



current ISRS filing. In other words, the claimed NOL is not asset specific, so it is not includable in the ISRS.

## **FACTS**

1. The Infrastructure System Replacement Surcharge (“ISRS”) is a surcharge allowing water companies, at the PSC’s discretion, to charge their customers a separate rate for certain costs incurred in compliance with government-mandated infrastructure replacements, improvements, and relocations. Sections 393.1000, 393.1003 and 393.1006 RSMo (collectively, “ISRS Statutes”). The ISRS is a “surcharge” because it is charged in addition to the rates set in a general rate case. Without the ISRS, a water company could not begin recovering the costs for the mandated replacements, improvements, and relocations until rates were reset in its next general rate case.

2. The ISRS is considered a “single-issue” rate mechanism because it increases rates for one category of cost - infrastructure - without considering all relevant factors. *PSC v. Office of Pub. Counsel (In re Laclede Gas Co.)*, 539 S.W.3d 835 (Mo. App. 2017).

3. The ISRS Statutes and the Commission’s ISRS rules require a water corporation to file a petition with the PSC that includes the company’s proposed rate schedules and the company’s supporting documentation. Section 393.1006.1(1) RSMo. It is the Commission itself that is required by statute to conduct an examination of the proposed ISRS to confirm compliance with the ISRS Statute. Section 393.1006.2(1). The PSC’s Staff may submit a report of its examination findings no later than sixty days after the petition is filed. Section 393.1006.2(2).

4. On August 20, 2018, MAWC filed its *Petition* seeking Commission authorization under Section 393.1000 to charge its customers for certain ISRS-eligible infrastructure system

replacements and relocations the Company had made in the period of January 1, 2018, through September 30, 2018. Since the Company filed in August, MAWC included pro-forma ISRS costs updated through September 30, 2018.

5. This is the first ISRS filing since the Company's most recent general rate case, No. WR-2017-0285.

6. In its *Petition* MAWC explained that it sought "to establish an ISRS [surcharge to recover] costs for infrastructure system replacements and relocations eligible for ISRS recognition [under statute]. MAWC also sought to recover all state, federal and local income or excise taxes applicable to such ISRS income and to recover all other ISRS costs such as depreciation expense and property taxes due within 12 months of this filing." *Petition 2*, para 4.

7. In its *Petition*, MAWC stated that its proposed rate schedule will "produce ISRS revenues of \$7,437,064 or an increase of 3.6% based on the base revenue level approved by the Commission in the most recently completed general rate case proceeding" on an annualized basis. *Petition* p. 6, para 14.

8. Staff reviewed the Company's filing and its Recommendation to the Commission was to approve ISRS surcharge revenues of \$6,377,082. Staff Recommendation at 5.

9. MAWC subsequently provided Staff with updated work papers to include its actual ISRS investment through September 30, 2018. At that time, MAWC deducted \$63,295 of ISRS ineligible costs related to removing and replacing *customer owned lead service lines*, which the Company incorrectly included in its initial *Petition*. Staff Recommendation at 3.

10. In addition to these *customer owned lead service lines* costs identified by the Company, Staff also removed various non-ISRS eligible costs including: \$15,100 repairs to

customer owned appliances and equipment; duplicate charges of \$24,586; costs for installation of new service lines and additional costs of \$48,508 for customer *owned lead service line replacement* costs (above the \$63,295 MAWC removed) for a total of costs of \$110,902 that should not have been included in MAWC's filing. Tr. Vol. 1, 31:11-25.

11. Staff also removed MAWC's proposed net operating loss ("NOL") of \$9,368,663.

### **ARGUMENT**

The issue the parties submitted to the Commission is: In determining MAWC's ISRS rates in this case, under the applicable statute, may MAWC's accumulated deferred income tax, (ADIT) balance in rate base be reduced by the ADIT asset resulting from ins net operating loss(es), if any.

More specifically the issue is whether MAWC may include its claimed net operating loss (NOL) in rate base. In order to answer that question "yes," the Company must prove it actually has an NOL or NOLC for the period of time January 1, 2018 and that it was specifically related to the infrastructure the Company claimed was ISRS eligible. The Company cannot meet its burden of proof.

**As the proponent of a change in rates the Company has the burden of proof.**

"Section 393.150 gives the Commission the authority to conduct a hearing regarding the propriety of new rates filed by any water corporation and to make a decision regarding those rates. Section 393.150.2 places the burden of proving that an increased rate is just and reasonable on the public utility. And all charges made or demanded 'shall be just and reasonable and not more than allowed by law.'"

Similarly, Section 393.1006 gives the Commission the authority to conduct a hearing on

an ISRS Petition: “The commission may hold a hearing on the petition and any associated rate schedules and shall issue an order to become effective not later than one hundred twenty days after the petition is filed.” Section 393.1006 RSMo (2016). Only if “the commission finds that a petition complies with the requirements of sections 393.1000 to 393.1006, [shall] the commission . . . enter an order authorizing the **water** corporation to impose an ISRS that is sufficient to recover appropriate pretax revenues, as determined by the commission pursuant to the provisions of sections 393.1000 to 393.1006.

**The Company did not generate any NOL in the ISRS period of January 1, 2018 and September 30, 2018**

Mr. Riley explained that “an NOL is a tax return has yet been filed that covers this timeframe so no NOL [can] yet be claimed.” Exh. 6, Riley Direct, 3:23-25. The Company will file its 2018 tax return “sometime in 2019.” Tr. Vol. 1, 40:20-22. Since an NOL is a tax return item, the Company has not generated any NOL during the ISRS period.

Staff witness, Ms. Lisa Ferguson’s, Direct testimony reinforces both Public Counsel’s and Staff’s position that the Commission should deny MAWC’s request to include NOL in this ISRS case: “There has been no incremental actual generation of NOLs by MAWC during this ISRS period associated with ISRS plant additions or for any other reason.”

**The Company failed to prove its claimed NOL is related to any of the ISRS-eligible infrastructure claimed in this case.**

It is undisputed that the NOL adjustment proposed in MAWC’s *Petition is not asset specific* to the infrastructure MAWC claims to be ISRS eligible. For any NOL to be considered in an ISRS case, it must be directly related to ISRS-qualifying plant.

Public Counsel's tax expert witness, Mr. John Riley, CPA, describes what the term NOL means:

First and foremost, an NOL is a tax return adjustment not a regulatory item. Specifically, an NOL is an accounting fiction where, for income tax purposes, a company reports deductions that are higher than reported revenues. This is an item the Company recognizes on its tax return as a taxable income loss.

Exh. 6, Riley Direct, 2:14-23.

Mr. Riley further explains that an: "NOL has no connection to the Infrastructure System Replacement Surcharge. If an NOL were actually to be considered, its possible inclusion would need to be addressed in a rate case, not an ISRS proceeding." Exh. 6, Riley Direct, 4:2-5.

Addressing the critical issue in this case, Mr. Riley testifies the claimed NOL does not relate to any specific ISRS-eligible infrastructure:

Another limitation that excludes an NOL from ISRS consideration is that an NOL is not asset specific and *cannot be tied to any specific ISRS qualifying or non-ISRS qualifying infrastructure investment*. This is in contrast to identifying deferred tax liability to an asset.

Exh. 6, Riley Direct, 4: 6-8. (emphasis added).

Turning to the testimony of MAWC witness, John R. Wilde, when at hearing Mr. Wilde was asked the direct question, "An NOL is not attached to any certain infrastructure, any particular asset?" Mr. Wilde answered: "You're correct with that." Tr. Vol. 1, 52:16-18. With that response, Mr. Wilde agreed with Public Counsel's testimony the NOL is not asset specific. There was no redirect regarding Mr. Wilde's response. TR. VOL. 1., 69:6 -73:3.

The third party to this case, the Commission Staff and specifically Mr. Oligschlaeger, takes the position that the Company has not had any NOL costs that would have occurred during the ISRS period of January 2, 2018 through September 30, 2018. "The ISRS period extends from

January 1, 2018, through September 30, 2018. *Only costs directly associated with qualifying ISRS plant* that became in-service during those nine months should be reflected in ISRS rates resulting from this proceeding.” Exh. 3, Oligschlaeger Direct, 6:16-23(emphasis added).

Mr. Oligschlaeger explains that MAWC is proposing “to use prior booked amounts of NOL as carry-forwards to offset taxable income in 2018 and 2019.” Mr. Oligschlaeger further clarifies: “[i]n other words, MAWC is no longer ‘generating’ an NOL [in 2018]; it is instead in the position of “using” the NOL booked in *prior* years to reduce future taxable income.” Exh.3, Oligschlaeger Direct, 7:1-8. During the hearing in further support of Staff’s position MAWC has not generated any NOL during this ISRS case Mr. Oligschlaeger testified:

As clearly shown in the response to Staff Data Request No. 4, the balance of Missouri-American's NOL deferred tax asset has been declining at a steady rate so far in 2018. The response [to DR 4] also indicates that this reduction is expected to continue until at least the end of 2019. This means that MAWC is expected to use its prior NOL to offset taxable income in 2018 and 2019 and that the Company is not projecting any additional generation of NOL in the aggregate for the ongoing future. (the chart showing the offset to taxable income is at Ferguson Direct, 6:6-7)

Tr. Vol. 1, 88:3-12.

**There is no violation of the Internal Revenue Service normalization rule.**

Staff firmly refuted the Company’s claim it might be in violation of the IRS normalization rules. In response to the question: “In his direct testimony Mr. Wilde claims that failure to reflect a rate-based offset for a hypothetical NOL in this case could or would lead to an IRS Code tax normalization violation. Do you agree?” Tr. Vol.1, 89:6-10. Mr. Oligschlaeger responded: “Staff has not found any support for this contention in the IRS Code or in private letter rulings cited by Mr. Wilde.” Tr. Vol. 1, 89:11-13. Mr. Oligschlaeger further stated that there are two specific situations in which NOLs may be relevant. Tr. Vol. 1 89:19-25. t

However, neither situation applies to Missouri-American during this particular ISRS period. ·So far in 2018, MAWC has not generated any new NOL in the aggregate and as a result its existing NOL balance has been decreasing, not increasing.· Since MAWC is not currently generating any additional amount of NOL in aggregate, no violation of the tax normalization rules is at risk in this case. Tr. Vol. 1, 90:3-10.

Moreover the IRS Private Letter Rulings on which Mr. Wilde relied do not support the Company's position. Mr. Oligschlaeger was definite: "None of the PLRs attached to Mr. Wilde's testimony or otherwise provided to Staff by [the Company] are relevant to Missouri-American's current financial and taxable positions.· Without exception, all of the PLRs cited by Mr. Wilde address time periods in which the utility in question was generating NOL amounts. Again, MAWC is not currently generating any NOL [amounts]. It is using prior amounts instead. Tr. Vol. 1, 90:14-25.

## **CONCLUSION**

Based on the facts and law as explained in this brief, the Commission should reject the Company's arguments and issue its Order approving the amount of ISRS revenues recommended by Staff.

WHEREFORE Public Counsel respectfully submits its Brief for the consideration of the Commission.



Respectfully submitted,  
OFFICE OF THE PUBLIC COUNSEL

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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 27th day of November, 2018.

/s/ Lera Shemwell