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**

THE OFFICE OF THE PUBLIC COUNSEL'S POST-HEARING BRIEF

COMES NOW the Office of the Public Counsel ("Public Counsel" or "OPC") and presents its post-hearing brief to the Missouri Public Service Commission ("Commission") as follows:

Introduction

1. Missouri-American Water Company ("MAWC") seeks an accounting authority order ("AAO") deferring costs into NARUC account 186 so that it can attempt to recover additional money in its rate case. How would deferring costs into NARUC account 186 permit MAWC to seek recovery of costs from a prior period of time in a rate case? Generally, it would not. MAWC already has the authority to record costs into account 186. What the Company actually seeks is a determination that its tax obligations in St. Louis and Platte Counties are extraordinary and material. As Public Counsel will discuss in this brief, the Commission should reject the company's application for an AAO because these tax obligations, if deferred, do not meet the standard to be considered in a different accounting period for the purpose of developing authorized rates.

2. When considering a petition for an AAO, the Commission should keep in mind the interplay between issuance of an AAO and how the deferred costs will later be considered in ratemaking. The Commission is charged with setting just and reasonable rates upon consideration of all relevant factors. In Missouri, those rates are generally based on a historical test year, updated for known and measurable changes. (*State* ex rel. *GTE North, Inc. V. Pub. Serv. Comm'n*, 835

S.W.2d 356, 368 (Mo. App. W.D. 1992)). "The accepted way in which to establish future rates is to select a test year upon the bases of which past costs and revenues can be ascertained as a starting point for future projection." (*State* ex rel. *Sw. Bell Tel. Co. v. Publ. Serv. Comm'n*, 645 S.W.2d 44, 53 (Mo. App. W.D. 1982)). When costs or revenues fall outside of a test-year (or true-up period, as the case may be) the Commission will exclude those items from consideration when setting the utility's rates for service. In this way, the Commission ensures the balancing process utilized to establish just and reasonable rates is not distorted by considering piece-meal costs or revenues from prior periods.

3. However, as the Western District Court of Appeals reiterated recently, the Commission "remains the authority that determines when an item may be included in a different accounting period for the purpose of developing authorized rates." (*Kan. City Power & Light Co.'s Request v. Mo. Pub. Serv. Comm'n*, 509 S.W.3d 757, 770). In Commission practice an AAO preserves a company's ability to argue that a cost should be considered during a subsequent rate case. "The whole idea of AAOs is to defer a final decision on current extraordinary costs until a rate case is in order." (*Missouri Gas Energy v. PSC*, 978 S.W.2d 434, 438 (Mo. Ct. App. 1998)).

4. Applying the Commission's standards for reviewing AAOs to this case, Public Counsel's opposition is two-fold. First, no order is necessary for the company to record costs in account 186, Miscellaneous deferred debits. Were it not already permitted to do so, perhaps a Commission pursuant to Section 393.140(8) RSMo would be required.[1] However, the undisputed evidence in

[1] Section 393.140(8) RSMo grants the Commission granting the Commission the "power to examine the accounts, books, contracts, records, documents and papers of any such corporation or person, and have power, after hearing, to prescribe by order the accounts in which particular outlays and receipts shall be entered, charged or credited."

the record shows that no further Commission order is required for the company to record costs in account 186 (Tr. Vol 1, p. 91; Tr. Vol. 1, p. 117; Ex. 8, pp. 4-5). To the extent the company seeks an order granting a "regulatory asset" that is not a decision the Commission should make because the essence of a "regulatory asset" is that it is probable of rate recovery, and so, such a decision – if made by the Commission - must be made within a rate case proceeding (Ex. 9, p. 3).[2]

5. Public Counsel's second reason for opposing the requested AAO is that the property taxes MAWC plans to record in account 186 are not "extraordinary". Paying property taxes is not unusual, unforeseen, or infrequent. The requirement MAWC pay property taxes in the counties in which it operates is one of its most predictable and ordinary expenses. MAWC claims that separate tax obligations in two counties on opposite sides of the state should be considered a single extraordinary event. In this way, the company seeks to use an actual change by the taxing authority (although not an extraordinary or material one) to shoehorn the larger dollar amount due St. Louis county into a single AAO. The additional tax obligations MAWC must pay in Platte and St. Louis Counties are separate occurrences that, when viewed either together (inappropriately) or separately (as is appropriate), are not extraordinary and material.

The company's request does not meet the Commission's standard for deferral (Issue 1)

6. When evaluating AAO applications, the Commission has stated the "initial inquiry is whether the costs sought to be deferred are indeed extraordinary. If they are not, the inquiry is at an end, and the other questions are moot." (*See In the Matter of Missouri Public Service and St. Joseph Light & Power, Divisions of UtiliCorp United, Inc*., 11 Mo.P.S.C.3d 600, 602-3 (2002)).

[2] Outside of a rate case whether to record a cost in any account, including account 186 or as a "regulatory asset", is a decision resting with company management.

This has been the standard since the landmark 1991 *Sibley* case, wherein the Commission determined that AAO's are allowed only when the event is extraordinary, unusual and unique, and not recurring (*In the Matter of Missouri Public Service,* 1 Mo. P.S.C. 3d 200, at 205 (1991) also known as the "Sibley" case). This "extraordinary" standard has been applied regularly by the Commission and was affirmed recently by the Western District Court of Appeals, stating "we will not second-guess the PSC's reasoned decision that only extraordinary items may qualify for deferral treatment" (*Kan. City Power & Light Co.'s Request v. Mo. Pub. Serv. Comm'n*, 509 S.W.3d 757, 770). Furthermore, in addition to whether an item is extraordinary, the Commission will consider the materiality of the costs to annual reported earnings in AAO cases (Ex. No. 10, p. 8). The "rule of thumb" used by the Commission in past AAO cases was that the extraordinary costs must be at least 5 percent of net income of the period (*Id*). The application of these standards were summarized by the Commission in a recent decision denying rate recovery of a deferred item wherein the Commission explained that in granting the AAO, it only determined (1) that an item could be deferred under accounting standards and (2) that the item was extraordinary and material. (*See In the Matter of Union Electric Company d/b/a Ameren Missouri's Tariff to Increase Its Revenues for Electric Service*, Report and Order, File No. ER-2014-0258, p. 39). MAWC's application fails to meet these standards.

Language required for order granting deferral to be consistent with accounting standards

7. The company's position statement explains that MAWC seeks authorization "to record on its books a deferred debit in NARUC account 186" for incremental increases in property taxes in two counties (MAWC's Statement of Position, p. 3). No Commission action is required for MAWC to take that action. However, the list of issues in this case contains two issues pertaining

to terminology in any final order that impacts whether the tax obligations can be deferred under accounting standards. Public Counsel raises these issues due to the company's various requests that the Commission grant a "regulatory asset" or ratemaking treatment.[3]

8. The first question on this point is, "[i]f granted, should the Commission AAO Order direct MAWC to create a regulatory asset or simply allow MAWC to defer the expenses as a miscellaneous deferred debit to USOA Account 186?" (**Issue 3**). Public Counsel's position, supported by the testimony of Chief Public Utility Accountant Charles Hyneman C.P.A., is that company management has the authority to record these expenses to Account 186 (Ex. 8, p. 4). Similarly, MAWC management has the discretion record theses expenses as a "regulatory asset" (Ex. 8, p. 5). However, under generally accepted accounting principles ("GAAP") as enforced by the Financial Accounting Standards Board ("FASB") and the Securities and Exchange Commission ("SEC"), the Commission cannot classify these deferred expenses as a "regulatory asset" in this AAO case (Ex. 8, p. 5). This is because the Commission has a long-standing policy not to grant any ratemaking treatment in an AAO case.

9. The Commission should be aware that there are consequences if it orders the creation of a "regulatory asset". Under GAAP, a regulatory asset has a special, unique, and mandatory characteristic that the expenses deferred by a utility are "probable" of recovery in a rate case (Ex. 8, pp 7-8). The SEC only allows a utility to reflect a "regulatory asset" on its balance sheet if the utility believes the deferred expenses are probable of recovery in rates (Ex. 8, p. 15). GAAP and

[3] MAWC had initially asked for an order with language permitting it to maintain these property tax expense deferrals on MAWC's balance sheet "until the effective date of the Report and Order in MAWC's next general rate proceeding and, thereafter, until all eligible costs are amortized and recovered in rates." (Ex. 10, p. 10). Public Counsel understands the company has since abandoned its request for this explicit ratemaking treatment.

the SEC define this "probable of recovery" as rate recovery being "likely to occur." If the Commission takes a position that it is not conferring rate treatment on deferred expenses, as it must to avoid single-issue ratemaking, but orders the creation of a "regulatory asset" it is, in effect, publicly stating that rate recovery is likely to occur - an inherently inconsistent position. To avoid this inconsistency, the Commission should – if it determines an AAO to be appropriate – make its "no ratemaking treatment" intent clear by simply allowing MAWC to make a deferral of expenses as a deferred debit in NARUC USOA Account 186 and not as a regulatory asset.

10. The second question related to whether the property tax obligations can be deferred under accounting standards is "[i]f granted, should the Commission AAO Order specifically state that it is not deciding that the deferred expenses are "probable" of rate recovery or that rate recovery is "likely to occur?" (**Issue 4**). If the Commission decides to grant an AAO, its Order should state explicitly that the burden to determine whether or not the deferred expenses qualify as a "regulatory asset" is completely on utility management and the Commission is expressing no opinion on the likelihood of future rate recovery.

11. Granting an AAO does not, in any way, signal any ratemaking treatment for the deferred costs. Commissioner Robert M. Clayton III expressed this very Commission policy in his Concurring Opinion in Case No. EU-2008-0233, an AAO case regarding winter storm damage, stating "[w]hile this grant of an AAO does not guarantee a utility recovery of certain costs, it does authorize accounting treatment that will enable **the possibility** of such recovery over and above standard costs of service in the future." (*In the Matter of the Application of Aquila, Inc. for the Issuance of An Accounting Authority Order Relating to its Electrical Operations*, Case No. EU-2008-0233, Concurring Opinion of Robert. M. Clayton III, p. 1) (emphasis added). In this way it

is equally likely the Commission will not to allow rate treatment of the deferral as it is to allow rate treatment. The Commission should note the distinction between allowing an accounting treatment that "enables a possibility" of recovery and an order designating the deferral as a "regulatory asset" which, in effect, states to the financial community that the Commission believes these deferrals are probable of recovery and rate recovery is likely to occur. This clear contradiction and irreconcilable position is the reason why the Commission, if it determines an AAO is appropriate, should not include language referring to the deferral as a "regulatory asset."

12. If the Commission decides to issue an AAO, answering these two issues (Issues 3 and 4) consistent with Public Counsel's recommendations ensures any order granting deferral will be consistent with accounting standards and regulatory requirements.

The tax obligations in St. Louis and Platte Counties are not extraordinary and material

13. As explained above, the initial inquiry the Commission should make is "whether the costs sought to be deferred are indeed extraordinary." (*See In the Matter of Missouri Public Service and St. Joseph Light & Power, Divisions of UtiliCorp United, Inc*., 11 Mo.P.S.C.3d 600, 602-3 (2002)). If they are not, the inquiry is at an end (*Id*). In its Report and Order in Case No. EU-2012-0027, the Commission defined "extraordinary item" as "an item that pertains to an event that is extraordinary, unusual and infrequent, and not recurring." (*In the Matter of the Application of Union Electric Company d/b/a Ameren Missouri for the Issuance of an Accounting Authority Order Relating to its Electrical Operations*, File No. EU-2012-0027, Report and Order, p. 3).

14. MAWC is required to maintain its books and records in accordance with the 1973 National Association of Regulatory Utility Commissioners ("NARUC") uniform systems of accounts ("USOA") for class A water companies, as revised in 1976 (*See* Commission Rule 4 CSR 240-

50.030(1)). The NARUC USOA in General Instruction No. 7, applicable to MAWC requires that items be “not typical” or not “customary” business activity of that company. The full definition is as follows:

> 7. Extraordinary Items.
>
> It is the intent that net income shall reflect all items of profit and loss during the period with the sole exception of prior period adjustments as described in General Instruction 8. 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. Commission approval must be obtained to treat an item as extraordinary. Such request must be accompanied by complete detailed information. (See accounts 433and 43r).

(Ex. 10, pp. 4-5).

15. The evidence in the record is that these property tax expenses are recurring and typical business activities of the company. Property taxes, when considered as a category of cost, are routine and ongoing, and should be considered to be among the most "ordinary" of costs incurred by a utility (Ex. 6, p.7). During the hearing Staff’s witness Mr. Oligschlaeger further testified that “assessment and payment of property taxes are annual recurring events for utilities” (Tr. Vol. 1, p. 103). No witness testified that property taxes were not recurring and typical costs.

16. Instead, MAWC argues that the sum of unrelated increases to the company’s property tax obligation in two separate counties should be considered together in this single AAO request. This argument by MAWC ignores that tax increases, too, are not unusual. OPC witness Mr. Riley testified that property tax increases are common among Missouri Utilities (Ex. 10, p. 3). Changes in methodology are also normal and, to a certain extent, expected. Staff witness Mr. Oligschlaeger

testified that "actions taken to change the parameters of how utility assets are assessed by taxing authorities should be considered as part of the ordinary discretion available to those bodies, and should not be considered to be inherently extraordinary in nature" (Ex. 6, p. 8). MAWC's own witness, Mr. Wilde, testified that the company can expect an assessor to exercise judgment and discretion in the method of determining the value of taxable property, stating "If you look at the statute, it's not like a you shall use this. It just tells you that this is a method. It also tells the assessor that they have discretion, if they don't feel that gets them to true value, to do something different." (Tr. Vol. 1, p. 65). If the company witness can reasonably expect an assessor to exercise discretion relating to methodology, circumstances when an assessor *exercises* that discretion regarding methodology can hardly be described as an unusual or non-recurring event.

17. Unable to meet the Commission's actual standard for an AAO, the company witness Mr. Wilde offers a novel definition of an AAO in his direct testimony, stating an AAO is "a mechanism used to allow a utility to defer expenses between rate cases to cover items that were not in effect at the time of the last rate case and were generally unforeseen." (Ex. 1, p. 8). The evidence in the record shows that MAWC's petition fails to satisfy even this relaxed (and legally unsupported) definition. First, "property tax" is an item that was in effect at the time of the company's last rate case and, in fact, was an item included in the company's rates. Second, to the extent that the county assessors independently changed a method (in St. Louis County, the assessor did not change) these changes should have been foreseen, both generally (as described above) and specifically (in regards to St. Louis County).

18. MAWC's theory relies on inappropriately combining the impact of two unrelated tax events. Properly viewed, one event is related to the tax obligation in St. Louis County and the other

is related to the tax obligation in Platte County. OPC's Mr. Riley, C.P.A., testified that the Platte County taxes and the St. Louis County taxes were separate events (Tr. Vol. 1, p. 163). MAWC's witness Mr. LaGrand agreed that the situations presented in the two counties are different (Tr. Vol. 1, p. 92).

19. The tax obligation in St. Louis County is not an increase due to an unexpected or unusual change in tax policy by the assessor. The company was simply reporting taxes incorrectly in St. Louis County for years. The witness for St. Louis County, Ms. Strain, testified that the county is not changing how taxes are assessed, but is simply making sure the company is using the correct recovery period (Tr. Vol. 1, p. 181). Ms. Strain, upon reviewing MAWC's return, inquired of other counties the company operates in and files taxes. She testified that she discovered MAWC had been using the correct 20-year recovery period in those counties "for years" (Tr. Vol. 1, p. 182). Thus, the "event" that caused to seek an AAO was due to an error the Company made on its property tax assessment filing; one that it did not make in other county tax assessment filings. This is certainly no basis for a request for extraordinary accounting treatment.

20. Based on the company's activities reporting taxes differently in 23 other counties than it did in St. Louis County in the past, Staff's Mr. Oligschlaeger testified "at the very least there should have been some anticipation" that the tax treatment in St. Louis County might change in the future (Tr. Vol. 1, p. 144). But the company had no plans to transition the way it self-reported its tax filings until the county forced compliance (Tr. Vol. 1, p. 44). Despite knowing of an eventual change as far back as 2007, the company or the company's consultant did not even discuss a transitional period with the county until this year (Tr. Vol. 1, p. 40). In assessing whether to grant an AAO application, the Commission has previously required that the allegedly extraordinary

event be the cause of the expenses which the Company incurred. (*See State* ex. rel. *Public Counsel v. PSC*, 858 S.W.2d 806, 811 (1993)). Had the company developed a plan, MAWC management – to the extent the increased tax obligation would have a material impact on the company's revenues – could have timed a transition to the different tax methodology around a rate case. Staff's Mr. Oligschlaeger indicated that making the change within the cutoff periods in a rate case could have affected the situation the company finds itself in now (Tr. Vol. 1, p. 129). An exchange between Commissioner Kenney and MAWC's witness Mr. LaGrand lends support to the proposition that MAWC's ability to time the filing of a rate case could have impacted MAWC's situation:

> **Q. (by Commissioner Kenney):** If the company would have changed their depreciation schedule from seven years to 20 years in 2007 or 2010 or 2013 or 2017, **unless that change coincided with a rate case and new rates go into place,** the company would have always been held at a loss unless the Commission granted like an AAO or something; is that correct?
>
> **A. (by Mr. LaGrand):** Yes, that's true.

(Tr. Vol. 1, p. 93) (emphasis added). Failure to prepare a transition plan and time it appropriately is a choice made by MAWC management and is no basis for the Commission to approve extraordinary accounting treatment.

21. Moreover, the impact of the tax obligation in St. Louis County does not necessarily meet the Commission's 5% materiality guide. MAWC presents the Commission with a misleading percentage that mismatches the increased tax obligation for a period greater than one year to the company's revenues from 2016. OPC witness Mr. Riley performed an analysis to break down the

tax obligation into separate 2017 and 2018 amounts (Ex. 10, p. 3; Ex. 11). For 2017, the impact was 6.2% (Ex. 11). However, as Staff witness Mr. Oligschlaeger testified this does not mean the AAO should be granted because the item is not extraordinary. Granting AAOs based solely or largely upon the materiality of the costs in question would inappropriately transform the use of AAOs to a primary purpose of safeguarding utility earnings levels (Ex. 6, p. 8). For the 2018 period, Mr. Riley calculated the impact to be 3.5%, well below the 5% threshold (Ex. 11).

22. Neither does the change to MAWC's tax obligation in Platte County rise to the level of being an extraordinary event. Although Staff's witness conceded that the situation in Platte county is different than the increased obligation in St. Louis County, he opposes the AAO for Platte County tax obligations. Changes to the parameters of how utility assets are assessed by taxing authorities should be considered as part of the ordinary discretion available to those bodies, and should not be considered to be inherently extraordinary in nature (Ex. 6, p. 8). Just as with the taxes in St Louis County, changes in methodology are also normal and, to a certain extent, expected. Furthermore, the dollar impact of the change in Platte County considered in isolation is not material (Ex. 6, p. 6). For these reasons, no AAO should be granted for MAWC's tax obligations in Platte County.

If the Commission grants an AAO, the deferred debit amortization should begin immediately (Issue 2)

23. The amortization of the deferred amounts should begin immediately in order to match the incurrence of the costs to the benefit received from the incurrence of the costs (Ex. 10, p. 10). The proper treatment for deferred costs is for the amortization expense to begin immediately or very soon after the project starts (Ex. 10, p. 11). This is a concept the Commission's Staff has endorsed in prior cases including in Case No. GU-2011-0392 (Ex. 10, pp. 11-12). Delaying the amortization

to a date significantly later than the date the benefit occurs (as the company proposes) is a distortion of the matching principle and should be rejected (Ex. 10 p. 10, 13). The foundational principle of both accounting and ratemaking is the matching principle and that is the foremost reason why the start date of the amortization should be matched as closely as possible with the benefits of the costs (Ex. 10, pp. 13-14).

Conclusion

24. The increases to MAWC's tax obligations in St. Louis County and Platte County are not extraordinary and material as defined by the NARUC USOA or Commission practice. As a result, these expenses do not meet the Commission's longstanding deferral standard. Therefore, Commission should reject the company's requested AAO (*See In the Matter of Missouri Public Service and St. Joseph Light & Power, Divisions of UtiliCorp United, Inc*., 11 Mo.P.S.C.3d 600, 602-3 (2002)).

WHEREFORE Public Counsel submits its Post-hearing Brief and asks the Commission to deny the company's AAO application.

Respectfully,

OFFICE OF THE PUBLIC COUNSEL

/s/ Tim Opitz
Tim Opitz
Deputy Public Counsel
Missouri Bar No. 65082
P. O. Box 2230
Jefferson City MO 65102
(573) 751-5324
(573) 751-5562 FAX
Timothy.opitz@ded.mo.gov

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I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all counsel of record this 22nd day of November 2017:

/s/ Tim Opitz