BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

INITIAL POSTHEARING BRIEF OF MIDWEST ENERGY CONSUMERS' GROUP

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November 22, 2017

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

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MIDWEST ENERGY CONSUMERS' GROUP

COME NOW the Midwest Energy Consumers' Group ("MECG"), pursuant to the Commission's September 6, 2017 *Order Scheduling Hearing and Setting Procedural Schedule* and hereby submits its Initial Post-Hearing Brief. In this brief, MECG addresses the request by Missouri American Water Company ("MAWC") for the issuance of an Accounting Authority Order ("AAO") allowing MAWC to defer increases in property taxes in St. Louis and Platte Counties.

1. REQUESTED RELIEF

On June 29, 2017, MAWC filed its request for an AAO. Through its Application, MAWC requests:

a) That Missouri-American Water Company is granted an Accounting Authority Order whereby the Company is authorized to record on its books a regulatory asset, which represents the increase from 2016 to 2017 in Missouri property taxes for the counties of St. Louis and Platte associated with the counties' change in the calculation of MACRs class lives; and

b) That MAWC may maintain this regulatory asset on its books 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.

2. STANDARD FOR ACCOUNTING AUTHORITY ORDERS

It is unquestioned that the consideration of Accounting Authority Orders be based upon the application of the "extraordinary" standard. The development of this standard is contained in two Court decisions: (1) the Missouri Supreme Court decision in *Utility Consumers Council of Missouri v. Public Service Commission*[1]*;* and (2) the Western District Court of Appeals decision in *State ex rel. Office of the Public Counsel v. Public Service Commission*.[2]

1. Utility Consumers Council of Missouri Decision

In the UCCM case, the Supreme Court had the opportunity to consider the Commission's implementation of a fuel adjustment clause.[3] Recognizing that a fuel adjustment clause allows for the deferral of changes in the cost of fuel for recovery in future rate cases, it is very similar to an accounting authority order. As such, the holding from the UCCM decision is relevant to the immediate issue facing the Commission.

There, the Supreme Court held that, absent express statutory authority, deferral accounting constitutes retroactive ratemaking and is therefore unlawful. Specifically, the Supreme Court held that it was unlawful retroactive ratemaking ("the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established") to allow the utility to collect such deferred fuel costs.

> The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect

[1] *Utility Consumers Council of Misouri v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc 1979 ("*UCCM"*).
[2] *State ex rel. Office of the Public Counsel v. Public Service Commission*, 858 S.W.2d 806, 811 (Mo.App. 1993) ("*OPC").*
[3] The UCCM case was decided decades prior to the enactment of Section 386.266 which provides a statutory basis for the current fuel adjustment clause.

> additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established. Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, *§§ 393.270(3)* and 393.140(5) they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses.

Thus, the UCCM stands for the proposition that deferral accounting constitutes unlawful retroactive ratemaking and is only allowed where the Commission is provided specific statutory authority.

2. OPC Decision

In 1993, the Commission considered Missouri Public Service Company's request to defer depreciation and carrying costs associated with its renovation of the Sibley generating station. In that case, the Commission was repeatedly told that the deferral of costs, as requested by Missouri Public Service, was unlawful retroactive ratemaking as defined by the *UCCM* court. In response, the Commission sought to carve out an exception to the doctrine against retroactive ratemaking for "extraordinary" costs – costs of the type that are not already reflected in rates.

> The Commission does not consider the granting of the deferrals of extraordinary items either single-issue or retroactive ratemaking as argued by Public Counsel. Retroactive ratemaking occurs when rates are set to recover for past deficiencies or to refund past excesses. . . The deferrals approved in Case No. EO-91-358 do not constitute retroactive ratemaking since they involve items which have been found to be extraordinary and therefore outside the current period match of revenues and expenses. Costs associated with extraordinary events such as losses, cancellations or service threatening timing differences have been authorized by the Commission. The Commission's discretion on what items to include in ordering operating expense and what are extraordinary items is broad.[4]

[4] Case No. EO-91-358, *Report and Order*, issued December 20, 1991, 1 Mo.PSC 3d 200, 212-213.

On review, the Court of Appeals agreed with the Commission's claim that there is a limited exception from the doctrine against retroactive ratemaking (i.e., deferral accounting) for extraordinary events.

> The Commission's decision to grant authority to defer the costs associated with the Sibley reconstruction and coal conversion projects by recording the costs in Account No. 186 was the result of the Commission's determination that the construction projects were unusual and nonrecurring, and therefore, extraordinary. . . . Because rates are set to recover continuing operating expenses plus a reasonable return on investment, ***only an extraordinary event should be permitted to adjust the balance to permit costs to be deferred for consideration in a later period.***[5]

Thus, absent specific statutory authority, the only authority for the Commission to engage in deferral accounting (i.e., retroactive ratemaking) is the limited exception provided by the OPC court. Specifically, absent specific statutory authority, the Commission's only authority to defer costs is where such costs are extraordinary ("unusual and nonrecurring, and therefore extraordinary").

3. THE PRACTICAL EFFECT OF AN ACCOUNTING AUTHORITY ORDER.

The use of deferral accounting has been repeatedly referred to as "extraordinary ratemaking." The use of the extraordinary tag is undoubtedly a result of the fact that deferral of costs from prior periods for recovery in later periods in problematic for at least four different reasons. ***First***, the consideration of select cost items from previous periods for future recovery destroys the critical "matching" concept inherent in good ratemaking and ignores the possibility of offsetting costs and revenues from that prior period. Specifically, in setting rates, the Commission traditionally considers all costs, revenues and investment all matched as of a common date. Deferral accounting allows the utility

[5] *State ex rel. Office of the Public Counsel v. Public Service Commission*, 858 S.W.2d 806, 811 (Mo.App. 1993) ("*Sibley*")

to selectively take costs that are increasing and defer them for recovery in a later case. As a result, the utility's financial condition is distorted. Past profits are inflated as a result of the removal of past costs from that prior period. Additionally, current profits are depressed by the inclusion of past costs into the rate period. Given the depression of current profits, current rate relief will be higher. As Staff explains:

> By deferring a cost that would otherwise be charged against net income immediately, the costs are preserved on the utility's balance sheet and the full amount likely can be sought for rate recovery in future rate cases. In other words, deferral of a cost allows the utility to avoid immediate charging of a cost against its income, and also increases the probability that the company can ultimately receive rate recovery of the cost in question even if the cost was incurred outside the ordered test year, update period or true-up period ordered in a general rate proceeding.[6]

Second, the implementation of tracking mechanisms eliminates some of the key aspects of traditional regulation through formal rate cases. These include the use of a test year in which costs are quantified in a balanced and internally consistent manner with appropriate matching of costs and revenues. In addition, the regulatory lag inherent in rate cases acts as an efficiency incentive which financially rewards the utility for achieving cost reductions. Specifically, while certain costs, including property taxes, may increase, the utility will be diligent to manage other costs to offset this increase. The utilization of deferral accounting creates an environment where utility management becomes indifferent to cost levels for those costs that are tracked.

Third, the implementation of trackers and the utilization of deferral accounting, while beneficial to the utility, imposes regulatory burdens on the other stakeholders to the utility regulation process. Each new cost tracking mechanism imposes additional regulatory burdens upon the Commission, its Staff, and concerned intervenors, through

[6] Exhibit 6, Oligschlaeger Rebuttal, page 4.

the creation of incremental monthly cost deferral accounting entries with carrying charges that should be rigorously analyzed for accuracy and prudence before being converted into incremental future rate increases. However, while increasing the burden, the incremental regulatory resources required for this needed critical analysis is often limited.

Ultimately, it is obvious that the utilization of deferral accounting and the implementation of tracker mechanisms constitutes a "heads we win, tails you lose" situation for the utility. As mentioned, the utility likely realizes improved current earnings and increased future revenues. On the other hand, consumers see higher rates caused by: (1) the regulator's failure to consider offsetting costs and revenues; (2) the elimination of consumer protections inherent in the ratemaking process; (3) the elimination of management incentives to minimize costs; and (4) the imposition of increased regulatory burdens without the addition of resources to handle those burdens. In the final analysis, given all of the problems with deferral accounting, it is understandable why the Missouri Courts have limited it to extraordinary events.

4. PAST ACCOUNTING AUTHORITY ORDERS HAVE BEEN FOR TRULY EXTRAORDINARY COSTS.

In the past, the Commission has been diligent to only provide for deferral accounting where the cost is truly "extraordinary". As Staff explains:

> Extraordinary events are events that are unusual, unique and not-recurring. The classic example of an extraordinary event impacting utility operations and costs are the occurrence of natural disasters, or so-called "acts of God," such as severe wind and ice storms, and major flooding.[7]

The reason for extending deferral accounting only to "extraordinary" events is somewhat obvious once one recognizes that utility ratemaking is based upon inclusion of ordinary

[7] Exhibit 6, Oligschlaeger Rebuttal, page 3.

costs, revenues and investment. As such, "extraordinary" costs, revenues and investment are not already included in rates. For this reason, "extraordinary" costs must be treated in an alternative fashion – through deferral accounting.

Q. Are the costs associated with extraordinary events normally included in utility rates on an ongoing basis?

A. No, because such costs are nonrecurring by definition. However, the policy in this state has been to authorize utilities to defer the costs to repaid and restore service in the aftermath of natural disasters through issuance of an AAO, and then allow the utility to recover prudently incurred deferred costs through an amortization to expense of the regulatory asset over a reasonable period of time.[8]

Given its steadfast adherence to the "extraordinary"standard, the Commission has limited deferral accounting to Acts of God including floods,[9] tornadoes,[10] and ice storms;[11] as well as the impact of new legislation[12] and rules[13] not previously reflected in rates.

Given the undeniable benefits, utilities have repeatedly attempted to extend deferral accounting to ordinary costs. Recently, the Commission considered KCPL's request to utilize deferral accounting for increases in property taxes, transmission costs and cyber-security expenses. Based upon the "extraordinary" standard, the Commission rejected KCPL's attempt to extend deferral accounting to these ordinary costs. The following quotation, while lengthy, is excellent recitation of the derivation of the "extraordinary" standard and the application of that standard to an ordinary cost.[14]

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[8] *Id.* at pages 3-4.
[9] See, Case Nos. WO-94-195; EO-94-149; and EO-94-35.
[10] See, Case Nos. GU-2011-0392 and EU-2011-0387.
[11] See, Case Nos. EU-2008-0138; EU-2002-1048; EO-97-224; and EO-95-193.
[12] See, Case Nos. TO-95-175; GO-94-255; GO-93-201; WO-93-155; EO-93-35; and EO-92-179.
[13] See. Case Nos. EU-2012-0131; GU-2007-0138; GR-2001-0292; GR-99-315; GR-98-140; GO-97-301; GR-96-193; GO-94-234; GO-94-220; GO-94-133; GO-92-185; GO-92-67; GO-91-359; GR-91-291; GO-90-215; GO-90-115; and GO-90-51.
[14] The provided quotation concerns transmission costs, a cost that the Commission found to be ordinary. In the Report and Order, the Commission simply referred back to its findings for transmission costs in its

KCPL's transmission costs are normal, ordinary and recurring operating costs, and not extraordinary. . . . The USoA allows deferral for "extraordinary items", which are defined as:

> Those items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence shall be considered extraordinary items. Accordingly, they will be events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the foreseeable future.

KCPL also requested a transmission tracker in its most recent rate case, ER-2012-0174, under a very similar fact situation. That Commission denied that requested tracker, finding that KCPL had failed to demonstrate that the projected cost increases were extraordinary:

> "Rare" does not describe cost increases in the utility business generally. Specifically, Applicants' evidence shows the following as to transmission. Transmission is an ordinary and typical, not an abnormal and significantly different, part of Applicants' activities. Also, Applicants showed that paying more for transmission than in the previous year is a foreseeably recurring event, not an unusual and infrequent event. Thus, "items related to the effects of" transmission cost increases are not rare and, therefore, are not extraordinary.

The evidence presented in this case showed that KCPL's transmission costs, while having increased in recent years, are normal, ordinary and recurring operation costs. These recurring costs are not abnormal or significantly different from the ordinary and typical activities of the company, so they are not extraordinary and, therefore, not subject to deferral under the USoA. The Commission concludes that KCPL has not met its burden of proof to demonstrate that projected transmission cost increases are extraordinary, so its request for a transmission tracker will be denied.

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decision to deny deferral accounting for property taxes and other ordinary costs. See, *Report and Order*, Case No. ER-2014-0370, issued September 2, 2015, page 56 ("KCPL has requested that the Commission approval the same type of deferral mechanism for property tax expenses that it requested for transmission fee expenses. For that reason, the Commission incorporates herein the analysis contained in the conclusions of law and decision section from the transmission fee expense issue discussed above. The Commission concludes that KCPL has not met its burden of proof to demonstrate that projected property tax increases are extraordinary, so its request for a property tax tracker
will be denied.").

Just as it did in the recent KCPL case, the Commission should be hesitant to accept MAWC's invitation to apply deferral accounting to an ordinary cost – property taxes.

5. AN INCREASE IN PROPERTY TAXES IS NOT EXTRAORDINARY.

In this case, Staff, Public Counsel, St. Louis County and MECG all oppose the application of deferral accounting to property taxes. As Staff explains, "utilities have incurred property taxes on an annual basis for many years. 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."[15] Furthermore, Staff points out:

> The majority of the dollars at issue in this proceeding relate to actions by St. Louis County to implement assessment practices that are currently being followed by every other county in Missouri in which MAWC operates. In short, there is nothing unusual or unique in how St. Louis County proposes to assess MAWC assets for property tax purposes and accordingly, this particular action by the taxing authority does not appear to meet the Commission's past criteria for deeming certain events to be "extraordinary."[16]

In this case, MAWC seeks to meet the "extraordinary" standard by claiming that the increase in property taxes resulting from an alleged sudden change in valuation methodologies implemented by St. Louis and Platte County. As Staff explains, taxing authorities generally calculate the assessed value by subtracting an estimated amount of depreciation from the asset's original cost.[17] In this case, MAWC alleges that St. Louis and Platte Counties began calculating the depreciation in a new manner. Specifically, St. Louis County, which utilized a 15-year life for water utility assets in 2017, began using a

[15] Exhibit 6, Oligschlaeger Rebuttal, page 7.
[16] *Id.*
[17] *Id.*, page 5.

20-year life in 2018.[18] Similarly, Platte County moved from a 20-year useful life for calculating depreciation to a 50-year useful life. The practical effect is obvious. By utilizing a longer lifespan, the asset retains a higher valuation. Given this, the assessed value is higher and the property taxes are increased.

The evidence indicates, however, that MAWC's claim that the taxing authority made some valuation changes is misplaced. The establishment of service lives for water assets is established by statute. In this case, Sections 137.010 et seq. provides the manner for the classification of assets as well as the service lives for such assets. In St. Louis County, the utility is required to self-report its personal property.[19] Through this process, the utility not only self-reports classification of property, but also the assessment rate based upon the application of the depreciation lives contained in Chapter 137. As St. Louis County explains, in its self-report for St. Louis County, MAWC misapplied the depreciation lives in Chapter 137 and inexplicably utilized a 7 year life.[20] The interesting part of this is that MAWC correctly applied the 20 year life in <u>all</u> the remaining 23 counties in which it operates.[21] Thus, any increase in property taxes that results from the application of a shorter depreciation life is <u>entirely</u> a result of MAWC's failure to properly apply the lives contained in Chapter 137.

6. CONCLUSION

In the final analysis, the Commission should reject MAWC's attempt to extend deferral accounting to an ordinary cost. Contrary to MAWC's assertions, the increase in property taxes is not analogous to the implementation of a new law or regulation. The

[18] *Id.*
[19] Exhibit 12, Strain Rebuttal, page 2.
[20] *Id.* at pages 2-3.
[21] Exhibit 6, Oligschlaeger Rebuttal, page 7.

increase in property taxes is not due to the sudden enactment of a new tax, but rather the result a correction in MAWC's wrongly calculated asset valuations in St. Louis County. Given that this is an "ordinary" cost, and does not meet the Commission's "extraordinary" standard, the Commission should reject MAWC's request.

Respectfully submitted,

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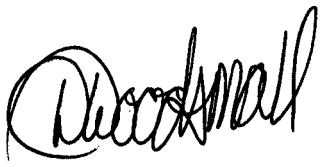
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.



David L. Woodsmall

Dated: November 22, 2017