

**EXHIBIT**

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**Exhibit No.:**

**Issue(s):**

Direct Testimony of Brian LaGrand/

Direct Testimony of John Wilde

**Witness/Type of Exhibit:**

Riley/Rebuttal

**Sponsoring Party:**

Public Counsel

**Case No.:**

WU-2017-0351

**REBUTTAL TESTIMONY**

**OF**

**JOHN B. RILEY**

Submitted on Behalf of the Office of the Public Counsel

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WU-2017-0351**


October 13, 2017

OPC Exhibit No. 10  
Date 11-08-17 Reporter XF  
File No. WU 2017 0351


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 )

STATE OF MISSOURI )  
 ) ss  
COUNTY OF COLE )

1. My name is John S. Riley. I am a Public Utility Accountant III for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

  
John S. Riley, C.P.A.  
Public Utility Accountant III

A circular notary seal for the State of Missouri. The outer ring contains the text "NOTARY PUBLIC" at the top and "STATE OF MISSOURI" at the bottom, separated by small stars. In the center, the words "NOTARY SEAL" are printed in a bold, sans-serif font.

  
Jerene A. Buckman  
Notary Public

My Commission expires August 23, 2021.

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**REBUTTAL TESTIMONY**  
**OF**  
**JOHN S. RILEY**  
**MISSOURI-AMERICAN WATER COMPANY**  
**CASE NO. WU-2017-0351**

**Introduction**

**Q. Please state your name, title and business address.**

A. John S. Riley, PO Box 2230, Jefferson City, Missouri  
65102

**Q. By whom are you employed and in what capacity?**

A. I am employed by the Office of the Public Counsel ("OPC") as a Public Utility Accountant  
III.

**Q. Please describe your educational background.**

A. I earned a B.S. in Business Administration with a major in Accounting from Missouri State  
University.

**Q. Are you a Certified Public Accountant ("CPA") licensed in the state of Missouri?**

A. Yes. I have been a Certified Public Accountant for nearly 20 years.

**Q. Are you a member of any professional Accounting organizations?**

A. Yes. I am a member of the Institute for Internal Auditors ("IIA").

**Q. Please describe your professional experience.**

A. I was employed by the OPC from 1987 to 1990 as a Public Utility Accountant I. In this  
capacity I participated in rate cases, and other regulatory proceedings before the Public  
Service Commission ("Commission"). From 1994 to 2000 I was employed as an auditor with

1 the Missouri Department of Revenue. I was employed as an Accounting Specialist with the  
2 Office of the State Court Administrator until 2013. In 2013, I accepted a position as the Court  
3 Administrator for the 19<sup>th</sup> Judicial Circuit until April, 2016 when I rejoined the OPC.

4 **Q. Have you previously filed testimony before the Missouri Public Service Commission**  
5 **("Commission" or "PSC")?**

6 **A.** Yes I have. A listing of my Case filings is attached as JSR-R-1

7 **Q. What is the purpose of your rebuttal testimony?**

8 **A.** The purpose of this testimony is to respond to the direct testimonies of MAWC witnesses  
9 Brian LaGrand and John Wilde related to the property tax Accounting Authority Order  
10 ("AAO") sought by MAWC in this case.

11 **Response to Direct Testimony Brian LaGrand.**

12 **Q. Mr. LaGrand states at page 5 of his direct testimony that MAWC has addressed this**  
13 **issue in its pending general rate case before the Commission. How did MAWC address**  
14 **this issue?**

15 **A.** In Case No. WR-2017-0285 Mr. LaGrand states at page 27 of his direct testimony:

16 Q. Is the company proposing a specific regulatory treatment for the  
17 significant increase in its property 2017-2018 tax obligation that  
18 results from the recent changes in how certain municipalities are  
19 assessing property taxes?

20  
21 A. Yes. Since the additional property taxes are unusual, material, and  
22 were not included in the cost of service for its current rates, the  
23 Company recently requested an Accounting Authority Order (WU-  
24 2017-0351) to record and defer on its books a regulatory asset for the  
25 significant increase in its property 2017-2018 tax obligation that  
26 results from the recent changes in how certain municipalities are  
27 assessing property taxes. The Company is requesting that the regulated  
28 asset be included in base rates in this case and amortized over 3 years.

1 **Q. MAWC's' claims that the increase in property taxes are unusual. Do you agree?**

2 A. No. Property tax increases are common among utilities in Missouri. In fact, property tax  
3 increases are so common that Kansas City Power & Light Company ("KCPL") sought an  
4 expense tracker to track the annual increases in property tax expense in File No. ER-2016-  
5 0285.

6 **Q. Are MAWC's' claims the additional property taxes are material supported?**

7 A. In MAWC's 2016 Annual Report to the Commission it reported net income of \$47.8 million.  
8 On an after-tax basis MAWC's estimated 2017 increase in property taxes is approximately  
9 6%. MAWC's 2018 estimated increase in property taxes is approximately 3% of its 2016  
10 net income. Given that the Commission has traditionally used a materiality threshold of 5%  
11 of net income, MAWC's estimate of the increase is material in 2017 but not material in 2018.  
12 OPC is, however, still attempting to verify the correctness of the exact amount of property  
13 taxes to include in a materiality analysis.

14 **Q. Have you reviewed MAWC's Application and direct testimonies in this case?**

15 A. Yes I have.

16 **Q. Does OPC consider the event that led to MAWC experiencing an increase in property**  
17 **taxes to be consistent with the types of events that would prompt the Commission to**  
18 **granting an AAO?**

19 A. No. It is my understanding that the Commission has traditionally required an event to be  
20 extraordinary before it will grant an AAO. The Commission traditionally has used the  
21 definition of an Extraordinary Item as found in the FERC and NARUA USOA General  
22 Instruction No. 7 as the basis for its conclusions. OPC does not consider increases in utility  
23 property taxes to be an extraordinary event under NARUC USOA standards.

1 **Q. What standard has the Commission applied when considering prior AAO cases?**

2 A. While the Commission has no specific standards on the types of transactions or events for  
3 granting a utility the authority to defer costs under an AAO, it has generally required a  
4 specific cost requested to be deferred to meet the FERC's definition of Extraordinary  
5 Item in FERC's USOA. This definition is as follows:

6 Extraordinary Items.

7 It is the intent that net income shall reflect all items of profit and loss  
8 during the period with the exception of prior period adjustments as  
9 described in paragraph 7.1 and long-term debt as described in  
10 paragraph 17 below. Those items related to the effects of events and  
11 transactions which have occurred during the current period and which  
12 are of unusual nature and infrequent occurrence shall be considered  
13 extraordinary items. Accordingly, they will be events and  
14 transactions of significant effect which are abnormal and  
15 significantly different from the ordinary and typical activities of  
16 the company, and which would not reasonably be expected to  
17 recur in the foreseeable future. (In determining significance, items  
18 should be considered individually and not in the aggregate. However,  
19 the effects of a series of related transactions arising from a single  
20 specific and identifiable event or plan of action should be considered  
21 in the aggregate. To be considered as extraordinary under the above  
22 guidelines, an item should be more than approximately 5 percent of  
23 income, computed before extraordinary items. Commission approval  
24 must be obtained to treat an item of less than 5 percent, as  
25 extraordinary. (See accounts 434 and 435.)  
26

27 **Q. Is this the same definition of Extraordinary Items used in the NARUC USOA?**

28 A. No. The NARUC USOA in General Instruction No. 7 has a much simpler description of  
29 extraordinary items. The NARUC USOA only requires that items be "not typical" or "not  
30 customary" business activity of that company.

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).

**Q. Does the FERC or NARUC USOA make any association between the definition of an extraordinary item and deferral of such costs as a deferred debit or regulatory asset?**

**A.** No, not that I am aware. The association between an extraordinary item and an expense deferral is only made by this Commission.

**MAWC's AAO Request**

**Q. Please summarize MAWC's AAO request in this case.**

**A.** On June 29, 2017, MAWC filed its *Application and Motion for Waiver* concerning the accounting for MAWC's increases in property tax expenses. Specifically, MAWC requests a Commission order granting an AAO containing the following language:

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.

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.

**Q. What is an AAO?**

A. An AAO is an order by the Commission that allows a utility to deviate from the Commission's normal accounting requirements and also deviate from the accounting requirements of generally accepted accounting principles ("GAAP"). Typically an AAO allows a utility to defer expenses on its balance sheet which then allows the utility an opportunity to address these deferred expenses in a rate case.

**Q. How does MAWC define an AAO?**

A. At paragraph 12 of MAWC's Application it defines an AAO as "a mechanism used to allow a utility to accrue expenses between rate cases to cover items that were not in effect at the time of the last rate case and were generally unforeseen."

**Q. Is this definition accurate?**

A. No. This is unlike any definition I have ever seen for an AAO and I do not believe any definition of an AAO similar to this definition has ever been used in a rate case in Missouri.

**Q. Do you have any other comments?**

A. Yes. At page 8 of his direct testimony, MAWC witness John Wilde defines an AAO as "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."

1 **Q. Is this definition accurate?**

2 A. No. Again this is unlike any definition I have ever seen for an AAO and I do not believe any  
3 definition of an AAO similar to this definition has ever been used in a utility rate case in the  
4 state of Missouri.

5 **Q. When it filed this AAO Application was MAWC “between rate cases”?**

6 A. No. MAWC filed this AAO Application on June 29, 2017. MAWC filed its pending rate,  
7 WR-2017-0285, on June 30, 2017, one day after it filed its AAO Application.

8 **Q. How does the Commission define an AAO?**

9 A. In its Report and Order in Case No. EU-2012-0027, the Commission stated:

10 An AAO is a mechanism to “defer” an item, which means to record  
11 an item to a period outside of a test year for consideration in a later  
12 rate action. Items eligible for deferral include an “extraordinary item”,  
13 an item that pertains to an event that is extraordinary, unusual and  
14 infrequent, and not recurring

15 **Q. How does the Staff define an AAO?**

16 A. In his rebuttal testimony in Case No. GU-2011-0392 (Staff Exhibit 2), Staff Accounting  
17 Manager Mark Oligschlaeger defined an AAO as “an authorization by the Commission for a  
18 utility to account for a cost in a different manner than is normally prescribed in the Uniform  
19 System of Accounts (USOA) which is adopted by the Commission.”

20 **Q. Is MAWC’s definition of an AAO remotely similar to the definitions adopted by OPC,**  
21 **the Commission and the Staff?**

1 A. No. To OPC's knowledge, nothing even remotely close to MAWC's definition has ever been  
2 used by the Commission or the Commission Staff in any prior AAO case. MAWC's definition  
3 seems to be tailored to the circumstances of this particular case.

4 Q. Is MAWC's definition of an AAO more like the definition of a rate case tracker, which  
5 may be ordered by the Commission for specifically identified and tracked expenses in a  
6 utility rate case?

7 A. Yes.

8 Q. Has the Commission restricted AAOs to costs that have certain characteristics?

9 A. Yes. Traditionally, the Commission, by granting an AAO, recognizes that certain costs  
10 incurred by a utility were extraordinary (unusual in nature and infrequent in occurrence).  
11 Materiality of the costs to annual reported earnings is also a factor considered by the  
12 Commission in AAO cases. The "rule of thumb" used by the Commission in past AAO cases  
13 was that the extraordinary costs must be at least 5 percent of net income of the period.  
14 Otherwise the cost was not considered material. When evaluating AAO applications, the  
15 Commission has stated the "initial inquiry is whether the costs sought to be deferred are indeed  
16 extraordinary. If they are not, the inquiry is at an end, and the other questions are moot. See  
17 *In the Matter of Missouri Public Service and St. Joseph Light & Power, Divisions of UtiliCorp*  
18 *United, Inc.*, 11 Mo.P.S.C.3d 600, 602-3 (November 14, 2002). The requested AAO was  
19 denied on the ground that uncollectibles are a normal cost of doing business.

20 Response to the Rebuttal Testimony of MAWC witness John R. Wilde

21 Q. Mr. Wilde, on page 11 of his direct testimony, states that, in the past, the Commission  
22 has granted an AAO to a Missouri utility for property taxes. Do these cases have similar  
23 facts?

1 A. No. Missouri Gas Energy ("MGE") was allowed to defer a Kansas property tax, but the  
2 circumstances were quite different. First, the tax imposed amounted to 9.03% of the  
3 Company's net income, which exceeded the Commissions materiality threshold.<sup>1</sup> Second,  
4 the Commission found that MGE had just *completed* a general rate case and initiating another  
5 rate case to capture these new taxes would have been cost prohibitive.<sup>2</sup> Finally, the property  
6 tax on MGE's natural gas inventories in Kansas was a newly instituted tax, and not a tax MGE  
7 had paid for many years. . These circumstances are clearly different from what MAWC's  
8 situation, a simple increase in existing property taxes by two Missouri counties where MAWC  
9 has paid property taxes for years.

10 Q. Mr. Wilde points out in his testimony that the Commission permits AAO's "where a  
11 utility has incurred some "extraordinary" expense that was not foreseen....."<sup>3</sup> Has Mr.  
12 Wilde made any argument in his testimony that an increase in property taxes is an  
13 extraordinary event?

14 A. No, he has not. There is no evidence in MAWC's Application or direct testimony that shows  
15 an increase in property tax expense meets the Commission's definition of an extraordinary  
16 event.

17 Q. Did St. Louis County unexpectedly shift its property tax policy as MAWC claims?

18 A. No. The County merely found an error in MAWC's tax reporting and corrected this error.  
19 MAWC is seeking an AAO, in part, due to an error the Company made on its property tax  
20 assessment filing. MAWC did not make this same error in other county tax assessment filings.  
21 This is certainly no basis for a request for extraordinary accounting treatment.

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<sup>1</sup> GU-2005-095, Page 7, line 5.

<sup>2</sup> *Id.* Page 8, line 19

<sup>3</sup> Wilde direct, Page 9 lines 9,10

**Amortization Start Date**

**Q. Please state OPC's concerns with MAWC's proposed ratemaking treatment of these deferred expenses.**

**A.** MAWC requests that the Commission, in its AAO, order MAWC 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."

**Q. Is this MAWC proposal a ratemaking proposal that should not be made in an AAO case?**

**A.** Yes. This request is a request for a ratemaking finding by the Commission and it is not an appropriate request to make in an AAO proceeding. Mr. Hyneman addresses this further in his rebuttal testimony. However, since MAWC made this ratemaking request, it is important to address the inherent weakness in this proposal.

**Q. What other weaknesses have you found?**

**A.** In rate cases, the Commission often cites to its rate case matching principle. The Commission has applied the matching principle to many of its past rate case ratemaking decisions. As its name implies, the matching principle matches the incurrence of costs to the benefits received from the incurrence of costs.

To state it differently, Matching requires that an expense be matched with the benefit associated with that expense. The proper treatment for these tax assessment costs is that the amortization to expense should begin immediately, or very soon after the payment for the property taxes take place. To delay the amortization of the expense deferral to a date significantly later than the date when the benefit of the expense is received is a distortion of the matching principle.

MAWC proposal results in a distorted matching principle. Under MAWC's proposal, MAWC believes that financial recognition of an expense incurred must be delayed until some future date when general utility rates are changed so that the expense can be directly included in the revenue requirement calculation.

**Q. Does the FERC address the matching principle?**

A. Yes. In its February 9, 2010 Brief for the Respondent, in Case Nos 09-2052 and 09-2053 before the U.S. Court of Appeals for the Fourth Circuit, FERC addressed the matching principle. In this Respondent Brief, the FERC expressed the importance of assigning costs to the periods in which benefits are expected to be received, i.e. the matching principle.

The Integration Order itself explained that costs incurred prior to customers receiving the commercial benefits of integration into the RTO should be allocated to the period when the related benefits are expected to be realized. This conclusion is based on the matching principle, which assigns costs to the periods in which benefits are expected to be realized.....As evidenced by the foregoing, therefore, the Commission has consistently applied the matching principle to justify its policy permitting deferral of RTO costs to time periods in which customers enjoy the benefits of RTO participation. (Citations omitted)

**Q. Does OPC agree with this Commission's general practice related to the start date of the amortizations for deferred expenses?**

A. Yes. The Staff position on this issue was stated in the rebuttal testimony of Staff witness Mark Oligschlaeger in his November 1, 2011 Rebuttal Testimony in Case No. GU-2011-0392. At page 4 of this testimony Mr. Oligschlaeger correctly states the Commission's practice on this issue:

Q. Is it the Commission's general practice to allow a utility to preserve deferrals on its balance sheet until such time that an amortization of the deferred costs can be included in the company's rates?

1 A. No. In most cases, utilities have agreed or the Commission has  
2 ordered that deferred costs begin to be amortized to expense a short  
3 time after the extraordinary event triggering the deferral has  
4 occurred, even if the company does not have a rate application on  
5 file. However, utilities still benefit from the deferral and  
6 amortization process in the absence of immediate rate recovery  
7 because they can spread the financial impact of the extraordinary  
8 event over a number of years rather than reflecting the entire impact  
9 in the year the extraordinary event occurred.  
10

11 **Q. Did Staff witness Amanda McMellen also address the issue of the amortization start**  
12 **date in her rebuttal testimony in Case No. GU-2011-0392?**

13 A. Yes. Ms. McMellen stated that Staff believes it is appropriate to begin to recognize expenses  
14 on the books of a regulated utility close in time to when those expenses are incurred. While  
15 authorization to defer these costs allows for the spreading of extraordinary costs over several  
16 years, it is not an appropriate use of AAOs to allow utilities to avoid recognizing any of the  
17 costs associated with the extraordinary event for an extended period of time. The earlier start  
18 date for the beginning of the amortization period avoids an unnecessary delay in recognizing  
19 the deferred costs for financial reporting purposes. Ms. McMellen also noted that amortizing  
20 the AAO deferral on a timely basis will result in the utility appropriately considering the  
21 deferral amortization, along with all other elements of its cost of service, in its analysis of the  
22 adequacy of its rates in the future.

23 Ms. McMellen testified further that Staff does not agree that an AAO amortization should  
24 begin with the effective date of the approved rates in the next rate case. Staff does not believe  
25 it is appropriate for utilities to “time” the booking of their expenses to exactly match the direct  
26 rate recovery of the expense. A utility’s “normal” expenses are charged to its income  
27 statement as incurred, and that approach is in no way tied to the timing of the rate recovery  
28 afforded these costs, if any. The simple act of attaching the word “extraordinary” to these

1 expense does not justify artificially synchronizing the booking of these expenses with receipt  
2 of the associated rate revenues.

3 Ms. McMellen explained that delay in beginning the deferral amortization until the effective  
4 date of rates of a utility's next general rate filing, which may be several years into the future,  
5 is a type of regulatory accounting "gamesmanship" designed to allow the utility the  
6 opportunity to maximize its rate recovery of the item in question.

7 Finally, Ms. McMellen stated that the beginning of the amortization period should not be  
8 delayed is to prevent almost certain over recovery of these costs. While a utility is requesting  
9 not to begin the amortization on their books until they can recover the costs in rates, they have  
10 no reason to be as diligent in timing the next rate case so that its rates might be proportionately  
11 reduced when the amortization expires. If rates are increased at the same time the amortization  
12 begins but are not decreased by the time the amortization expires, then the utility will be  
13 practically guaranteed an over-recovery of these costs. Staff's position is that neither the  
14 beginning nor ending point of an AAO amortization needs to be synchronized with rate  
15 actions by the Commission.

16 **Q. Do you agree with Staff witness Oligschlaeger and McMellen on the issue of the start**  
17 **date of any deferred expense?**

18 **A.** Yes. I agree with each of the points put forth by Staff in support of its position against  
19 unnecessarily delaying the start date of the amortization to expense of a deferred cost, whether  
20 it be to a deferred debit account of a regulatory asset account. However, of all the reasons  
21 listed by Staff against such a delay, the best reason is that the expenses deferred must be  
22 matched with the benefits created by incurring the costs. With this particular case, MAWC is  
23 incurring property tax expenses in 2017 in order to be able to provide utility service in 2017  
24 and for its shareholders to enjoy profits on its utility investments in 2017. The foundational  
25 principle of both accounting and ratemaking is the matching principle and that is the foremost



1       reason why the start date of the amortization should be matched as closely as possible with  
2       the benefits of the costs

3       **Q.     Does this conclude your rebuttal testimony?**

4       **A.     Yes, it does.**

**John S. Riley, CPA**  
**Summary of Case Participation**

ST LOUIS COUNTY WATER COMPANY	CASE NO. WR-88-5
SOUTHWESTERN BELL TELEPHONE COMPANY	CASE NO. TC-89-21
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. ER-2016-0023
KCP&L GREATER MISSOURI OPERATIONS COMPANY	CASE NO. ER-2016-0156
KANSAS CITY POWER & LIGHT COMPANY	CASE NO. ER-2016-0285
AMEREN MISSOURI	CASE NO. ER-2016-0179
EMPIRE DISTRICT ELECTRIC PRUDENCE REVIEW	CASE NO. EO-2017-0065
LACLEDE GAS COMPANY	CASE NO. GR-2017-0215