis of the Company's Supplementary Statement of Positions, it appears that this is undisputed.

The Staff said, in its Statement of Positions on this issue, that: "No ratemaking findings or conclusions of any kind should be included in any AAO issued by the Commission for MAWC's security costs."[36] The Company's position is essentially the same. MAWC said that an order granting an AAO should say: "That nothing in the Order shall be considered a finding by the Commission of the value for rate making purposes of the deferred expenditures."[37]

This language is substantially the same as that which the Commission used in its Report and Order in *In Re Missouri Public Service Co.*, Case No. EO-91-358, where it said: "That nothing in this order shall be considered as a finding by the Commission of the … costs to be

[35] Tr. 476, line 25 – Tr. 477, line 11.
[36] *Staff's Statement of Positions on Issues*, Issue 3.B, pp. 3-4.
[37] *MAWC's Supplemental Statement of Position*, Issue 3.B, p. 2.

deferred by ordered paragraph 1, the reasonableness of the expenditures, or the recovery of the expenditures."

CONCLUSION

The Commission should adopt the new four-part test that the Staff has proposed for judging applications for AAOs, and should reject the Company's Application in this case, because it does not satisfy the requirements of this test. Even if the Commission decides not to adopt this proposed test, it should reject the Company's Application. The Events of September 11 were tragic, devastating and extraordinary in some respects. But these events did not have an extraordinary effect on MAWC, and the Company should not be authorized to defer its security-related costs.

Respectfully submitted,

DANA K. JOYCE
General Counsel

/s/ Keith R. Krueger

Keith R. Krueger
Deputy General Counsel
Missouri Bar No. 23857

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-4140 (Telephone)
(573) 751-9285 (Fax)
kkrueg01@mail.state.mo.us

Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 20th day of August 2002.

/s/ Keith R. Krueger

_____