

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Missouri-American Water)
Company's Request for Authority to)
Implement General Rate Increase for Water)
and Sewer Service Provided in Missouri)
Service Areas)

Case No. WR-2022-0303

REPLY BRIEF

Comes now the Office of the Public Counsel (the “OPC”) and offers this reply post-hearing brief addressing Missouri-American Water Company’s (“MAWC”) and the Staff of the Public Service Commission of the State of Missouri’s (“Staff”) arguments regarding the remaining issue in this matter, Issue 3a related to affiliate transactions rules.

I. Argument: Issue 3a.¹ Should MAWC be required to file a Cost Allocation Manual with the Commission? Should the Commission open a new rulemaking docket in order to draft affiliate transactions rules for water and sewer?

Both MAWC and Staff oppose the OPC’s request for the Commission to open a new rulemaking docket to promulgate affiliate transactions rules for large water and sewer utilities and for the Commission to require MAWC to file a cost allocation manual (“CAM”) with the Commission. (*See generally* Staff Initial Post-Hearing Br., Doc. 233; MAWC Initial Br., Doc. 235). The OPC will first address MAWC and Staff’s arguments regarding the new rulemaking docket. It will then turn to their arguments regarding the filing of a CAM.

A. The Commission Should Open a New Rulemaking Docket to Promulgate Affiliate Transactions Rules for Large Water and Sewer Utilities

Though both MAWC and Staff oppose the OPC’s request for a new rulemaking docket to promulgate affiliate transactions rules for large water and sewer utilities, they do so for different reasons. MAWC makes three general arguments: (1) that water and sewer utilities should not be

¹ For clarity, the OPC retains the original numbering from the List of Issues, List and Order of Witnesses, Order of Opening, and Order of Cross-Examination. (Doc. 185).

subject to affiliate transactions rules, (2) the Commission considers MAWC’s affiliate transactions in its general rate cases, and (3) its transactions with the American Water Works Service Company, Inc. (the “Service Company”) would be exempt from the Commission’s current affiliate transactions rules. Staff, on the other hand, appears to center its argument on its belief that the OPC has asked the Commission to close Staff’s working group case that considers substantive changes to the Commission’s current affiliate transactions rules. The OPC will address each of these arguments in turn.

1. Missouri’s Large Water and Sewer Utilities Should be Subject to Affiliate Transactions Rules

In Mr. Brian LaGrand’s Surrebuttal Testimony, MAWC asserted, with no support, that Missouri’s water and sewer utilities should not be subject to affiliate transactions rules. (Ex. 15 “LaGrand Surrebuttal Testimony” 26, Doc. 229). MAWC expands on this assertion in its Initial Brief, stating that the situation that gave rise to the electric and gas affiliate transactions rules “does not exist in the water industry.” (MAWC Initial Br. 3-4). In support, MAWC refers to the types of entities affiliated with Missouri’s electric and gas utilities. (*Id.* 4). MAWC asserts that it “does not have unregulated electric generation (or water supply or sewer treatment), unregulated transmission (or pipeline) companies, gas (or water) marketers.” (*Id.*). Rather, MAWC states that the “majority (if not all) of MAWC’s transactions with affiliates are for corporate support, including its purchases of professional services from the service company and its access to debt markets through its financing affiliate.” (*Id.*).

Though MAWC may not have the same types of affiliates that Missouri’s regulated electric and gas utilities do, it remains important for the Commission to enact affiliate transactions rules applicable to large water and sewer utilities. As evidence of this, the Commission need look no further than the large and complex corporate structure of MAWC’s parent company, American

Water Works Company, Inc. (“American Water”). (See Schaben Direct Test., Schedule ADS-D-4 C, Doc. 81).² Each of the entities listed in the chart is likely an affiliated entity of MAWC under the definition of that term included in the Commission’s affiliate transactions rules.³ It is, in part, this complex corporate structure, created through “American Water’s aggressive acquisitions, system expansion and increasing investment in market-based non-regulated services” that make it “a textbook example of a utility the Commission had in mind when it drafted its existing affiliate transactions rules.” (Ex. 200 “Marke Direct Testimony” 3-4, Doc. 231).

Further, as the OPC pointed out in its Initial Brief, the OPC has twice raised concerns regarding MAWC’s interactions with American Water Resources, LLC (“AWR”). (See OPC Initial Br. 8-9, Doc. 234). AWR “provides service line protection to homeowners,” which includes, in part, water and sewer line protection, leak detection, and an in home plumbing emergency program. (Watkins Rebuttal Test. 6, Doc. 109; Marke Direct Test. 4-5). Though AWR is no longer an affiliate of MAWC as of December 2021, nothing precludes American Water from acquiring another, similar company, which may raise additional concerns. (See Marke Direct Test. 6-7).

The Supreme Court of the State of Missouri has also recognized the dangers associated with affiliate transactions in at least two cases. (See OPC Initial Br. 7-8 (referring to *State ex rel.*

² Though the Commission has not entered all of the pre-filed testimony into its electronic filing information system (“EFIS”) as exhibits, the Commission entered all of the OPC’s remaining exhibits into evidence during the March 29, 2023 On-the-Record presentation.

³ The Commission’s electric affiliate transactions rules define “[a]ffiliated entity” to be:

any person, including an individual, corporation, service company, corporate subsidiary, firm, partnership, incorporated or unincorporated association, political subdivision including a public utility district, city, town, county, or a combination of political subdivisions, which directly or indirectly, through one (1) or more intermediaries, controls, is controlled by, or is under common control with the regulated electrical corporation.

20 CSR 4240-20.015(1)(A). Each of the entities listed in American Water’s corporate chart are likely “under common control with” MAWC. *Id.*; 20 CSR 4240-20.015(1)(C); (see Schaben Direct Test., Schedule ADS-D-4).

Atmos Energy Corp. v. Pub. Serv. Comm'n, 103 S.W.3d 753 (Mo. banc 2003); *Office of the Pub. Counsel v. Mo. Pub. Serv. Comm'n*, 409 S.W.3d 371 (Mo. banc 2013) (hereinafter “*Public Counsel*”)). For instance, the Missouri Supreme Court pointed out that the

greater risk inherent in affiliate transactions arises because agreements between a public utility and its affiliates are not “made at arm’s length or on an open market. They are between corporations, one of which is controlled by the other. As such they are subject to suspicion and therefore present dangerous potentialities.”

Pub. Counsel, 409 S.W.3d at 377 (citation omitted). This concern regarding transactions not made at arm’s length exists regardless of whether the affiliate competes with the regulated entity in a similar market, such as an unregulated generation facility, or if the affiliate provides corporate support services, such as the Service Company. For instance, MAWC is at least as likely to pay its affiliated Service Company more for support services⁴ as a regulated gas corporation is to pay an unregulated affiliated pipeline more for use of the pipeline. In both instances, the increased price will likely benefit the overall parent company of the affiliated entities and both regulated utilities will likely recover their increased costs from their captive customers. Affiliate transactions rules that prohibit this increased price protect those captive customers in both situations.

Finally, Staff agrees with the OPC that water and sewer utilities with more than 8,000 customers should be subject to affiliate transactions rules. (*See* Ex. 115 “Bolin Rebuttal Testimony” 24, Doc. 230; Staff Initial Post-Hearing Br. 6). MAWC also settled its 2003 rate case, Case Number WR-2003-0500, based in part on its agreement that it, Staff, and the OPC would “use their best efforts to see that a rule regarding affiliate transactions is promulgated by the

⁴ The OPC will address below MAWC’s contention that its dealings with the Service Company would be exempt from the Commission’s current affiliate transactions rules.

Commission no later than April 16, 2005.” (Schaben Surrebuttal Test., Schedule ADS-S-1 “2003 Rate Case Stipulation and Agreement” 5,⁵ Doc. 162)

Though differences may exist between Missouri’s regulated electric and gas utilities and its regulated water and sewer utilities, the concerns associated with affiliate transactions are not different. It remains important for the Commission to enact affiliate transactions rules applicable to Missouri’s large water and sewer utilities. The Commission should disregard MAWC’s contention that water and sewer utilities should not be subject to affiliate transaction rules.

2. Though MAWC Submitted Testimony Regarding its Transactions with the Service Company, the Commission Lacks Regulatory Standards in Considering These Transactions

MAWC also opposes the Commission opening a rulemaking to promulgate affiliate transactions rules applicable to large water and sewer utilities stating that its “affiliate transactions are scrutinized in all of MAWC’s rate cases.” (MAWC Initial Br. 3). MAWC maintains that it provided testimony in this case “related to the necessity and reasonableness of the cost of services provided by the Service Company and whether MAWC was charged the lower of cost or market value.” (*Id.*).

The OPC does not dispute that MAWC submitted testimony regarding its Service Company charges. (*See generally* Baryenbruch Direct Test., Doc. 16). However, this does not change the fact that the Commission lacks regulatory standards applicable to transactions between a regulated water or sewer utility and its affiliated entities. The fact that MAWC is, at this time, voluntarily submitting testimony on the issues addressed in the Commission’s affiliate transactions rules, should not preclude the Commission from promulgating rules that would require MAWC to

⁵ The 2003 Stipulation and Agreement as attached to Ms. Schaben’s testimony includes two sets of page numbers. The page number identified here corresponds to the page number associated with Ms. Schaben’s schedule, which appears after the phrase “ADS-S-1 Page.”

continue submitting this testimony in the future. If the Commission does not promulgate affiliate transactions rules applicable to large water and sewer utilities and MAWC chooses not to submit this testimony in its next rate case, no clear standard would exist for the Commission to compel such evidence. Therefore, the Commission should disregard this argument as well.

3. The Service Company Would Likely be Subject to the Commission's Affiliate Transactions Rules

In addition to arguing that affiliate transactions rules should not apply to Missouri's water and sewer utilities, MAWC also contends that "the electric and natural gas affiliate transaction rules contain an exception related to transactions such as those in which MAWC engages in regard to the Service Company." (MAWC Initial Br. 5). MAWC cites in support the definition of "[c]orporate support" at 20 CSR 4240-20.015(1)(D) and 20 CSR 4240-20.015(2)(B), which contains an exception provision. (*See id.*). This argument ignores the fact that multiple, separate provisions exist in subsection (2) of the affiliate transactions rules. *See* 20 CSR 4240-20.015(2).

Using the Commission's electric affiliate transactions rules as an example, in 20 CSR 4240-20.015(2) the rules set forth the standards governing electric affiliate transactions. *See id.* For instance, in subsection (A) the rule provides:

- (A) A regulated electrical corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if—
1. It compensates an affiliated entity for goods or services above the lesser of—
 - A. The fair market price; or
 - B. The fully distributed cost^[6] to the regulated electrical corporation to provide the goods or services for itself; or

⁶ The Commission's rules define fully distributed cost ("FDC") to be

a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. FDC requires recognition of all costs incurred directly or indirectly used to produce a good or service. Costs are assigned either through a direct or allocated approach. Costs that cannot be directly assigned or indirectly allocated (e.g., general and administrative) must also be included in the FDC calculation through a general allocation

2. It transfers information,^[7] assets, goods or services of any kind to an affiliated entity below the greater of—
 - A. The fair market price; or
 - B. The fully distributed cost to the regulated electrical corporation.

20 CSR 4240-20.015(2)(A). Subsection (B) provides a separate standard, stating:

(B) Except as necessary to provide corporate support functions,^[8] the regulated electrical corporation shall conduct its business in such a way as not to provide any preferential service,^[9] information or treatment to an affiliated entity over another party at any time.

20 CSR 4240-20.015(2)(B).

If the OPC understands MAWC’s argument correctly, MAWC contends that the exception clause of subsection (B) applies to exempt any affiliate transaction involving corporate support functions. (*See* MAWC Initial Br. 5). In making this argument, MAWC essentially asks the Commission to conflate the two standards in subsections (A) and (B). However, this ignores the plain language of these two sections, which use distinct language and never refer to one another. Should the Commission decide it must address this issue,¹⁰ it must give effect to the plain language of the rules. *See Baker v. Dir. of Revenue for Mo.*, 569 S.W.3d 63, 68 (Mo. Ct. App. 2019) (“Administrative regulations are interpreted under the same principles of construction as statutes.”)

20 CSR 4240-20.015(1)(F).

⁷ Information is “any data obtained by a regulated electrical corporation that is not obtainable by nonaffiliated entities or can only be obtained at a competitively or prohibitive cost in either time or resources.” 20 CSR 4240-20.015(1)(G).

⁸ Corporate support is defined to mean “joint corporate oversight, governance, support systems and personnel, involving payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, and research and development activities.” 20 CSR 4240-20.015(1)(D).

⁹ Preferential service is “information or treatment or actions by the regulated electrical corporation which places the affiliated entity at an unfair advantage over its competitors.” 20 CSR 4240-20.015(1)(H). An unfair advantage is “an advantage that cannot be obtained by nonaffiliated entities or can only be obtained at a competitively prohibitive cost in either time or resources.” 20 CSR 4240-20.015(1)(J).

¹⁰ At this stage, the Commission need not decide whether MAWC’s relationship with its Service Company is exempt from the current affiliate transactions rules. Rather, a case considering the applicability of the affiliate transactions rules to the Service Company—such as a general rate case that includes a disallowance based on this issue—is a more appropriate venue. At this juncture, it should be enough that MAWC transacts with entities that likely qualify as affiliated entities under the Commission’s affiliate transactions rules.

(citation omitted)); *In re Application of Union Elec. Co. v. Mo. Pub. Serv. Comm'n*, 591 S.W.3d 478, 485 (Mo. Ct. App. 2019) (“Our primary rule of statutory interpretation is to give effect to legislative intent as reflected in the plain language of the statute at issue.” (internal quotation marks and citations omitted)).

Specifically, in describing the general prohibition against providing a financial advantage to an affiliated entity, Subsection (A) uses the terms financial advantage, fair market price, and the defined term “fully distributed cost.” *See* 20 CSR 4240-20.015(2)(A). The provision prohibits a “regulated electrical corporation” from providing “a financial advantage to an affiliated entity.” *Id.* It then describes what is a financial advantage. *Id.*

However, Subsection (B) prohibits a “regulated electrical corporation” from conducting its business so as to give “preferential service, information, or treatment” to an affiliated entity. 20 CSR 4240-20.015(2)(B). Subsection (B) includes an exception provision, which allows a “regulated electrical corporation” to provide “preferential service, information, or treatment” to an affiliated entity when it is “necessary to provide corporate support functions.” *See id.*

Subsection (B) does not refer to a financial advantage or to Subsection (A) at any point. *See id.* Rather, it uses distinct language that refers to a wholly separate situation—“preferential service, information, or treatment.” *Id.* This shows that Subsection (B), including its exception provision, is a standalone provision that applies to wholly different instances from Subsection (A). *See Brady v. Ashcroft*, 643 S.W.3d 565, 585 (Mo. Ct. App. 2022) (“When different statutory terms are used in different subsections of a statute, appellate courts presume that the legislature intended the terms to have different meaning and effect.” (internal quotation marks and citations omitted)). Because it is a separate provision, the exception clause of Subsection (B) does not affect the

general prohibition against providing a financial advantage to an affiliate as described in Subsection (A).

Should the Commission choose to address MAWC's argument that its transactions with its Service Company may be exempt from the Commission's current affiliate transactions rules, the Commission should disregard such an argument as legally incorrect.

4. The OPC is Not Asking the Commission to Close Staff's Working Group Case

It appears that Staff's argument that the Commission should not open a rulemaking docket centers on its belief that the OPC requests that the Commission close Staff's working group docket, Case Number AW-2018-0394. (*See* Staff Initial Post-Hearing Br. 6-8). Though this may have been Dr. Geoff Marke's initial recommendation in his Direct Testimony, it is clear from Dr. Marke's Surrebuttal Testimony, the OPC's Position Statement, and Counsel for the OPC's Opening Statement that this position changed throughout the pendency of this matter. (Marke Direct Test. 13; Ex. 201 "Marke Surrebuttal Testimony" 13-14, Doc. 232; OPC Position Statement 8, Doc. 197; Tr. 69-70, Doc. 226).

The OPC's recommendation is that the Commission should *both* continue the working group case, Case Number AW-2018-0394, and open a new rulemaking docket to consider affiliate transactions rules applicable to large water and sewer utilities. (*See id.*; OPC Initial Br. 9-12). In proceeding with both the working group case and the new rulemaking docket, the Commission could continue considering the important and, in some cases, controversial changes to the affiliate transactions rules *and* quickly promulgate affiliate transactions rules applicable to large water and sewer utilities. This would ensure that MAWC's customers are protected by enforceable affiliate

transactions rules while the Commission considers broader changes to the affiliate transactions rules themselves.¹¹

However, as the OPC explained in its Initial Brief, it is simply not enough to *only* continue Staff's working group case. (OPC Initial Br. 10-11). One of the reasons that this is insufficient is because there are currently two working group cases that must proceed in tandem: Case Numbers AW-2018-0393 (customer information rule) and AW-2018-0394 (changes to the affiliate transactions rules). Staff appears to suggest in its Initial Post-Hearing Brief that the rules considered in both of these working group cases will proceed simultaneously. (Staff Initial Post-Hearing Br. 8 (stating that "Staff must complete the forms required by the Secretary of State, finalize draft rules in Case Nos. AW-2018-0393 and AW-2018-0394, and then move forward with formal rulemakings.")). However, during the evidentiary hearing on this issue, Staff's witness testified that Staff does not plan to file a draft rule in Case Number AW-2018-0393 simultaneously with filing draft affiliate transactions rules. (Tr. 78-79). Staff's witness could not identify a timeline for the filing of a draft rule in Case Number AW-2018-0393. (*Id.*).

Because Staff's argument that the Commission should not open a rulemaking docket appears to center on its belief that the OPC requests that the Commission close Staff's working group docket, which is not the OPC's position, the Commission should disregard Staff's argument.

¹¹ Staff argues that opening a new rulemaking docket will "put the brakes on current work and delay the implementation of new rules. And significantly, it will negate the participation of stakeholders and OPC who expended resources to participate in rulemaking workshops and provide feedback and comments to assist Staff [in] get[ting] the draft rules to this stage." (Staff Initial Post-Hearing Br. 8). These statements appear to rely on Staff's understanding that the OPC asks the Commission to close Case Number AW-2018-0394. Staff cites nothing that suggests that the Commission cannot both open a new rulemaking docket and continue considering the changes to the affiliate transactions rules in the working group case. (*See id.*). In proceeding with the working group docket, the Commission will continue working toward the implementation of new affiliate transactions rules, which will give meaning to the parties' participation in that case.

B. The Commission Should Also Require MAWC to file a CAM

Both MAWC and Staff also suggest that the Commission not require MAWC to file a CAM because the Commission has previously ordered MAWC to file a CAM as part of accepting the Stipulation and Agreement in Case Number WR-2003-0500. (MAWC Initial Br. 2-3; Staff Initial Post-Hearing Br. 3). MAWC also asserts that the OPC's request has "elements of rulemaking outside of the statutorily prescribed process." (MAWC Initial Br. 3). Staff, on the other hand, takes issue with the OPC's concerns regarding the sale of AWR. (Staff Initial Post-Hearing Br. 4-6). The OPC will again address each argument in turn.

1. Although the Commission Has Previously Ordered MAWC to File a CAM, it Should Do So in This Case as Well

Both Staff and MAWC point out that the Commission ordered MAWC to provide a CAM in accepting the Stipulation and Agreement in Case Number WR-2003-0500. (MAWC Initial Br. 2-3; Staff Initial Post-Hearing Br. 3-4). However, neither MAWC nor Staff point to any authority to suggest that the Commission cannot reaffirm its prior decision in this case and, again, require MAWC to file a yearly CAM. (*See id.*).

Further, the OPC does not dispute that MAWC has a CAM. (*See Marke Direct Test. 4*). However, "because the Commission's affiliate transaction rules do not apply to MAWC, its CAM lacks any enforceable standards and, thus, provides minimal protection, if any." (*Id.*). Therefore, the OPC requests that the Commission require MAWC to file a CAM after it promulgates affiliate transactions rules applicable to large water and sewer utilities.

2. The OPC Does Not Request a Rulemaking as a Part of this Rate Case

MAWC also argues that the OPC's request regarding the CAM "has elements of rulemaking outside of the statutorily prescribed process." (MAWC Initial Br. 3). MAWC asserts

that the “Commission must avoid rulemaking by processes other than that found in Chapter 536, RSMo.” (*Id.*).

The OPC is not asking the Commission to establish a new rule as a part of this rate case. In ordering MAWC to file a yearly CAM, the Commission would simply be reaffirming what it ordered MAWC to do in accepting the Stipulation and Agreement in Case Number WR-2003-0500. As to rulemaking, the OPC requests only that the Commission open a new rulemaking docket to promulgate affiliate transactions rules applicable to large water and sewer utilities. (*See Marke Surrebuttal Test. 13*).

3. Staff Misunderstands the OPC’s Reliance on the Sale of AWR

Staff also argues that the OPC misplaces its reliance on the sale of AWR to support its position that the Commission should order MAWC to file a yearly CAM. (Staff Initial Post-Hearing Br. 4-6). Staff explicitly states that the “sale of an affiliate does not automatically trigger the affiliate transactions rules.” (*Id.* 6). Though this may be correct, Staff has misunderstood the OPC’s reliance on this transaction.

In his Direct Testimony, Dr. Marke cited to the sale of AWR to illustrate his concern that MAWC’s CAM lacks enforceable standards. (*See Marke Direct Test. 4*). This is directly tied to the fact that the Commission’s affiliate transactions rules do not apply to Missouri’s regulated water and sewer utilities.

The OPC remains concerned with the potential interactions between MAWC, the Service Company, and AWR.¹² (*See Schaben Surrebuttal Test. 18-20, Doc. 162*). However, the fact that

¹² In a footnote, Staff addresses the OPC’s concern that MAWC may be sharing customer information with AWR. (Staff Initial Post-Hearing Br. 5 n.13). Staff asserts that “[a]n equally—if not more—plausible explanation for th[e] AWR] letter [received by a MAWC customer] is that AWR[] merged MAWC’s publically-available service area data with any database containing resident address information.” (*Id.*). Although this is an alternative explanation, it is also possible that AWR had access to that information through the Service Company because it was an affiliate of MAWC and it used that information to send the letter. (*See Schaben Surrebuttal Test. 18*). It is, at least in part, the unknown source of this information that raises concern for the OPC.

MAWC's CAM lacks enforceable standards because the Commission's affiliate transactions rules do not apply to water and sewer utilities, supports the OPC's recommendation that the Commission open a rulemaking docket to expeditiously adopt affiliate transactions rules applicable to Missouri's large water and sewer utilities.

II. Conclusion

WHEREFORE, the Office of the Public Counsel respectfully requests the Commission open a rulemaking docket to promulgate an affiliate transactions rule applicable to Missouri's large water and sewer utilities and require MAWC to file a yearly CAM, thereby affirmatively answering both questions in the lone remaining issue in this case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the forgoing have been mailed, emailed, or hand-delivered to all counsel of record this 14th day of April 2023.

/s/ Lindsay VanGerpen