BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American	)	
Water Company's Request for	)	
Authority to Implement a General	)	Case No. WR-2024-0320
Rate Increase for Water and Sewer	)	
Service Provided in Missouri Service	)	
Areas	)	

JOINT RESPONSE TO MOTION TO ESTABLISH A FUTURE TEST YEAR

COMES NOW the Office of the Public Counsel ("OPC"), Missouri Industrial Energy Consumers ("MIEC"), Consumers Council of Missouri ("Consumers Council"), Midwest Energy Consumers Group ("MECG"), AARP, the City of St. Joseph, Missouri, and the City of Riverside, Missouri (collectively referred to as the "movants") and for their *Joint Response to Motion to Establish Future Test Year*, states as follows:

On July 1, 2024, Missouri-American Water Company ("MAWC") filed tariff sheets designed to implement a general rate increase. Included with this filing was a *Motion to Establish Future Test Year*. On July 2, 2024, the Commission filed an *Order Directing notice, Establishing Time to Intervene, Setting Time to Respond, and Consolidating Cases* that ordered, among other things, that "[a]ny party wishing to respond to Missouri-American's Motion to Establish Future Test Year shall do so no later than July 26, 2024." Pursuant to that order, the movants now collectively file this *Response to Motion to Establish Future Test Year* and ask the Commission to reject MAWCs request and order the use of an historic test year with true-up.

MAWC's Proposed Future Test Year Violates Missouri Law

Under long-standing Missouri precedent, a utility is only permitted to earn a return on a plant investment if that investment has been utilized to provide service to customers.[1] As the courts have explained:

> The utility property upon which a rate of return can be earned **must be** utilized to provide service to its customers. That is, **it must be used and useful**. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in its rate base.[2]

This caselaw has been cited to and relied upon by the Commission in recent cases to conclude that a utility is not permitted to earn a return on plant that has been abandoned by the utility.[3] Just as a utility cannot earn a return on plant that is abandoned (because it is no longer used and useful), the law prohibits a utility from earning a return on plant that has not yet even been built (because it is equally not used and useful). Yet that is exactly what MAWC is proposing to do with its future test year.

MAWC is requesting Commission approval to earn a return on investment for plant that will not be placed into service before May 31, 2025. However, the operation

[1] *State ex rel. Union Elec. Co. v. Pub. Serv. Com.*, 765 S.W.2d 618, 622 (Mo. App. W.D. 1988) (emphasis added); *see also State ex rel. Mo. Office of the Pub. Counsel v. PSC of Mo.*, 293 S.W.3d 63, 75 (Mo. App. S.D. 2009)(citing same).

[2] *Id.*

[3] *Amended Report and Order*, pg. 67, EO-2022-0040, EFIS Item No. 186 ("The cost of the abandoned environmental projects at Asbury meet the definition of energy transition costs as defined by the securitization statute. As such those costs may be recovered through securitization. **However, those costs would not be includible in Liberty's ratebase and thus it may not recover a return on those investments**")(emphasis added)

of law date for the Commission to issue new rates in this case is May 28, 2025. This means that as soon as the Commission approves rates in this case, MAWC will begin to collect a return on investments that the Company has not yet made and ultimately may never actually make. Moreover, even if these investments are made, there is no guarantee that the investments will be made in a timely manner. As such, these investments will simply exist as "phantom plant" on the Company's books; thereby allowing the Company to charge customers for return on non-existent assets that are providing no benefit to customers. Because this "phantom plant" is categorically not used and useful at the time it is included in rate base, MAWC's proposed future test year would result in an immediate violation of Missouri law. It also creates a situation of immediate over-earnings for the Company as MAWC will be collecting the cost of capital that it has not yet spent.

Compounding the issue of over-earnings due to the return on investments that do not exist is the concerns related to over-earning due to the return of investments that do not exist. Included in the Commission's final approved rates to be issued in this case will be depreciation expense that mirrors the accrual of depreciation on MAWC's existing assets. In the event the Commission orders a future test year, the Commission will also need to include depreciation expense for those assets MAWC predicts it will build in the coming year. Again, this results in immediate over-earning by MAWC because the Company will be collecting money to reflect the accrual of depreciation that does not, and from an accounting perspective cannot, occur until after the plant is put into service. Even if MAWC proposed to cure this flaw by booking depreciation reserve accruals before the plant being depreciated was placed into service, which would most likely violate general accounting principles, new problems would arise. Booking depreciation before plant is even placed into service will result in an accelerated depreciation of the utility's assets, which will ultimately distort those asset's depreciable lives on a going forward basis and skew regulatory oversight of the Company's books.

Given the overearning that will necessarily occur with both the return "on" and return "of" MAWC's rate base in the event of a future test year, it is easy to see why past Commissions have disregarded this methodology. Not only does it violate Missouri's requirements that rate of return only be earned on plant that is used and useful, it also seriously infringes on the statutory requirement that a water or sewer corporation's rates be "just and reasonable" by allowing the Company to recover far more than it actually spends to provide service to its customers.[4] For these reasons alone, the Commission should deny the Company's request for a future test year.

In the face of the legal problems so far outlined, MAWC presents a 2013 "report" by the National Regulatory Research Institute ("NRRI") that attempts to suggest the used and useful requirement can be by-passed when using a future test year. However, the NRRI paper that MAWC relies upon is actually only the results of a survey that solicited feedback on future test year by participating commissions. As the paper itself explains:

[4] RSMo. § 393.130.1

> This survey paper tries to answer [questions posed regarding future test year]. NRRI sent out 14 general questions to 21 state utility commissions that have used FTYs in setting utility rates. Fourteen commissions replied. Responses to some questions reflected commonalities across states while other responses were more heterogeneous, suggesting varying experiences and views on the part of those commissions that have applied FTYs in their ratemaking.[5]

With regard to the very specific question of the "used and useful" principle, what was actually posed by the NRRI was simply this: "If your commission requires a project to be 'used and useful' before a utility can recover any of its costs from its customers, how does this mandate reconcile with an [future test year]?"[6] As the paper indicated, there were a myriad of responses among just the fourteen states that actually provided survey answers.

The State of Kentucky explained that its Commission does not require a project to be used and useful at all in order to be recovered.[7] Alabama and Illinois, meanwhile, both claimed that projects that are not "used and useful" either can or should be excluded from the future test year, respectively.[8] Some states did allow projected rate base to be included, but even then there were exceptions and restrictions. Connecticut, for example, only allows "Projects scheduled for completion by the mid-point of the rate year [to] be part of the revenue requirements[.]"[9] Florida stated the inclusion of projected costs "would be highly case-specific[.]" Tennessee has

[5] Ken Costello et al., *Future Test Years: Evidence from State Utility Commissions*, NRRI Report 13-10, pg. iv, Oct. 2013, available at https://pubs.naruc.org/pub/FA86C105-05F5-9766-BC78-29829AC50361).
[6] *Id.* at pg. 47.
[7] *Id.*
[8] *Id.*
[9] *Id.*

evidently started to rely more on trackers and deferrals according to its response.[10] And Wyoming indicated rate base had only been included using "phase-in" rates through stipulation.[11] Given the wide range of variety of responses provided to the NRRI survey, MAWC is wrong to simply claim that the Commission can ignore the legal "used and useful" requirement based on the survey itself. This is especially true when considering that none of the fourteen states surveyed were applying Missouri law and that many operate under completely different statutory and regulatory frameworks.

MAWC's assertion that the Commission has clear authority to adopt future test year is further undermined by the Missouri Legislature's recent consideration of several bills that would have authorized use of a future test year for regulated water and sewer utilities.[12] None of the bills containing those provisions on future test year became law. If the authority existed as MAWC claims in its motion, there would have been no need for such legislation to be offered. Furthermore, the fact that such legislation was offered, but failed to advance and become law, could be interpreted as an indication that the General Assembly does not deem this authority to be consistent with good ratemaking policy or the protections to the public that the Commission should provide. Given the consideration and failure to advance of the future test year legislation, MAWC's claims that current statutes authorize use of a forecasted future test year should be looked at with a high degree of skepticism.

[10] *Id*. at 49

[11] *Id*. at 50.

[12] Among these bills were SB1280, SB740, HB2167, and HB1746.

Missouri's legal precedent prohibits earning a return on investments that are not used and useful and this prohibits the inclusion in rate base of prospective capital investments.[13] Instead, the Missouri Commission has relied on the time-tested and reliably proven method of utilizing historical data to make informed decisions regarding expected costs, the same way any non-regulated business would prepare its budget. That is why Missouri's courts have noted that "[t]he accepted way in which to establish future rates is to select a test year upon the basis of which past costs and revenues can be ascertained as a starting point for future projection."[14] Moreover, this system if far from the negative concept MAWC attempts to paint it as. Reviewing a historic test year is not just a matter of verifying the books and records of the utility. Instead, the historical data is often adjusted to make it more representative of the period that rates will be in effect. Normalizing or annualizing certain revenues and expenses including weather, sales, overtime, storm damage, rate case expenses, etc. are appropriate regulatory adjustments that provide a sound and accepted method to set rates appropriately based on historical figures. There is no reason to abandon this tried-and-true method of regulation that is the status-quo for the vast majority of states in the US for as long as utilities have been regulated.

MAWC's Claimed "Need" for a Future Test Year is Greatly Exaggerated

MAWC's motion outlines a claimed "need" for a future test year that can be boiled down into effectively three claims: (1) the need to recover additional capital

[13] *See State ex rel. Union Elec. Co. v. Pub. Serv. Com.*, 765 S.W.2d 618, 622 (Mo. App. W.D. 1988); *State ex rel. Mo. Office of the Pub. Counsel v. PSC of Mo.*, 293 S.W.3d 63, 75 (Mo. App. S.D. 2009).
[14] *State ex rel. Sw. Bell Tel. Co. v. Pub. Serv. Com.*, 645 S.W.2d 44, 53 (Mo. App. W.D. 1982)

investments made after the historical test year period; (2) an unsubstantiated claim of declining usage; and (3) an inaccurate claim regarding its earned ROE. Each of these three propositions is significantly overstated if not outright false, as will now be shown.

The Need to Recover Additional Capital Investments

MAWC throws out some rather large numbers with regard to its expected capital investments. It claims that it "anticipates placing in service approximately $163 million of investments in water and sewer facilities between January 2025 and May 2025" and that it "also plans to place an additional $409 million in capital investments in service during the future test year, including approximately $220 million of WSIRA eligible investments." This first of these two numbers is a complete mislead. According to the Company's own filing, MAWC's proposed true-up test year ends December 31, 2024, and the future test year begins May 31, 2025.[15] The Company's own proposed test year thus includes a gap from January 1, 2025 to the end of May that same year. This is precisely when the Company claims it will be making the supposed $163 million of investments. Therefore, these dollars would still not be included in the Company's rates even under its own future test year proposal as the costs would still be outside the test year.

Notwithstanding the fact that the Company's proposed future test year excludes costs incurred in the five-month gap that it made for its own case, there is a

[15] May 31, 2025 being the first day of the "twelve months ending May 31, 2026 indicated in the Company's motion.

much larger issue with the Company's rationale regarding future capital investments. The Company is quick to separate the costs it refers to in its motion into the categories of WSIRA and non-WSIRA eligible. As a reminder, the WSIRA is the statutory surcharge mechanism found in Revised Statutes of Missouri sections 393.1500 through 393.1509 that already allows the Company to recover certain capital costs incurred between rate cases. Because these costs are already recoverable in between rate cases, the Company has no justification for claiming they contribute to the need for a future test year. That does not, however, stop MAWC from trying. The Company argues that "[m]any of these WSIRA investments would not be reflected in a WSIRA rate until well after the end of the proposed future test year in this case." Yet the Company conveniently ignores the *reason* for why this is. That reason being that the WSIRA statute requires that all capital investments included for recovery be "in service **and used and useful**" in order to be eligible.[16] This once again means the investments must legally be put into service before the Company can include them in the WISIRA. This also further demonstrates how the Company is attempting to utilize the proposed future test year as an end-run around Missouri legal prohibitions. As already stated, recovery of WSIRA eligible costs do not create a "need" for a future test year, but rather, show exactly how the legislature wanted to deal with capital investments made between rate cases. What then of the non-WSIRA eligible costs?

[16] RSMo. § 393.1503(3)(b).

Given the restrictions placed on WSIRA eligibility, the legal conclusion to draw is that costs not eligible for recovery under the WSIRA were costs the legislature determined water utilities did not need to recover despite the lag built into the regulatory framework. In other words, the legislature clearly considered these costs that the utilities should incur in-between general rate cases, which contradicts the Company's claim that these costs create a "need" for a future test year. Moreover, there is a clear reason for why non-WSIRA eligible costs do not create a need for a future test year: the restriction on eligibility is based on prohibiting "projects intended solely for customer growth."[17]

What MAWC has failed to mention is that non-WSIRA eligible costs largely represent investments made to expand its customer base. This distinction is important because while MAWC does have to invest additional money to make these investments, it also begins to earn additional revenues as new customers enter its system. Thus, while MAWC bemoans the $189 million in non-WSIRA investments it intends to make over the future test year period, it ignores the fact that these investments will lead to increased revenue from new customers. This additional revenue will mitigate if not eliminate the increased annual costs that MAWC's investments will bring, thus eliminating the remaining "need" the Company claims for a future test year due to these investments.

[17] RSMo. § 393.1503(3)(c).

Unsubstantiated Claim of Declining Usage

To begin with, MAWC's claims regarding declining usage in Missouri is offered without support and is highly suspect on its face. More importantly though, MAWC's claim ignores countervailing examples of positive regulatory lag that would also be affecting the Company. To explain, MAWC is basically arguing that because customer usage declines each year, its revenue also declines. By extension the Company is therefore also arguing that if it came in for a rate case each year its rates would need to be adjusted upward to account for the declining revenues brought on by declining usage. However, the Company does not consider that, in addition to its supposed decline in usage, the Company is also experiencing a continuous increase in accrued depreciation. Because depreciation ultimately serves to offsets rate base, the continual increase to depreciation ultimately serves to drive down rates. Therefore, if the Company came in for a rate case each year, the claimed declining usage that would trigger an increase to its revenue requirement would be offset against increased depreciation causing a decrease to revenue requirement, which could potentially result in a complete nullification of the two. This is why it is important to consider both "positive" and "negative" regulatory lag when a utility argues for something like a future test year. For every instance where a utility claims that negative regulatory lag causes it to lose revenues, there is usually an instance of positive regulatory lag that allows it to gain revenue that is being overlooked.

Inaccurate Claims Regarding Earned ROE

MAWC's final attempt to support its request for a future test year is based on the claim it has not been able to earn an ROE consistent with an approximate authorized ROE in the 9.5% to 10% range. This is simply wrong. First, if the goal of setting rates is to ensure that utilities consistently earn at or near their authorized ROEs, then the Commission should eliminate, or at least dramatically reduce, the equity risk premium it allows on shareholder investment. An investor who purchases a 30-year bond with a 5.5% annual coupon in an investment grade utility company is almost certain to receive a constant 5.5% annual return over the life of the bond. If an investor is assured a similarly constant earned ROE of 9.5% on the purchase of the utility's common equity, then the investor's risk is similar to investing in the fixed coupon bond, which makes the additional 4.0% return a superfluous windfall. As such, utility equity investors can and actually do expect a utility may fail to earn its authorized ROE for common equity, yet they still actively chose to invest in those stocks because of the equity risk premium built into the Company's rates. Failure by MAWC to earn a specific ROE is thus not good grounds for needing a future test year.

Second, American Water Works Company Inc. (American Water) has control over MAWC's capital structure ratios because its balance sheet is funded through affiliate financing transactions (*i.e.* whether capital provided to MAWC is booked as an internal promissory note or an equity infusion). Therefore, American Water has control over the denominator (the amount of common equity) in determining MAWC's earned ROE (net income/average common equity). OPC witness David Murray testified in MAWC's 2022 rate case that if the Commission adopted his ROE recommendation of 9%, due to the delta between American Water's actual common equity ratio (40.45%) and American Water's requested ratemaking common equity ratio (50.43%) for MAWC, American Water can generate an additional margin of 8.19% (pre-tax) for the approximate 10% of MAWC's per books common equity ratio (50.43% minus 40.45%) funded by debt issued by American Water's financing subsidiary, American Water Capital Corporation. Mr. Murray's testimony in the 2022 rate case did not take the next step of calculating the pro forma impact of this additional margin on American Water's ROE from MAWC. For purposes of this response to MAWC's proposed future test year, OPC estimates this additional margin could be over 4%, which would translate into an actual ROE of approximately 13% compared to MAWC's per books ROE of 8.72%. American Water has increased the proportion of common equity in its capital structure to approximately 45% since the 2022 rate case, which would cause the actual ROE to be lower, but still above the authorized ROE implied by MAWC's financial statements.[18]

There are Significant Policy Problems with a Future Test Year

In addition to explaining the legal issues with the future test year proposed by MAWC and refuting the Company's arguments for why such a thing is even needed, it is important to consider the many policy problems that come with using a future test year. Frankly, a full recitation of all the issues with the future test year

[18] If regulatory mechanisms are enacted to reduce MAWC's business risk even lower, then ratepayers should receive consideration for the additional leverage this lower business risk allows.

methodology would be too long for this motion. This can be seen in the nearly forty-page NRRI report titled *Future Test Years: Challenges Posed for State Utility Commissions* that has been attached to this motion. Unlike the survey paper relied upon by MAWC, this report represents a detailed examination of the future test year and all of its associated problems and concerns:

> This paper will first discuss the arguments for an FTY and why utilities have advocated it for ratemaking. It will then identify the major elements of an FTY and what challenges they pose for state utility commissions. The paper will look at, for example, what can go wrong if a commission is unable to sufficiently evaluate a utility's forecasts in rate cases. Although in theory an FTY seems appealing, its effect on the public interest hinges on a commission capability to meet the challenges that it presents. In other words, the merits of an FTY rest on the details of whether the forecasts (1) reflect prudent utility management and (2) contain a minimal margin of error. After all, if a utility makes poor forecasts, if a cost or sales element is susceptible to a potentially large forecasting error, or if the utility biases its forecasts that go undetected, an FTY could easily take money away from utility customers and give it to the utility and its shareholders. This paper shows that when the utility wants to avoid what analysts call a "ratchet effect," it could attempt to inflate its costs in line with its forecasts. Customers end up paying excessively for service while utility shareholders earn lower returns. In effect, this avoidance benefits utility management at the expense of two of its major stakeholders: customers and shareholders.[19]

While the Commission is strongly encouraged to read the NRRI report in its entirety, the OPC will address the most salient policy concerns, not all of which are covered by the NRRI report, here.

[19] Ken Costello et al., *Future Test Years: Challenges Posed for State Utility Commissions*, NRRI Report 13-08, pg. v, July 2013, available at https://pubs.naruc.org/pub/FA86BF62-93FE-6709-21AB-3E836A9FDD28).

Information Asymmetry

Stated most simply, information asymmetry refers to a situation where one party to a proceeding/transaction has more or better information than another. This difference in relative access to information creates an imbalance of power between the parties, which ultimately results in inefficient outcomes. This issue is especially acute in the case of a future test year, as the NRRI report explains:

> The core problem with FTYs for commissions is information asymmetry. Commissions are at a distinct disadvantage relative to the utility in interpreting and evaluating the utility's performance. Commissions generally lack the knowledge, for example, to detect when the utility is efficient or inefficient, and the opportunities for utilities to minimize their costs. As part of their duties, they need to evaluate whether the utility's projected costs reflect competent utility management, or imprudent management. A utility naturally would argue that its projections reflect its best effort given the conditions it faces. To rebut this claim, commission staff and interveners would need to provide evidence to the contrary. They can show, for example, the invalidity of some assumptions or forecasting methodologies that underlie their predictions.[20]

Because a utility has the luxury of being able to develop its rate case at its leisure before the case is ever filed with the Commission, it can spend as much time as necessary building up forecasts and developing models to support its position. The company thus starts with a wealth of information in its own favor. Information that has been carefully curated by the utility to identify what supports its request and to bury anything that would contradict its position. The Commission's staff and intervenors do not get any such indulgence.

[20] *Id.* pg. 19.

Because of the limited nature of the rate case timeline, intervenors and the Commission's staff do not have the time to develop their own forecasts and models. Instead, the Commission's staff and intervenors have to rely largely on what the Company has already developed in the lead-up to filing its rate case. Further, the Company is under no obligation to supply all available information at the beginning of their case. Instead, the other parties must go through the tedious process of discovery in an attempt to pry away what information the Company has. This discovery process is not only time-consuming but is often fraught with objections by the Company as it seeks to hoard information and claim anything that does not directly support its position must be "irrelevant." Again, this is addressed in the NRRI report:

> Although the utility may have the burden to demonstrate the reasonableness of its predictions, any proposed adjustments by other parties would require an evaluation showing the predictions' shortcomings. The utility has a big advantage over other parties in knowing its prudent costs. It is hard for commission staff and interveners to either (1) show that the utility's costs are excessive or (2) produce independent forecasts that reflect efficient utility management. For the commission, it comes down to a judgment call in determining the appropriate cost for an FTY. Probably the truth lies somewhere between the utility's high forecasts and the interveners' low forecasts.[21]

The inherent problem of information asymmetry already poses a significant problem in the Commission's current historical test year model. Allowing for a future test year will grow that problem exponentially. In order to protect the integrity of the regulatory framework by ensuring the Commission has the best possible information

[21] *Id.*

available upon which to render its decision, the Commission should deny the request for a future test year.

Reduced Incentive to Minimize Costs

One of the most common refrains that is heard when considering a future test year is the need to mitigate "regulatory lag." What is often overlooked, however, is the importance that company-benefiting regulatory lag (often referred to as "positive" regulatory lag) plays in ensuring the good governance of a regulated utility. For example, it is well established that state utility commissions rely on positive regulatory lag to provide incentives for the utility to minimize costs and operate efficiently. This is because a utility is allowed to keep any profits that result from lowering its costs below what was included in its base rates during the period between general rate cases. By allowing the Company to retain the savings that arise for improving the efficiency of its operations between general rate cases, the utility has an incentive to minimize its costs and thereby behave prudently. This incentive is completely lost under MAWC's proposal.

To illustrate this point, consider a simple example. A certain amount of expense will be included in MWAC's case to cover the cost of buying chemicals used to treat drinking water and make it safe for consumption. Under a historical test year, this cost would be based on an average of what the Company spent previously. If MAWC could find a way after rates were set to lower the costs it incurred to procure these chemicals below what was in the historical test year, the difference would constitute pure profit to MAWC. The Company thus has a very strong incentive to find ways to lower the cost of buying its chemicals and will negotiate strenuously to find the best possible price. Now compare that to MAWC's proposed test year.

Under MAWC's proposal, the Commission would set rates based on how much it estimates MWAC will spend on buying chemicals in the future test period. However, there would also be a reconciliation process under MAWC's future test year proposal that would check the estimates once the test year was over. If MAWC spent any less than what was estimated, the Company would have to return the difference to customers and reduce its rates going forward. This sounds like a good deal for customers until one realizes that it just means MAWC has **absolutely no incentive** to reduce its chemical costs. In other words, MAWC will have absolutely every reason to spend up to the maximum that it can on each expense item included in rates to "demonstrate" the accuracy of its predictions while losing nothing in the process because it would never have gotten to keep any potential cost savings anyway. This would be a major blow to utility regulation in this state.

The phenomenon just described is sometimes referred to as a "use it or lose it" budget and is often cited as one of the leading causes of inefficiency within business departments and state or federal agencies. This is just one of the many reasons identified in the NRRI report that shows how a future test year impedes efficient operations:

> . . . FTYs can have a negative effect on cost efficiency. One reason is self-fulfilling predictions to avoid a "ratchet effect." Another possible reason lies with imputing in an FTY expected cost increases yet to be determined. A utility, for example, might have a weaker incentive to negotiate wage increases below the amount already included in rates. A

> third reason lies with information asymmetry, in which a commission would find it difficult to identify imprudent costs in a utility's rate filing. As such, the threat of disallowed costs lessens and thereby removes an important tool for commissions to control a utility's costs. Overall, an FTY would seem to score poorly in achieving cost efficiency.[22]

The Commission should not encourage inefficient behavior by removing the Company's ability to earn a larger return between rate cases. Instead, the Commission should continue to utilize the historical test year that incentives cost savings and increased efficiency in the utility by encouraging it to find ways to reduce costs below historic levels.

Questions Regarding the Standard for Prudency

A small but important point that needs consideration is how the Commission would apply the traditional standard of prudence with a future test year. For example, Missouri Courts have previously held that "In order to disallow a utility's recovery of costs from its ratepayers, a regulatory agency must find both that (1) the utility acted imprudently [and] (2) such imprudence resulted in harm to the utility's ratepayers."[23] It is unclear how exactly this standard could possibly be applied when using a future test year as it will be necessarily impossible to prove harm has occurred for expenses that have not yet been incurred. A future test year therefore appears to create a *de facto* elimination of all prudence evaluations, which would constitute a momentous shift in Commission practice and jurisprudence.

[22] *Id*. pg. 26.

[23] *In re Atmos*, 389 S.W.3d 224, 228 (Mo. App. W.D. 2012) (quoting *State ex rel. Assoc. Natural Gas Co. v. Public Service Comm'n*, 954 S.W.2d 520, 529 (Mo. App. W.D. 1997)).

Even if the Commission were to allow prudence evaluations (despite apparent contradiction of established case law), there are yet more prudence questions that must be addressed. For example, the prior section described how the proposed reconciliation process eliminates absolutely all incentive for MAWC to mitigate expense incurred in the future test year period below the limits set in rates. Does this mean that the Commission's staff and other intervenors will be permitted to argue the Company was imprudent if it failed to take obvious steps to mitigate those costs? It is absolutely certain that there are at least some among the intervenors who will take the opportunity to argue for additional cost disallowances during the proposed reconciliation process under the theory now laid out. The Commission needs to consider what impact these legal and procedural issues will have on the case and recognize that a future test year case will result in significantly more administrative resources being expended as a result.

Limitation on Resources

As has been alluded to previously, a utility like MAWC has a distinct advantage over the Commission's staff and other intervenors through the use of a future test year. As explained by the NRRI:

> Utilities have a distinct "resource" advantage over other parties that they can better exploit under an FTY rate filing. Given the limited time for rate cases and the complexity of evaluating forecasts, parties may have insufficient time to thoroughly assess a utility's forecasts.
>
> One possible outcome is the utility hiding inflated costs and not "getting caught." Utilities would (1) have an incentive to overstate its costs, as

> discussed elsewhere in this paper and (2) vigorously challenge other parties who propose to adjust the costs downward.[24]

There are yet other advantages that the Company has over other parties that are not addressed by the NRRI report. For example, because the Commission allows the Company to recover at least part of the cost of prosecuting its rate case, MAWC (which already begins with substantially greater resources) can spend liberally on expert witnesses and consultants. The Commission's staff and intervenors, by contrast, are constrained not only by the limited time of the rate case, but also by substantially smaller budgets and available personnel. This is especially troubling given the size of the rate increase requested in this case, which stands at nearly 45% of its existing revenue requirement.

Given the sheer size of the rate increase being requested, this case will already require a higher-than-normal level of scrutiny by all interested parties. If the Commission were to add onto that by granting MAWC's request to cast aside the historical test year it will effectively guarantee both that parties are deprived of a truly meaningful opportunity to be heard and that MAWC's customers will receive an enormous rate increase at a time where most customers are already struggling under high inflation.

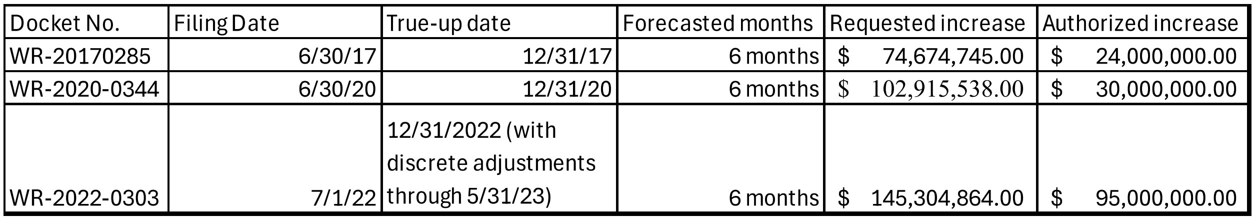
The Commission's staff and other intervenors are already overburdened with a deluge of rate cases being filed by multiple utilities across multiple services at the

[24] Ken Costello et al., *Future Test Years: Challenges Posed for State Utility Commissions*, NRRI Report 13-08, pg. 23, July 2013, available at https://pubs.naruc.org/pub/FA86BF62-93FE-6709-21AB-3E836A9FDD28).

same time.[25] The Commission should not make this already perilous regulatory situation worse. The Commission should deny MAWC's request to disrupt multiple decades worth of regulation paradigm absent an extensive and thoughtful dialogue with other stakeholders over the concerns addressed in this motion and the NRRI report that would allow parties to move forward constructively.

MAWC's Inability to Accurately Forecast Costs

In its motion, MAWC references its most recent three rate cases. Looking at those cases, if we compare the utility's initial request with the increase ultimately authorized, the Commission can see that even using historical test year data with a true up - the company has been unable to accurately forecast its costs.



Docket No.	Filing Date	True-up date	Forecasted months	Requested increase	Authorized increase
WR-20170285	6/30/17	12/31/17	6 months	$ 74,674,745.00	$ 24,000,000.00
WR-2020-0344	6/30/20	12/31/20	6 months	$ 102,915,538.00	$ 30,000,000.00
WR-2022-0303	7/1/22	12/31/2022 (with discrete adjustments through 5/31/23)	6 months	$ 145,304,864.00	$ 95,000,000.00

As this chart shows, MAWC's requests have exceeded that amount ultimately authorized by the Commission. The inaccuracy of forecasts with a 6 month true-up period should raise additional concerns that using the projections necessary for a

[25] At the time of filing the current and ongoing large utility general rate cases include requested rate increases by Evergy Missouri West, Inc. d/b/a Evergy Missouri West (ER-2024-0189) (electric); Union Electric Company d/b/a Ameren Missouri (ER-2024-0319) (electric); Empire District Electric Company d/b/a Liberty (ER-2024-0261) (electric); Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty (GR-2024-0106) (gas); Union Electric Company d/b/a Ameren Missouri (GR-2024-0369) (gas); Liberty Utilities (Missouri Water) LLC d/b/a Liberty (WR-2024-0104) (water); and Missouri-American Water Company (WR-2024-0320) (water)

future test year will result in customers paying more due to the inaccuracy of MAWC's forecasts.

Response to Request for Discrete Adjustments

MAWC's request for what it terms "discrete adjustments" is really nothing more than a request for a "future test year lite," in that, it is an attempt to shoehorn in costs outside of the historical test year. Despite this fact, it is certainly true that the Commission has permitted these types of discreet adjustments in the past. However, it is important to note that the past Commission decisions have allowed all parties to propose discrete adjustments.[26] Should the Commission decide to permit the discrete adjustments requested by MAWC, it should further allow all parties to the case to propose such adjustments as it has done in the past.

Test Year Recommendation

Given the multitude of problems, both legal and practical, associated with future test years, the Commission should reject MAWC's proposed future test year and instead order a historical test year with true-up as it has done in all previous MAWC cases.

WHEREFORE, the movants respectfully request the Commission reject MAWC's future test year proposal and order a historical test year with true-up.

[26] *See* 2020 Order 4, WR-2020-0344 (stating "**the parties** may make specific (discreet) adjustments . . . ." (emphasis added)); 2017 Order 3, WR-2017-0285 (stating "**Parties** may present further adjustments for the Commission's consideration . . . ." (emphasis added)); 2022 Order 7, WR-2022-0303 (stating "Additionally, **the parties** may submit discrete adjustments for the time period through May 31, 2023." (emphasis added).

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 twenty-sixth day of July, 2024.

/s/ John Clizer