BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri-American Water Company for an Accounting Order Related to Property Taxes in St. Louis County and Platte County	))))	**File No. WU-2017-0351**

REPLY BRIEF

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), by and through counsel, and for its *Reply Brief,* states as follows:

Missouri-American Water Company ("MAWC") filed this request for an accounting authority order ("AAO") to defer approximately $4.8 million in 2017 and $2.7 million in 2018,[1] amounts representing the difference in tax liability from prior years in the counties of Platte and St. Louis County. For reasons outlined in its *Post Hearing Brief*, Staff does not support MAWC's request for an AAO, as MAWC has not met the threshold standards of extraordinary required for the amounts to be deferred through an AAO.[2]

ARGUMENT

MAWC has not met the standards to be granted an AAO

As AAOs are a departure from routine Uniform System of Accounts ("USOA") accounting, the USOA has outlined guidance on the appropriate items or events that are eligible for an AAO treatment. Instruction 7 governs booking AAOs and states:

> Those items related to the effects of events and transactions which have occurred during the period and which are not typical or customary business activities of the company shall be considered extraordinary

[1] MAWC'S *Statement of Position*, filed October 30, 2017.

[2] Ex. 6, Rebuttal Testimony of Mark Oligschlaeger, p 3, lines 10-23.

items. Commission approval must be obtained to treat an item as extraordinary.[3]

As outlined in Staff's *Post Hearing Brief*, the increases in MAWC's tax liability is not unusual or non-reoccurring, such as an "Act of God", a new regulation requiring a costly environmental upgrade, or an unusual, non-reoccurring action taken due to policy considerations. Property taxes are incurred on an annual basis, making them ordinary and reoccurring, and Staff views actions taken to change the parameters of how utility assets are assessed by taxing authorities as part of the ordinary discretion available to those bodies, and not considered inherently extraordinary in nature.

MAWC, in its *Initial Brief,* refers to the increases in property tax liability as "unpredictable".[4] Unpredictable seems a strong word for an action that was taken in 23 of the counties MAWC operates in,[5] but MAWC labels St. Louis County's use of the statutorily ordered 20 year recovery life just that.[6] Contrary to MAWC's claims, there is no discretion to use an incorrect recovery period, the statute clearly states:

> 2. To establish uniformity in the assessment of depreciable tangible personal property, each assessor shall use the standardized schedule of depreciation in this section to determine the assessed valuation of depreciable tangible personal property for the purpose of estimating the value of such property subject to taxation under this chapter.
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> 3. For purposes of this section, and to estimate the value of depreciable tangible personal property for mass appraisal purposes, each assessor shall value depreciable tangible personal property by applying the class life and recovery period to the original cost of the property according to the following depreciation schedule.[7]

[3] *See* Uniform System of Accounts for Class A Water Utilities, National Association of Regulatory Utility Commissioners, pg. 16 (1996).
[4] *MAWC's Initial Brief*, filed November 22, 2017, pages 3 and 12.
[5] Ex. 3, Staff Data Request.
[6] RSMo. 137.122.
[7] *Id.*

Recovery periods are also set forth in the Internal Revenue Service ("IRS") Publication 946, which governs how utilities report those taxable assets.[8] St. Louis County requiring MAWC to use the same recovery period mandated by Missouri law, the IRS, and used in 23 of the 24 counties MAWC operates in is hardly unforeseeable or unpredictable. Nor is it extraordinary or unusual, which makes MAWC's argument for a property tax AAO inappropriate.

MAWC attempts to argue in its *Initial Brief* that what MAWC is labeling a change in tax methodology by Platte County and St. Louis County results from a single and identifiable event, the State Tax Commission's decisions regarding Union Electric Company d/b/a Ameren Missouri and Laclede Gas Company and allegations those utilities were underreporting their assets.[9] This argument fails upon critical examination. As stated by Staff in its *Post Hearing Brief*, as well as the Office of Public Counsel ("OPC") and the Midwest Energy Consumer's Group ("MECG"), the evidence proves St. Louis County did not change their tax methodology. They are simply requiring MAWC use the correct recovery period.[10] To label an enforcement of current statutes and IRS regulations as a change brought on by other utilities underreporting their assets is erroneous. Furthermore, these are two distinct transactions, occurring on opposites sides of the state, with different recovery periods. The St. Louis County transaction involves assessing assets in St. Louis County with a 20-year recovery period, and the resulting liability; the Platte County transaction involves assessing assets in Platte County with a 50-year recovery period and that resulting liability. These are not one single transaction; these are two distinct transactions, performed by separate tax

[8] Tr. I, 195:9-22.
[9] *MAWC's Initial Brief*, filed November 22, 2017, page 9.
[10] Tr. I, 181:13-21.

authorities on distinct assets in two different counties. There is no evidence in this case that the actions taken by St. Louis County and Platte County were in any way coordinated or jointly undertaken. Although Staff finds it appropriate to view the impact of the years 2017 and 2018 in tandem for each taxing transaction,[11] Staff does not believe it is appropriate to combine discrete, unrelated transactions in separate counties just because they both fall under the broad umbrella of property taxes. Combining the Platte County and St. Louis County transactions would not further MAWC's cause as well, since neither transaction is extraordinary. Property taxes and subsequent changes in them due to increases in liability or subtle variations in taxing methodology are some of the most reoccurring and ordinary expenses a utility can occur.

MAWC finally tries to bolster its argument that the taxing transactions in Platte County and St. Louis County are extraordinary by focusing on the percentage of the increase in tax liability.[12] A 92% increase in property tax is not extraordinary; it is material. Materiality only matters in the second part of the analysis regarding AAOs. The first threshold is extraordinary. Material impacts alone cannot make an event or transaction extraordinary, or there would be no need for the second prong of the analysis. If so, every time a utility built new plant it could claim a property tax AAO, as their tax liability would increase by a significant magnitude, and could likely have a material impact.[13] Allowing the precedent that materiality can alone make an event or transaction extraordinary could have unintended consequences on material costs that a utility incurs that also happen to be reoccurring in the ordinary course of doing business. The Commission should decline expanded deferral accounting in such a way, and

[11] Tr. I, 145:2-3.
[12] *MAWC's Initial Brief*, filed November 22, 2017, page 8.
[13] Tr. I, 154:-23-25 through 155:1-2.

continue evaluating AAOs as case law and precedent dictate, by evaluating if an event or transaction is extraordinary, and then examining if it is material.

Commission case law does not support MAWC's request

MAWC spends much of its brief analogizing the present request to past Commission decisions, which upon closer examination support denying MAWC's position.

MAWC references a St. Louis County Water case involving an AAO request for main replacements in the days prior to the ISRS program.[14] Those series of AAO requests involved infrastructure critical to the provision of safe and adequate service.[15] If MAWC's request is denied in this case, MAWC will still be able to continue to provide safe and adequate service. Furthermore, the Commission later refused to allow recovery of the second AAO deferral request, and denied an AAO request for a third AAO.[16] Using the St. Louis Water case to argue costs outside the control of the utility are appropriate for an AAO is misleading, as later case history shows that those same costs outside the control of the utility were denied AAO treatment as being ordinary and reoccurring, which property taxes and increases in tax liability are also.

In its reply brief, MAWC attempts to compare the current request for a property tax deferral to a series of AAOs granted in the early 1990s for utilities concerning Other Post Employment Benefit ("OPEB expenses"). However, the comparison is in no way apt.

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[14] *See MAWC's Initial Brief*, filed November 22, 2017, pages 4 and 5, *In the matter of St. Louis County Water Company's Tariff Designed to Increase Rates for Water Service to Customers in the Company's Service Area*, Case No. WR-96-263, p. 13 (Report and Order issued December 31, 1996).
[15] In Re St. Louis Cty. Water Co., WO-98-223, 2001 WL 521854 (Feb. 13, 2001)
[16] *Id.*

In 1992, the Financial Accounting Standards Board ("FASB") promulgated Statement of Financial Accounting Standard No. 106 ("FAS 106"), which changed the required accounting for OPEBs from a "pay-as-you-go" method (based on the amount of actual payments to retirees) to an accrual method (based upon estimates of the value of OPEBs "earned" by employees in the current year, but not be paid out until a later time, often decades later). Utility rates in Missouri at that time were also set on a "pay-as-you-go" basis. Changeover to an accrual method of accounting from OPEBs was expected to lead to very material increases in cost of service for ratepayers if this change was adopted for ratemaking purposes.

The AAOs issued by the Commission in the 1992-1993 timeframe were intended to allow utilities to maintain pay-as-you-go regulatory accounting for OPEBs after the effective date of FAS 106, to match the prevailing rate treatment of this item. Crucially, however, the utilities were not anticipating recovery of deferred amounts in their next general rate proceedings, as MAWC is requesting here for property taxes; instead, the initial expectation was that the deferrals would reverse over time as the accrued amounts that were deferred were actually paid out in future years to retirees. In other words, the initial AAO requests were premised upon a belief that pay-as-you-go ratemaking treatment might continue to be applied by the Commission for the ongoing future.[17]

Therefore, the FAS 106 AAOs issued in the early 1990s were intended to prevent the utilities from suffering material financial detriment and utility customers from experiencing large rate increases due to a change in financial standards prior to the

[17] In 1994, this whole issue became moot when the Missouri Legislature passed a law mandating accrual/FAS 106 ratemaking treatment of OPEB expenses as long as the utility placed the accrual rate collections in an external trust mechanism.

Commission even considering the appropriateness of implementing FAS 106 for accounting and rate purposes. These AAOs certainly were not primarily intended to shield the utilities in entirety from the negative impact of changes in their incurred costs associated with normal and customary business activities, as MAWC seeks to do presently.

Through testimony and its *Initial Brief*, MAWC argues that a 2005 Missouri Gas Energy ("MGE") case stands for the proposition that increased property taxes are eligible for a deferral if they impose an increased burden on the utility.[18] However, the MGE case's actual holding is little more complex than MAWC's statement imply. In 2004, Kansas assessed a new type of tax on the value of natural gas storage inventories in the state.[19] This tax was new, and therefore there was no prior level of expense for this tax built into rates.[20] The tax liability would also fluctuate wildly, based on the value of the natural gas inventory stored on December 31 of each year.[21] MGE had also just completed an expensive rate case.[22] Finally, the legal status of the taxes at issue was unknown, so Staff and other parties to the case opposed uncertain costs being included in rates, as there was a possibility of a successful legal challenge, which would place an expense item in rates that was not being actually charged to MGE, allowing for over-recovery.[23] None of those circumstances are present in this case. MAWC is experiencing an increase to a tax it was already incurring on assets that

[18] See *MAWC's Initial Brief*, filed November 22, 2017, pages 5-6, Ex. 5, Surrebuttal Testimony of Brian W. LaGrand, page 10, lines 4-22 through page 11, lines 1-19, and Ex. 1, Direct Testimony of John R. Wilde, page 11, lines 15-22.
[19] *In the matter of the Application of Missouri Gas Energy, a Division of Southern Union Company, for an Accounting Authority Order Covering the Kansas Property Tax for Gas in Storage*, Case No. GO-2005-0095 (Report and Order issued September 8, 2005), page 4.
[20] *Id.*
[21] *Id.* at 6.
[22] *Id.* at 8.
[23] *Id.* at 9.

had been taxed for the last 10 years.[24] MAWC has a tax liability level already baked into rates, what MAWC is experiencing is just an increase to that level in rates. That is in contradiction to a new type of tax, like what MGE experienced. MAWC is also in the midst of their rate case, as opposed to just concluding one like MGE. Therefore, unlike the MGE situation, additional rate case expense will not be incurred to capture one additional cost. MAWC's cost is known and measurable, not fluctuating like MGE's, and the legal status of the St. Louis County tax is not at issue, as MAWC is not appealing St. Louis County's decision.[25] This makes MAWC's request an appropriate item to true up and include going forward in the rate case. The *Report and Order* in the MGE case sums it up:

> In most cases, the payment of property taxes by a utility would not be a fit subject for an AAO. MGE, like all investor-owned utilities, routinely pays property taxes. Again, like all other investor-owned utilities, MGE is routinely allowed to recover the taxes it pays from its ratepayers through the inclusion of those tax payments in its cost of service when its rates are calculated in a rate case.[26]

MAWC's circumstances are not the extraordinary ones found in the MGE case, and therefore, do not make them eligible to receive an AAO.

MECG in its *Initial Post Hearing Brief* aptly compares the AAO request in this case to Kansas City Power and Light Company's ("KCPL") request for a property tax tracker in its 2014 rate case.[27] MAWC in its *Initial Brief*, tries to distinguish the KCPL case by claiming since it was in a rate case, it was evaluated under the all relevant factors standard, as well as distinguishing it by claiming it was for ordinary tax

[24] Ex. 1, Direct Testimony of John R. Wilde, page 10, line 20.

[25] Tr. I; 183:10-15.

[26] *In the matter of the Application of Missouri Gas Energy, a Division of Southern Union Company, for an Accounting Authority Order Covering the Kansas Property Tax for Gas in Storage*, Case No. GO-2005-0095 (Report and Order issued September 8, 2005), page 14.

[27] *Initial PostHearing Brief of Midwest Energy Consumer's Group*, filed November 22, 2017, pages 7-9.

increases.[28] Firstly, this argument assumes that MAWC's tax increases are not ordinary, or were less ordinary than the tax increases faced by KCPL. Staff disagrees with that assertion, for reasons outlined above and in its *Post Hearing Brief*. If anything, KCPL requesting a tracking mechanism for property tax increases shows how common and reoccurring tax increases are, due to changes in methodology, additional assets, or other factors. Second, MAWC mistakes how the Commission, and later the Western District Court of Appeals ("Western District"), evaluated KCPL's request for a tracker.[29] Both the Commission and the Western District used the USOA extraordinary standard, also used in evaluating AAO requests, such as MAWC's instant action. Since trackers act to defer costs, much as an AAO does, the Commission found it appropriate to evaluate requests for trackers under the extraordinary standard.[30] The Commission found KCPL's property tax increases were not extraordinary, and denied the tracker request.[31] The Western District upheld the Commission's decision to evaluate tracker requests and AAOs in the same manner.

> The PSC has the power, pursuant to section 393.140(4), to prescribe uniform methods of keeping accounts. The PSC has adopted a rule that requires utilities to use the USOA to maintain their books and records. *See* 4 CSR 240–20.030. KCPL's arguments regarding the USOA and its alleged right to use a tracking accounting deferral mechanism completely ignore that the PSC's decision that only extraordinary expenses should be allowed such treatment is a policy decision that has been made by the PSC and is not dictated by whether, in the abstract, the USOA provides a mechanism to defer costs, whatever the type.

[28] *MAWC's Initial Brief*, filed November 22, 2017, pages 6-7.
[29] See *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electrical Service*, Case No. ER-2014-0370, *Report and Order* Issued Sept. 2, 2015 and In Matter of Kansas City Power & Light Co.'s Request for Auth. to Implement a Gen. Rate Increase for Elec. Serv. v. Missouri Pub. Serv. Comm'n, 509 S.W.3d 757, 764 (Mo. Ct. App. 2016), reh'g and/or transfer denied (Nov. 1, 2016), transfer denied (Feb. 28, 2017).
[30] See *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electrical Service*, Case No. ER-2014-0370, *Report and Order* Issued Sept. 2, 2015, page 53.
[31] *Id.* page 55.

> The manager of the PSC's auditing unit testified that the PSC will issue accounting authority orders ("AAOs"), which serve to allow a utility to deviate the normal method of accounting for certain expenses, most often associated with "extraordinary" events. The request by KCPL for the "tracking" accounting mechanism is the same as a request for an AAO, as it seeks to book a particular cost, normally charged as an expense on a utility's income statement in the current period, to the utility's balance sheet as a regulatory asset or regulatory liability. The manager testified that the PSC in prior cases has stated that the standards for granting the authority to a utility to defer costs incurred outside of a test year as a regulatory asset are: 1) that the costs pertain to an event that is extraordinary, unusual and unique, and not recurring; and 2) that the costs associated with the event are material.
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> In deciding that only extraordinary costs qualify for deferral, the PSC has followed the USOA's guidance that "it is the intent that net income shall reflect all items of profit and loss during the period." 18 C.F.R. Part 101, General Instruction 7.[32]

The Western District affirmed the Commission's decision to reject KCPL's property tax tracker request. The KCPL case is most analogous case precedent for property tax deferral requests, and that precedent is that increases in property taxes are not extraordinary, and therefore do not qualify for deferral accounting.

Conclusion

The Commission should not grant the AAO MAWC has requested in this case. The taxing transactions at issue are not extraordinary, nonrecurring, but in fact are one of the most predictable and ordinary cost a utility can incur. Furthermore, the discrete taxing transaction involving Platte County does not have a material impact on the annual revenues of MAWC. MAWC's attempts to argue revenue shortfalls due to the increased property taxes should be viewed skeptically. Although property tax expense has risen above the level set in the 2015 MAWC rate case (Case No. WR-2015-0301), it is likely other expenses have decreased, which means at this point in time, it is

[32] In Matter of Kansas City Power & Light Co.'s Request for Auth. to Implement a Gen. Rate Increase for Elec. Serv. v. Missouri Pub. Serv. Comm'n, 509 S.W.3d 757, 769–70 (Mo. Ct. App. 2016), reh'g and/or transfer denied (Nov. 1, 2016), transfer denied (Feb. 28, 2017).

inappropriate to argue lost dollars or revenue shortfalls.[33] For an ordinary, reoccurring cost such as property taxes, increases should be considered as part of all relevant factors to match expenses, investments, and revenues, which will determine if the revenue requirement is truly insufficient. The USOA intends for only truly extraordinary items to be exempt from this basic ratemaking principle, and MAWC's request in this case does not meet the burden required.

WHEREFORE, on account of all the foregoing, Staff prays that the Commission will issue its findings of fact and conclusions of law as recommended by the Staff herein; and granting such other and further relief as is just in the circumstances.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic mail, or First Class United States Postal Mail, postage prepaid, on this 1st day of December 2017, to all counsel of record.

/s/ Nicole Mers

[33] Tr. I, 154:8-22.