

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

In the Matter of the Joint Application	)	
of Missouri-American Water Company,	)	
St. Louis County Water Company d/b/a	)	
Missouri-American Water Company and	)	Case No. WO-2002-273
Jefferson City Water Works Company	)	
d/b/a Missouri-American Water Company	)	
for an accounting authority order relating	)	
to security costs.	)	

**APPLICATION FOR REHEARING OR, IN THE ALTERNATIVE,  
MOTION FOR RECONSIDERATION**

COMES NOW, the Office of the Public Counsel (Public Counsel), and respectfully moves the Missouri Public Service Commission (Commission) to vacate its decision in the above-styled case, and set this matter for rehearing. In the alternative, Public Counsel respectfully requests that the Commission reconsider both the result and the underlying rationale for the decision in its Report and Order, granting Missouri-American Water Company (Company) an Accounting Authority Order for expenditures related to security costs incurred after the terrorist attacks on the World Trade Center and Pentagon on September 11, 2001. This motion is filed pursuant to §386.500 RSMo (2000), and 4 CSR 240-2.160. Public Counsel requests review because the Commission's decision in this case was arbitrary, capricious and an abuse of discretion, and not supported by substantial and competent evidence.

Further, if the intent of the Commission was to allow deferrals related to non-mandated security enhancements in the name of national security, it could have made such a ruling by announcing an additional factor to be considered in determining whether to grant an AAO deferral. Such a decision would have

resulted in allowing the Company to defer these expenses without reversing the Commission's prior standard for determining whether an AAO should be granted: that a Company requested deferral for costs which are extraordinary, unusual, unique and non-recurring. Because the Commission could have made such an explicit exception without suggesting that the standard consistently used by the Commission since 1991 did not exist, the Commission should not have made the arbitrary and capricious statement that the parties that relied on this standard simply misunderstood the nature of an AAO.

In support of this motion, Public Counsel states as follows:

1. In its Report and Order in this case, issued Dec. 11, 2002, the Commission granted Missouri-American Water Company an AAO for costs incurred in the course of its evaluation and improvement of security of its Missouri water treatment, transmission and distribution systems. That AAO will allow the Company to defer costs incurred between September 11, 2001 and September 11, 2003.

2. An AAO is a mechanism which allows a regulated utility to deviate from generally accepted accounting standards by deferring costs from one period to another. Because a regulated utility's rates are set on the basis of costs determined in a designated test period, deferrals of costs from one period to another distort the true cost a company incurs to provide service. As the Commission stated in *of In the Matter of the Application of St. Joseph Light & Power Company for the issuance of an Accounting Authority Order, Case No. EO-2000-845* (Dec. 14, 2000):

“The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates whereby the Commission considers all relevant expenses in a particular historical test year to determine a reasonable revenue requirement for the future. The deferral of costs distorts the expenses recognized in that test year by importing costs from a previous period. For that reason, the Commission has considered requests for AAOs on a case-by-case basis and has **granted them only under limited circumstances.**” (emphasis added.) EO-2000-845, Slip Op. at p. 8.

3. Public Counsel and other parties opposed the Company’s request for this AAO. In reaching this position, Public Counsel analyzed the request of the Water Company under the prevailing standard for granting AAOs. Public Counsel reviewed a number of cases, beginning with *In the Matter of Missouri Public Service*, 1 MPSC 3d 200 (1991) (the *Sibley* rebuild case). In that case, the stated that “the test that the Commission has used for determining whether or not to grant an AAO is whether the expense to be deferred is “extraordinary, unusual and unique and not recurring.” 1 MPSC 3d, at 205. In the *Sibley* rebuild case, the Commission found that costs of rebuilding a power plant were extraordinary, but that the costs of purchased power, which the company also sought to defer, were not. As a result an AAO issued only for the rebuilding costs, not the ordinary, recurring costs of purchased power, even though the level of purchased power may have been higher during the period for which deferral was sought.

4. The evidence in this Missouri-American case demonstrated that the costs for which the Company sought deferral were ordinary security costs, and are and will be recurring. The evidence also demonstrated that the level of these costs increased due to an increased awareness of the need for security

measures adequate to protect the drinking water supply, an awareness gained after the events of September 11, 2001. The evidence further demonstrated that the Company suffered no actual harm during the attacks of September 11, and that no state or federal agency had mandated any of the improvements the Company implemented for which deferral of cost recognition was requested here. The evidence did demonstrate that a number of recommendations were made to all utility companies for best practices, and that the few practices on that list that the Company did not already have in place were included in the improvements. However, this evidence does not establish that the Company incurred extraordinary costs.

5. In *State ex. rel. Missouri Office of the Public Counsel v. Public Service Commission*, 858 S.W. 2d 806, 810 (Mo. App. W.D. 1993). (affirming the Commission's decision in the *Sibley* rebuild case), the Missouri Court of Appeals (Western District) found that the Commission's decision to grant an AAO was lawful and based on substantial and competent evidence because the Commission, in evaluating the evidence, found that the amounts sought to be deferred were "extraordinary."

6. Utility company applications for AAOs in which the Commission based its decision on the "extraordinary" requirements of *In the Matter of Missouri Public Service*, 1 MPSC 3d 200 (1991), include:

- *In Re Union Electric Company*, No. EO-92-179 (June 12, 1992).
- *In Re UtiliCorp United, Inc.*, No. ER-93-37 (June 18, 1993).
- *Missouri Gas Energy v. Public Service Commission*, 978 S.W.2d 434 (Mo. App. W.D. 1998).

- *In re Application of United Water Missouri, Inc.*, Mo. PSC Case No. WA-98-187 (April 30, 1999).
- *In the Matter of the Application of St. Joseph Light & Power Company for the issuance of an Accounting Authority Order*, Case No. EO-2000-845, Slip Op. at p 8. (Dec. 14, 2000).<sup>1</sup>
- *The matter of the Consideration of An Accounting Authority Order for St. Louis County Water Company*, No. WO-98-223 (Feb. 13, 2001).
- *In the Matter of Missouri Public Service and St. Joseph Light and Power*, GO-2002-175 (Nov. 14, 2002). (the *Aquila* case.)
- In addition, several AAO applications were resolved by stipulated agreements. In those cases, Public Counsel evaluated the applications in light of the “extraordinary” standard in the Sibley rebuild case, and considering whether any recurring expenses met the “act of god” or governmental mandate exceptions that the Commission has allowed in the past.

Cases in which the Commission declined to base its decision on *In the Matter of Missouri Public Service*, 1 MPSC 3d 200 (1991), choosing instead to rely on a determination that “the requested AAO is reasonable under all the circumstances” include:

- This case (Report and Order, at 28.)

Clearly, the parties who argued to the Commission that an AAO should not be granted unless the Applicant could establish that the expenses were “extraordinary” based that claim on a number of clear decisions by the Commission that this was the appropriate test— a standard used for a decade by

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<sup>1</sup> “The test that the Commission has used for determining whether or not to grant an AAO is whether the expense to be deferred is “extraordinary, unusual and unique and not recurring.” *In the Matter of Missouri Public Service*, 1 MPSC 3d 200, 205 (1991). However, the simple fact that an expense is extraordinary and nonrecurring is not enough to justify the deferral of that expense. Implicit in the Commission’s previous orders regarding requests for AAOs is a requirement that there must be some reason why the expense to be deferred could not be immediately included for recovery in a rate case.” *St. Joseph Light & Power Co.*, Slip Op. at p. 8.

the Commission in evaluating applications for AAOs. This hardly makes such a position and argument “driven by a basic misunderstanding of AAOs.” (R&O, at 30.)

7. The company had the burden of proving that its request was necessary, and that it met the criteria for an AAO. It failed to meet its burden of proving that the costs it incurred were the result of an extraordinary event, and that the costs were extraordinary, unusual, unique and non-recurring. The company further failed to prove that it was required to incur the costs as the result of a governmental mandate or “act of god.” The Company could only present evidence that recommendations were made by a number of governmental and private entities concerning the need to enhance security.

8. In its Report and Order, the Commission suggested that Public Counsel and the Staff, along with the other intervenors, were operating under a fundamental misunderstanding of what an AAO is and the requirements for granting an AAO. The Commission stated that an AAO may be granted whenever, in consideration of all the surrounding circumstances, the Commission believes an AAO would be appropriate. This contradicts prior Commission decisions which caution that AAO deferrals should only be granted in limited circumstances. While prior Commission decisions do not have the force of *stare decisis* on subsequent Commission cases, the Commission cannot arbitrarily and discriminatorily change its policy. *In Re Otter Tail Power v. FERC*, 583 F.2d 399, 408 (8<sup>th</sup> Cir. 1978.) Rather, the Commission must have a rational basis for changing its policy. No rational basis was presented in the Report and Order in

this case. Denying that a standard exists does not constitute a rational basis for a changing policy.

9. In its discussion of the “extraordinary, unusual, unique, non-recurring” expense criteria for granting an AAO, the commission noted that these criteria were “encompassed by the reasonable-under-the-circumstances standard.” However, the commission failed to recognize that “reasonable under the circumstances” could easily include recurring, non-unique, ordinary costs, and that the adoption of the new standard invited all regulated utilities to a fire sale of AAO’s as long as they can convince a majority of commissioners that the request is “reasonable.”

10. On November 14, 2002, the Commission reiterated the extraordinary, unique, non-recurring standard for granting AAOs, and denied Aquila an AAO for authority to defer certain bad debt expenses. Aquila’s request was denied because the Commission determined “that the expenses are not extraordinary.” This order issued 26 days before the order in the Missouri-American case in which the commission denied that it followed the extraordinary standard. In the Aquila case (GO-2002-175) in its conclusions of law, the Commission stated that:

“The test that the Commission has used, and continues to use here, for determining whether or not to grant an AAO is whether the expense to be deferred is extraordinary and not recurring:

The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates. Rates are usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. *State ex rel.*

*Union Electric Company v. PSC*, (UE), 765 S.W.2d 618, 622 (Mo. App. 1988).

Allowable operating expenses are those which recur in the normal operations of a company, and a company's rates are set for the future based upon its past experience for a test year with adjustments for annualizations, normalizations and known and measurable changes. Under historical test year ratemaking, costs are rarely considered from earlier than the test year to determine what is a reasonable revenue requirement for the future. Deferral of costs from one period to a subsequent rate case causes this consideration and should be allowed only on a limited basis.

This limited basis is when events occur during a period which are extraordinary, unusual and unique and not recurring. These types of events generate costs which require special consideration. *In the Matter of Missouri Public Service*, 1 MPSC 3d 200, 205 (1991).

**The Commission's initial inquiry is whether the costs sought to be deferred are indeed extraordinary. If they are not, the inquiry is at an end, and the other questions are moot. Because the Commission concludes that the costs Aquila seeks to defer are not extraordinary, it will not address the other issues identified by the parties."** (emphasis added.)

The test relied on by the Commission in the *Aquila* decision is the same test relied on and litigated by Public Counsel in this Missouri-American case.

11. In this Missouri-American case, however, the Commission said this:

The arguments raised against Missouri-American's request may be summarized as follows: First, the expenditures in question are not eligible for deferral because they are normal business expenses in that utilities always have a duty to provide appropriate security for their facilities. Second, **the expenditures in question are not eligible for deferral because they are not extraordinary**, either in amount or in purpose, as shown by the fact that Missouri-American's management chose to make them and was not required to make them. These arguments are driven by **a basic misunderstanding of AAOs. The test, as explained above, is whether deferral is reasonable under all the circumstances.** (emphasis added.)

One cannot read these two decisions together without coming to the inescapable conclusion that the Commission has decided that, from now on, it

will have NO STANDARD for granting AAOs and will grant or deny an AAO based upon the subjective belief of at least three commissioners that a utility's request for a deferral is reasonable. Abandoning an objective standard and allowing utilities to deviate from Generally Accepted Accounting Principles based on subjective factors, when the company cannot meet the objective test, is arbitrary and capricious. The Company's customers in this case were denied the due process guaranteed them by the Fifth and Fourteenth Amendments to the U.S. Constitution and Art. I, Sec. 10 of the Missouri Constitution, because their representatives litigated the case under an existing, long-established objective standard, only to be told that the standard no longer exists. Indeed, the Commission denied that such a standard ever existed. This disregard for the company's customers is detrimental to the public interest.

12. There is some language in the report and order that suggests that the Commission may have wished to grant the AAO in this case because, while there is no current governmental mandate for utilities to upgrade security, security upgrades were encouraged, and may be a good idea. The State of Missouri's security task force released a list of recommended security procedures for utility companies. The witnesses for Missouri-American, at the hearing in this case, testified that, prior to September 11, Missouri-American already had most of those security procedures in place. The witness further testified that all of those procedures would be in place by the end of the upgrade period. If the Commission wanted to carve out another type of case in which an AAO could be considered-- security upgrades in light of the greater awareness of security

issues following Sept. 11-- it could have done so without disavowing the existing test for granting AAOs.

### **CONCLUSION**

The Commission's decision in granting Missouri-American's application for an AAO is arbitrary and capricious and not based upon substantial and competent evidence. The case presented by Missouri-American failed to meet the "extraordinary, unique, unusual and non-recurring" objective test relied on by the Commission and parties who practice before the Commission for a decade. No rational basis was provided for deviating from that standard. Worse, the Commission, in its Report and Order disavowed the standard it has used consistently since 1991, without providing a rational basis for doing so.

WHEREFORE, Public Counsel respectfully requests that the Commission vacate the Report & Order in this case, and either: (1) set this matter for rehearing, or (2) reconsider and revise its decision in this case.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 20<sup>th</sup> day of December 2002:

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