

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

In the Matter of the Application of Summit)	
Natural Gas of Missouri, Inc. for an Accounting)	<u>File No. GU-2014-0032</u>
Authority Order Related to State and County)	
Changes in Assessment Methodology)	

STAFF RECOMMENDATION

COMES NOW the Staff ("Staff") of the Missouri Public Service Commission ("Commission"), by and through counsel, and for its Staff Recommendation in this matter hereby respectfully states:

1. On August 12, 2013, Summit Natural Gas of Missouri, Inc. ("SNG") filed an *Application and Motion for Waiver* requesting an accounting authority order ("AAO") that would allow SNG to undertake certain accounting procedures in connection with a change in the assessment methodology for the calculation of property taxes. The Motion requested waiver of the Commission's rule requiring 60-day notice before filing a case likely to be contested,¹ and Staff does not object to this motion.

2. On August 16, 2013, SNG amended its Application to correct an error referencing the appendices attached to the Application. SNG states that the amendment did not change the conclusions of the Application.

3. On October 17, 2013, SNG amended its Application a second time to correct errors in the amount of property tax expense from Rogersville and Gallatin. Staff does not object to SNG's motion for leave to file this second amended Application.

¹ Commission Rule 4 CSR 240-4.020(2).

4. On October 11, 2013, the Commission issued its *Second Order Extending The Deadline For Filing Staff Recommendation*, ordering the Staff to file its recommendation to the Commission no later than October 18, 2013.

5. Accordingly, Staff hereby submits its *Memorandum*, attached hereto as Appendix A and incorporated by reference, recommending that the Commission deny SNG's request for an AAO related to state and county changes in tax assessment methodology. Or, in the alternative, if the Commission decides to approve the AAO, Staff recommends that the approval include certain conditions described in Staff's *Memorandum*.

6. In this case, SNG states that, as a result of the changes in the assessment methodology for the calculation of state and county property taxes, SNG was required to pay a significant increase in property taxes. SNG charged the full amount of the increase in its property taxes to expense on its income statements for 2011 and 2012.

7. As explained in Staff's *Memorandum*, the Commission in previous AAO cases has allowed utility companies to defer costs incurred outside of a rate case test year as a regulatory asset when those costs are the result of events occurring during a period that are "extraordinary, unusual and unique, not recurring," and when those costs are "material." In its Application, SNG asserts that the increased property taxes for 2011 and 2012 meet this standard.

8. Staff's recommendation does not address these elements, because Staff found that SNG has already accounted for the 2011 and 2012 property tax expenses in

a manner that now makes it unlawful for the Commission to allow SNG to recover those past expenses in any future retail rates.

9. The Commission's authority to approve AAOs comes from Section 393.140(4) RSMo., which grants the Commission discretion to prescribe uniform methods of keeping accounts, records and books, to be observed by gas corporations within its jurisdiction.² Commission Rule 4 CSR 240-40.040(1) directs gas companies within the Commission's jurisdiction to use the uniform system of accounts ("USOA") prescribed by the Federal Energy Regulatory Commission.³ The rules adopted by the Federal Energy Regulatory Commission (FERC), indicated in Commission in General Instruction No. 7, that only items that occur *in the current period* should be considered for the special accounting treatment available for extraordinary items.⁴

10. Therefore, typically, a utility should request an AAO soon after it incurs an extraordinary cost. Doing so allows the utility to defer, or *capitalize*, that cost—that is, treat that cost as a "regulatory asset" on its balance sheet, likely to be recovered in future rate, rather treating the cost as an operating expense on its periodic income statement (that is, as a routine cost of doing business.) Deferral treatment has two benefits for the utility and its shareholders: First, by keeping the extraordinary amounts off the income statement, shareholders do not suffer reduced earnings for the period in which the extraordinary expense was incurred. Second, a Commission-approved AAO provides the utility with some confidence that the utility will have the opportunity to

² RSMo § 393.140(4).

³ 4 C.S.R. 240-40.040

⁴ 18 C.F.R. pt. 201 (emphasis added).

recover that extraordinary cost in a subsequent rate case, even though the extraordinary cost may fall outside the test year for that rate case.

11. However, this type of deferral treatment is not what SNG is seeking in this case. In this case, SNG already has recorded the 2011 property tax cost as an *operating expense on its income statement* for that period; SNG also already has recorded its 2012 property tax cost as an operating expense on its income statement for that period. As a result, SNG's shareholders have already realized a lower level of earnings for those periods than they otherwise might have realized, all else being equal.

12. Now SNG has requested Commission approval for an AAO that would purportedly allow the utility to "defer" those costs—even though those costs have been included in the Company's income statements, and even though those income statements have been used to determine shareholder earnings for those periods. In accounting terms, it is simply impossible to "defer" a cost to a subsequent period when that cost has already been incorporated into the income statement of a prior period. As explained in Staff's *Memorandum*, that cost has already been dealt with—there is no outstanding cost left over to "defer."

13. Therefore, the relief SNG is requesting in this case cannot be properly described as a "deferral," because the Company is not asking to defer recognition of the costs on its income statements. The cost has already been recognized on the income statement, and thus absorbed by the utility's shareholders.

14. Rather, the Company is asking the Commission to allow it to recover additional rate revenue in its next rate case to compensate the utility's shareholders for

earnings they would have received in the 2011 and 2012 periods, but for the additional property tax expense.

15. Retroactive ratemaking occurs when rates are set to recover past expenses. The Missouri Supreme Court stated:

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 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 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 prospective language of the statutes, Sections 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.⁵

16. SNG's property tax expenses in this case are *past expenses*, recorded as such on the Company's income statement, which resulted in past "losses" to shareholder earnings due to imperfect matching of rates with the unexpected increase in property taxes. As the Supreme Court explained, this is a risk of doing business, which SNG chose to place on its shareholders by treating the cost as an expense on its income statement.

17. The statutory prohibition against retroactive ratemaking means that it is unlawful for the Commission to order future ratepayers to compensate the utility's shareholders for these past expenses that resulted in a lower level of earnings than the shareholders might have expected for the 2011 and 2012 period. Rates should reflect the ongoing cost of service, plus a return, required to provide utility service to the

⁵ *State ex rel. Util. Consumers' Council of Missouri, Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 59 (Mo. 1979). (Citations omitted, emphasis added).

customers who are paying those rates. To allow the Company to pursue additional profit unrelated to the costs of serving current customers is not only unfair to those customers, but also such ratemaking would remove any incentive for a utility to operate prudently and efficiently in any given period, because they utility could simply recover the higher expenses from future ratepayers, and thus provide higher return to shareholders. Such ratemaking would make the Commission a guarantor of a certain level of shareholder profit, and such a guarantee is unlawful.⁶

WHEREFORE, based on the reasons stated above and in Staff's *Memorandum* attached hereto as Appendix A, Staff respectfully requests that the Commission deny SNG's application for AAO, or, in the alternative, if the Commission decides to grant SNG's AAO request, Staff recommends that the Commission attach the following conditions to its approval:

1. Nothing in the Commission's order shall be considered a finding by the Commission of the reasonableness of the amounts booked by SNG pursuant to the order, and the Commission reserves the right to consider the ratemaking treatment to be afforded all amounts booked by SNG pursuant to the order.
2. Any government refunds or credits applicable to incurred property tax expenses shall be used to offset the total amount booked by SNG pursuant to the order.
3. SNG is to maintain detailed supporting records, work papers, invoices and other documents to support the amounts booked

⁶ Rates are based in part on the rate of return which the utility has the *opportunity* to earn, but "there is no requirement that the Commission provide a particular return on rates." *State ex rel. Missouri Gas Energy v. Pub. Serv. Comm'n*, 210 S.W.3d 330, 335 (Mo.Ct.App. 2006). It is a well-accepted principle of regulation that common stockholders contribute what is known as "risk capital" to the utility company for which they receive a compensatory rate of return. Among the uncertainties that common stockholders accept in return for this added compensation is the danger of earnings shortfall, for whatever reason. *State ex rel. Union Elec. Co. v. Pub. Serv. Comm'n of State of Mo.*, 765 S.W.2d 618, 622 (Mo. Ct. App. 1988).

under this AAO, including any related deferred taxes recorded as a result of this accounting treatment. Such records shall be made available for review by the Commission Staff, The Office of the Public Counsel and other interveners, pursuant to 4 CSR 240-2.085 and Section 386.480.

Respectfully Submitted,

**STAFF OF THE MISSOURI
PUBLIC SERVICE COMMISSION**

/s/ John D. Borgmeyer

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CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing were served electronically to all counsel of record this 18th day of October, 2013.

/s/ John D. Borgmeyer

M E M O R A N D U M

TO: Missouri Public Service Commission Official Case File
File No. GU-2014-0032, Summit Natural Gas of Missouri, Inc.

FROM: Amanda C. McMellen, Utility Services - Auditing
Mark L. Oligschlaeger, Utility Services - Auditing

/s/ Mark L. Oligschlaeger 10/18/13
Utility Services-Auditing / Date

/s/ Amanda C. McMellen 10/18/13
Utility Services-Auditing / Date

/s/ John D. Borgmeyer / 10/18/13
Staff Counsel's Office / Date

SUBJECT: Staff Recommendation to deny SNG's request for an Accounting Authority Order for certain accounting procedures for costs related to property taxes in 2011 and 2012.

DATE: October 18, 2013

Authority Requested in SNG's Application

On August 12, 2013, Summit Natural Gas of Missouri, Inc. ("SNG") filed an Application for an Accounting Authority Order (AAO) requesting accounting treatment for what it characterized as extraordinary and unusual costs resulting from the increased property tax expense associated with changed methodologies for assessment calculations for 2011 and 2012. SNG requests authority to defer these extraordinary costs in the manner prescribed by the Uniform System of Accounts (USOA). SNG states in its amended Application that it incurred approximately \$3.7 million of extraordinary costs for property taxes in 2011 and 2012. SNG states that it will seek recovery of these deferred amounts in the next rate proceeding.

Background for AAO Deferral Requests

The primary purpose of AAOs is to allow utilities to seek authority from the Commission to change the normal accounting afforded to certain revenues, expenses or rate base items as set forth under the USOA. A secondary purpose of many AAOs is to provide a utility with the opportunity to seek rate recovery of certain types of costs incurred prior to the test year established in a rate proceeding. Normally, only costs incurred within a test year or shortly thereafter are eligible for recovery in rates.

In the past, the Missouri Public Service Commission ("Commission") has granted authority for utilities to defer costs in a number of circumstances, almost always involving the occurrence of "extraordinary events" of various types. In almost all AAO applications, utilities seek permission to "defer" costs; that is, to capitalize on their balance sheets costs that would normally be charged to expense on the income statement by the utilities when incurred. Costs that are deferred in this manner are called "regulatory assets." For accounting purposes, many AAOs have been issued by the Commission to allow the utilities to "spread" or "amortize," the cost of extraordinary events

over five or ten years, as opposed to reflecting the entire amount of the cost as a loss in one period. When regulatory assets are created by the Commission through authorization of AAO requests, the utility generally seeks rate recovery of the deferred costs at a later time. If the Commission grants subsequent rate recovery of the deferred amounts, the deferrals are subsequently amortized to expense on the income statement.

Standard for Deferral Authorization

In its Report and Order in Case Nos. EO-91-358 and EO-91-360, related to AAOs requested by Missouri Public Service, a division of UtiliCorp United, Inc. (now KCP&L Greater Missouri Operations Company) (“Order”), the Commission stated its criterion for deferral of costs incurred outside a rate case test year. The Commission has consistently used this same criterion since those cases. In that Order, the Commission stated:

The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates.... 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. [Order, pages 6-7.]

In the “Standards for Deferral” section of the Order, the Commission described the following criteria for allowing utility companies to defer costs incurred outside of a rate case test year as a regulatory asset:

1. Events occurring during a period that are extraordinary, unusual and unique, and not recurring¹; and
2. The costs associated with the extraordinary event are material.

¹ The Federal Energy Regulatory Commission (FERC) USOA defines the term “extraordinary items” in General Instruction No. 7. The FERC USOA for electric utilities reads as follows:

Extraordinary items. It is the intent that net income shall reflect all items of profit or loss during the period with the exception of prior period adjustments as described in paragraph 7.1 and long-term debt as described in paragraph 17 below. 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. (In determining significance, items should be considered individually and not be in the aggregate. However, the effects of a series of related transactions arising from a single specific and identifiable event or plan of action should be considered in the aggregate.) To be considered as extraordinary under the above guidelines, an item should be more than approximately 5 percent of income, computed before extraordinary items. Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary.

Authority to Defer 2011 and 2012 Property Taxes Should Not Be Granted

In its Application, SNG seeks authority to defer the increase in the Company's property taxes for 2011 and 2012 associated with changes in its assessment imposed by the Missouri State Tax Commission and the counties in which SNG provides natural gas service in Missouri. However, as discussed below, SNG's request is not a true "deferral," and is unlike past utility requests to defer the costs associated with extraordinary events to allow the opportunity for future rate recovery of the costs. The root problem with SNG's AAO application is that it was not timely filed.

A deferral request seeks to delay charging of certain costs as an expense on a utility's income statement, as would normally be the practice under the terms of the USOA. Instead, if this request was granted it would preserve the costs as a regulatory asset on the utility's balance sheet to allow consideration of the deferred costs in a future rate application. If the Commission allows rate recovery of the deferred costs, the costs will typically be charged to the utility's income statement through an amortization to expense over several years.

However, this approach is not what SNG is seeking through this Application. To "defer" something is to delay or postpone it, and in the normal context of AAO applications the utility seeks to delay or postpone recognition of certain costs on its income statement in a deferral request. However, in this instance SNG has already charged the full amount of the increase in its property taxes to expense on its income statements for 2011 and 2012. Accordingly, there are no property tax expenses for those years that can be "deferred" by SNG at this time; SNG has already charged these amounts against its net income calculations. Because of this, the asserted accounting purpose of this Application by SNG (i.e., to "defer" property tax expenses) is invalid; no accounting relief of this nature can be granted to SNG because 2011 and 2012 property taxes cannot be deferred at this time. Given this, Commission Staff ("Staff") asserts that the true purpose of this application is for SNG to inappropriately set up the opportunity for future rate recovery of amounts related to past financial losses not normally eligible for prospective rate recovery.

By charging the higher property tax expense it incurred in 2011 and 2012 against its net income, SNG recorded lower earnings in these periods than it otherwise would have experienced. As a result, in essence, SNG is seeking authority from the Commission, through this Application, to create a regulatory asset equal to future revenue streams it hopes the Commission will authorize in future rate proceedings, with those revenue streams equal to SNG's quantification of the increase in property taxes it has previously recognized for the years 2011 and 2012. The practical impact of allowing SNG the relief it seeks in this Application by recording these regulatory assets would be to provide SNG the opportunity to obtain higher rates in subsequent periods to compensate for increased property taxes, in the event the Commission allows amortization in rates of the regulatory assets. In Staff's view, the AAO mechanism should not be used to simply allow utilities to obtain a more favorable position to obtain ultimate rate recovery of out-of-period costs absent a compelling accounting rationale for granting the AAO. Moreover, Staff is advised by counsel that granting the AAO as requested by SNG may be suggestive of retroactive ratemaking, which is prohibited in Missouri.

Staff is not aware of any prior instances where the Commission granted an AAO allowing deferral of costs already expensed by the utility on its financial statements.

Unlike SNG's 2011 and 2012 property taxes, SNG's incurred 2013 property tax costs would be eligible for deferral at this time, if the costs otherwise qualify for this treatment under the Commission's standards for deferral, because those costs have not yet been recorded on SNG's final "closed" 2013 financial statements. However, SNG is not seeking authority to defer any portion of its 2013 property taxes in this Application. Staff will consider the appropriate rate treatment of SNG's 2013 property taxes in SNG's planned 2014 rate case.


Staff Recommendation

For the reasons previously described, the Staff recommends that the Commission deny SNG's AAO Application in this case.

Staff Recommendations if Commission approves AAO:

In the alternative, if the Commission decides to grant SNG's AAO request, Staff recommends that the Commission attach the following conditions to its approval:

1. Nothing in the Commission's order shall be considered a finding by the Commission of the reasonableness of the amounts booked by SNG pursuant to the order, and the Commission reserves the right to consider the ratemaking treatment to be afforded all amounts booked by SNG pursuant to the order.
2. Any government refunds or credits applicable to incurred property tax expenses shall be used to offset the total amount booked by SNG pursuant to the order.
3. SNG is to maintain detailed supporting records, work papers, invoices and other documents to support the amounts booked under this AAO, including any related deferred taxes recorded as a result of this accounting treatment. Such records shall be made available for review by the Commission Staff, The Office of the Public Counsel and other interveners, pursuant to 4 CSR 240-2.085 and Section 386.480.


Notary Public

Shuzell Hankin
Notary Public