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Issue(s): Net Operating Loss (NOL)
Witness/Type of Exhibit: Riley/Rebuttal
Sponsoring Party: Public Counsel
Case No.: WO-2020-0190

REBUTTAL TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WO-2020-0190

**

**

Denotes Confidential Information has been redacted

May 27, 2020

PUBLIC

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

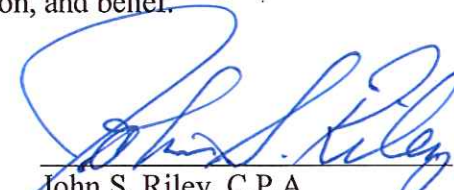
In the Matter of the Petition of Missouri-American)
Water Company for Approval to Change an) Case No. WO-2020-0190
Infrastructure System Replacement Surcharge)
(ISRS))

VERIFICATION OF JOHN S. RILEY

John S. Riley, under penalty of perjury, states:

1. Attached hereto and made a part hereof for all purposes is my rebuttal testimony in the above-captioned case.

3. My answer to each question in the attached rebuttal testimony is true and correct to the best of my knowledge, information, and belief.



John S. Riley, C.P.A.
Public Utility Accountant III
Office of the Public Counsel

REBUTTAL TESTIMONY
OF
JOHN S. RILEY
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WO-2020-0190

1 **Q. What is your name and what is your business address.**

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

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

4 A. I am employed by the Missouri Office of the Public Counsel (“OPC”) as a Public Utility
5 Accountant III.

6 **Q. Are you the same John S. Riley that filed direct testimony in this case?**

7 A. Yes.

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

9 A. The purpose of my rebuttal testimony is to respond to the direct testimony offered by Staff
10 witness Mark Oligschlaeger and Missouri American Water Company (MAWC) witnesses
11 John Wilde and Brian LaGrand. In general, I will be discussing how the testimony of each of
12 these witnesses has misinterpreted the private letter ruling (PLR) that lies at the heart of this
13 case and its effect on the *Stipulation and Agreement* entered into in File No. WO-2019-0389.
14 I will also provide specific discussion of how the Company and Staff erred when including a
15 net operating loss (NOL) balance in the ISRS calculations for this case because the NOL
16 calculations were incomplete for two separate and distinct reasons. The first is that neither
17 the Company nor Staff have recognized Contributions In Aid of Construction (“CIAC”)
18 revenues as an offset to expenses. The second is that there is an ongoing revenue stream that
19 is associated with the new ISRS assets that will completely eliminate any argument of the

1 existence of an NOL during the interim period. For these reasons, the tariff sheet should be
2 rejected and recalculated with the NOL offset eliminated.

3 **Q. Have you reviewed the testimony of Staff witness Mark Oligschlaeger?**

4 A. Yes.

5 **Q. What does Mr. Oligschlaeger say with regard to the existence of an NOL in MAWC's**
6 **ISRS cases?**

7 A. On page eight of his testimony, Mr. Oligschlaeger states as follows:

8 The fundamental disagreement in recent MAWC ISRS cases between MAWC
9 on one side, and Staff/OPC on the other, was whether ISRS plant additions
10 actually caused a tax loss (i.e., net operating loss) to occur due to no revenues
11 being collected by MAWC for the plant additions until the plant could be
12 incorporated directly into ISRS rates. MAWC argued a tax loss occurred; Staff
13 and OPC argued it did not.

14 This is a correct statement. The central disagreement in these cases has always been whether
15 ISRS plant additions **actually caused** a NOL. Unfortunately, Mr. Oligschlaeger's next
16 statement, where he says that ** _____

17 _____
18 _____ ** is decidedly incorrect.

19 Mr. Oligschlaeger supports his statement by a citation to the third full paragraph on page 7 of
20 23 in MAWC's Confidential Appendix M. However, **and this is very important to**
21 **understand**, what Mr. Oligschlaeger is referring to is a segment from the section labeled
22 "facts" and represents **only what MAWC told the IRS**. That section is literally preceded by
23 a sentence that states: "[t]he relevant facts **as set forth in your submission** are set forth
24 below." (Emphasis added).

1 I already addressed this at length in my direct testimony, but I will reiterate myself here in
2 response to Mr. Oligschlaeger. When a request is made to the IRS for a private letter ruling
3 the IRS takes the facts presented by the taxpayer at face value and applies them to the
4 situations that the taxpayer wishes to have the Service clarify. In this case, the IRS was asked
5 to answer 12 specific questions. **None** of the twelve specific questions concerned whether
6 ISRS plant additions **actually caused** an NOL. The “facts” found in the section labeled “facts”
7 in the PLR thus only represent what MAWC alleged to the IRS, nothing more.

8 **Q. What about the IRS’s findings with regard to requested ruling no. 9? Is Mr.**
9 **Oligschlaeger correct that this finding means the IRS was effectively affirming that**
10 **ADIT must be offset by assumed tax loss/NOL?**

11 A. No. The IRS’s response to requested ruling number nine literally begins with the phrase
12 “[u]nder the circumstances described,” which re-affirms the OPC’s point that the IRS was
13 not making a determination of whether an NOL existed or should be assumed, but rather,
14 was working off the facts and circumstances as MAWC had described them wherein the
15 Company claimed it did have an NOL. Mr. Oligschlaeger’s suggestion that the IRS
16 determined the Commission must “assume” a tax loss simply because MAWC presented false
17 information to the IRS is nonsensical.

18 **Q. Given the problems with Staff’s interpretation of the PLR you just described, how**
19 **should the Commission approach the question of whether or not there is an NOL in this**
20 **case?**

21 A. The Commission should find the same way it has it the last two fully-litigated MAWC ISRS
22 cases by determining that the Company had no NOL. This Commission’s position has been
23 twice affirmed by the Western District Court of Appeals. The fact that the IRS issued a PLR
24 based on a false scenario does not change the situation and is irrelevant to MAWC and this
25 case. Moreover, there are two additional reasons for why the Commission should continue to
26 find that MAWC does not have an NOL that were never addressed by the PLR: (1) the failure

1 of MAWC to consider CIAC, and (2) the existence of ongoing revenue related to the pipes in
2 question arising from the sale of water flowing through those pipes.

3 **Q. What is the basis for MAWC’s argument that it has an NOL?**

4 A. In the last three MAWC ISRS cases, the Company has tried to change the basic rules of
5 accounting to suit its needs. ISRS cases are limited, specific ratemaking procedures. The key
6 word here is “rates”. An ISRS proceeding recognizes and adjusts revenue **requirement** by
7 adjusting rates. What the Company has tried interjecting into these past cases is revenue
8 **recognition** or what they call a lack of revenues. MAWC claims that, because the surcharge
9 revenues have not been billed to customers immediately after costs are incurred, the Company
10 receives no revenues to offset its expenses. However, no one has accepted this argument in
11 the past three ISRS cases and the IRS certainly didn’t agree to it in the PLR.

12 **Q. Should the Commission accept MAWC’s argument that ratemaking is calculated**
13 **presently and not prospectively?**

14 A. Absolutely not. The Commission rejected this NOL line of thinking twice and the Western
15 District twice affirmed the Commission’s decision to do so. Rates are and always have been
16 set **prospectively**. Unfortunately, Staff believes that the IRS has confirmed an NOL and, in
17 doing so, has apparently changed its stance on this incredibly basic issue. But, as I said in
18 direct testimony, the IRS didn’t address the question of an actual NOL. In fact, it was never
19 provided enough information to make an informed decision. Nonetheless, here we are once
20 again addressing the same question of whether or not an NOL exists. I will walk through the
21 two reasons previously outlined that explain why there are revenues present to offset the
22 Company’s expenses and dispel the Company’s claim to this fictitious NOL. In doing so, I
23 can hopefully neutralize any idea that the IRS has issued a normalization violation mandate.

1 **Q. Your first point concerned CIAC. How does CIAC fit into the revenue calculations?**

2 A. An income tax loss, otherwise referred to as an NOL, is an **income tax return generated**
3 **event**. MAWC is arguing that because it receives no revenue from the pipes it has installed
4 prior to an ISRS being set, it has suffered this specific type of income tax return generated
5 event. The problem with the Company's position is that it has conveniently neglected to
6 recognize **another** income tax return generated event as revenue. That would be CIAC.

7 Since the passage of the 2017 TCJA, CIAC is considered taxable income for utility companies
8 (Schedule JSR-R-1). For ratemaking purposes, CIAC is considered an offset to rate base.
9 Now that CIAC has been considered income, Staff grosses the number up for taxes within the
10 revenue requirement. CIAC is present in the Company's ISRS workpapers and is separated
11 from its own ISRS plant additions. This is an important point because it demonstrates that the
12 Company's argument that no revenues have been collected prior to the ISRS going into effect
13 is false. CIAC, as an income tax generated event, is present long before ISRS rates are
14 collected and it can and should be matched to the accelerated depreciation that Company
15 claims as the expense causing the NOL.

16 **Q. What is the amount of CIAC included in the Company schedules?**

17 A. Company's answer to OPC data request 1301, attachment 2, **Net CIAC** tab, (Schedule JSR-
18 R-2) indicates that MAWC received \$1,052,050 in CIAC during the ISRS period. The
19 Company should have included this amount as taxable income which would offset any
20 expenses that the Company claims as taxable expenses during the ISRS period.

1 **Q. What was the total amount of NOL claimed by the Company associated with the ISRS**
2 **period?**

3 A. MAWC provides this answer in the same workpapers mentioned above, but this calculation
4 is performed on the Tax tab. The Company claimed an NOL of \$326,427 associated with the
5 ISRS period.

6 **Q. So the income tax authorized events directly related to the ISRS time period is CIAC**
7 **related taxable income of \$1,052,050 and an accelerated depreciated expense of**
8 **\$326,427?**

9 A. That is correct.

10 **Q. Based on these numbers what conclusion do you draw?**

11 A. Because the CIAC related income amount of \$1,052,050 greatly exceeds the accelerated
12 depreciated expense of \$ 326,427, MAWC is currently receiving revenues related to this ISRS
13 case and is thus not suffering any type of net operating loss.

14 **Q. The second issue you raised concerned “ongoing” revenues. Could you please explain**
15 **what you meant by this statement?**

16 A. An ISRS proceeding only concerns the replacement of old or damaged pipe with newer
17 versions of the same. In other words, it is a replacement of existing rate base. However, this
18 replacement is not carried out in an accounting vacuum. There is not a MAWC supervisor
19 standing at a main waiting for the Commission to hand down its ISRS order before they turn
20 a spigot and suddenly customers are receiving water. No. As soon as the pipe is pressure
21 tested and fit for service, it is back in the system moving water and therefore causing revenues
22 to be earned.

1 To claim that there are no revenues associated with that asset that is (1) in service and (2)
2 being used to transport water to paying customers is categorically wrong. One can make the
3 argument that the new infrastructure has not resulted in an increase to rates, but that is not the
4 only revenues that one must consider. In other words, just because the new asset isn't reflected
5 in rates doesn't mean it is not providing a means for the utility to make money.

6 **Q. Can you elaborate on how the ISRS assets are associated to current revenues?**

7 A. The replaced assets were in current rates and generating current revenues. Replacing that pipe
8 does nothing to change current rates and it does nothing to change the fact that the new
9 operational assets are directly responsible for current revenues. An ISRS case is a ratemaking
10 process to recognize new assets and set rates prospectively. However, the moment water
11 started running through the new pipe it was generating revenues for the utility based on the
12 current (before the ISRS case) rates.

13 **Q. Can one not make the argument that because the new assets are not recognized in rates**
14 **it therefore is not generating revenue?**

15 A. No. You cannot have it both ways. The ISRS functions as a means of replacing current assets
16 with new assets, not as a means of installing or connecting brand-new customers. These
17 current assets are already in rate base and are already producing revenues for the utility. If
18 you claim a loss because of accelerated depreciated on the new assets prior to ISRS rates being
19 set, how can you turn a blind eye to the revenue those assets are already helping to provide by
20 stepping into the shoes, so to speak, of the now retired prior assets that are already in rates?
21 To put it simply, it is ridiculous for a company to claim it is "operating at a loss" because it is
22 not *immediately* collecting the cost of new pipes that are in service while simultaneously
23 ignoring the fact that it is still collecting revenues for pipes that have now been retired.

1 **Q. Are there any other problems with Mr. Oligschlaeger's testimony?**

2 A. Yes. Mr. Oligschlaeger answers a question on Page 9 of his testimony with the following

3 As previously discussed, the consequences of a violation of the Code's
4 normalization restrictions can be serious. Therefore, consistent with
5 its understanding of the IRS's ruling in the present PLR, Staff has
6 removed any deduction for accelerated depreciation associated with
7 IRS plant additions from its calculation of MAWC's ISRS revenue
8 requirement in this case.

9 With the shortened schedule, I was not been provided a copy of Staff workpapers or schedules
10 but this step should not be taken. Staff should be calculating ADIT and offsetting rate base
11 as it has in every other ISRS case. The calculations should be similar to the updated plant
12 amounts that would supplement MAWC's original schedules but without the NOL inclusion
13 in the calculations.

14 MAWC answer to OPC data request 1301, attached as Schedule JSR-R-3, indicates that the
15 calculated revenue requirement without an NOL adjustment to ADIT is **\$8,872,475**

16 **Q. Have you reviewed the testimony of Company witness John Wilde?**

17 A. Yes. Mr. Wilde argues that IRS's PLR concluded that a normalization violation had occurred
18 in MAWC's prior ISRS cases.

19 **Q. Do you agree?**

20 A. No. As I have laid out extensively in both direct and rebuttal testimony, the IRS was presented
21 with a false set of facts in MAWC's PLR request. The IRS accepted these facts at face value,
22 which is what they always do when a PLR is requested, and determined **based on those facts**
23 that a normalization violation had occurred. But because the underlying facts were false, this
24 decision has no bearing on MAWC's prior ISRS cases. Again, the IRS was never asked to
25 determine if an NOL existed and it never did. The PLR is therefore just a very expensive
26 "what if" determination.

1 **Q. Have you reviewed the testimony of Company witness Brian LaGrand?**

2 A. Yes. Mr. LaGrand also describes the NOL adjustment as needed to cure a normalization
3 violation. He is equally incorrect for the same reasons I just laid out with regard to Mr. Wilde.

4 **Q. Could you summarize your testimony?**

5 A. As I argued in direct testimony, the PLR never affirmed an NOL. To claim one is
6 categorically wrong. It is irrefutable that revenues are associated to the new assets prior to
7 the setting of new ISRS rates. Whether one accepts that CIAC is taxable revenues or that the
8 new pipe has replaced old pipe in current rates, matters not; the Company's accelerated
9 depreciation does not take place in a vacuum and in either case revenues must be considered.
10 Further, because there is no NOL, there is no normalization violation. The Company's
11 \$35,328 NOL calculation must be removed from the proposed ISRS tariffs.

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

13 A. Yes it does.

**DATA INFORMATION REQUEST
Missouri-American Water Company
WR-2020-0190**

Requested From: Tim Luft
Date Requested: 5/21/2020

Information Requested:

What is the Company's understanding of the taxability of Contributions in Aid of Construction ("CIAC")?

Requested By: John Riley - Office of Public Counsel – (john.riley@opc.mo.gov)

Information Provided:

As a result of the enactment of the TCJA, CIAC is taxable, with very limited exceptions.

	Jan-18 - Jul-18	Aug-18 - Sep-18	Total
Mains, Valves and Hydrant Replacements			
Reimbursements	(\$2,337)	\$0	(\$2,337)
Amortization	\$19	\$0	\$19
Net CIAC	(\$2,318)	\$0	(\$2,318)

	Jan-18 - Jul-18	Aug-18 - Sep-18	Total
Relocations			
Reimbursements	(\$1,059,928)	\$0	(\$1,059,928)
Amortization	\$7,878	\$0	\$7,878
Net CIAC	(\$1,052,050)	\$0	(\$1,052,050)

Missouri-American Water Company
 ISRS Revenue Requirements Calculation
 St. Louis County Operations

1	Infrastructure System Replacement Surcharge Revenue Requirement	
2		
3	Water Utility Plant Projects--Replacement Mains, and Associated Valves and Hydrants (RM) RSMo 393.1000 (8a):	
4	<u>Task Orders Placed in Service (TOPS):</u>	
5	STLC-Replacement Mains and Associated Valves and Hydrants	\$65,156,806
6	Net Contributions in Aid of Construction	(10,928)
7	Deferred Taxes	(9,290,764)
8	Accumulated Depreciation	(309,021)
9		
10	Total Net 393.1000 (8a)	\$55,546,094
11		
12	Water Utility Plant Projects--Main Cleanings and Relinings (RM) RSMo 393.1000 (8b):	
13	<u>Task Orders Placed in Service (TOPS):</u>	
14	STLC-Main Cleanings and Relinings	\$0
15	Net Contributions in Aid of Construction	0
16	Deferred Taxes	0
17	Accumulated Depreciation	0
18		
19	Total Net 393.1000 (8b)	\$0
20		
21	Water Utility Plant Projects--Facilities Relocations (FR) RSMo 393.1000 (8c):	
22	<u>Task Orders Placed in Service (TOPS):</u>	
23	STLC-Relocated Facilities	\$1,010,834
24	Net Contributions in Aid of Construction	(298,250)
25	Deferred Taxes	(67,483)
26	Accumulated Depreciation	(7,484)
27		
28	Total Net 393.1000 (8c)	\$637,617
29		
30	Accumulated Depreciation and Deferred Taxes on Investment in Current ISRS	
31	Accumulated Depreciation - Prior ISRS	(\$441,997)
32	Deferred Taxes - Prior ISRS	(18,781)
33		
34	Total	(\$460,778)
35		
36	Total ISRS Rate Base	\$55,722,933
37		
38	Overall Pre-Tax Rate Of Return per Last Order	9.44%
39		
40	Revenue Requirement on Capital	\$5,260,245
41	Depreciation Expense	873,085
42	Property Taxes	2,739,145
43	Revenue Cap Adjustment	0
44		
45	Total Revenue Requirement	\$8,872,475
46		
47	Adjustments:	
48	Undercollection from ISRS reconciliation	-
49		
50	Adjusted Total Revenue Requirement	\$8,872,475
51		
52	Allocation of Revenue by Class	
53	Rate A	\$8,834,510
54	Rate B	10,795
55	Rate J	27,170
56		
57	Grand Total Revenues Collected in Proposed ISRS	\$8,872,475