

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

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

STATEMENTS OF POSITION

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Statements of Position*, states as follows:

ISSUE 1. Should MAWC’s incremental pre-tax revenue requirement in this matter include a total of \$35,328 associated with MAWC’s proposal to address alleged normalization violations related to eligible infrastructure system replacements included in MAWC’s currently effective ISRS?

Staff’s Position: Yes. In recent ISRS cases, Missouri-American Water Company (“MAWC”) has raised the possibility that the Commission’s actions regarding the purported existence of a net operating loss (“NOL”) may not be in compliance with the IRS Code’s normalization restrictions. Following Commission decisions disagreeing with these assertions, MAWC took the step of seeking clarification from the Internal Revenue Service (“IRS”) through the Private Letter Ruling process as to whether the normalization restrictions were, in fact, being violated. Prior to the submission of its request, Staff was provided drafts of the PLR request and provided feedback to MAWC, including detailed explanations and justifications for Staff’s positions and those reflected in Commission orders regarding these matters. Staff’s comments were attached to MAWC’s request sent to the IRS on June 6, 2019. The IRS provided the requested PLR in December 2019. Staff has reviewed the PLR, and, through its analysis, concludes that the IRS determined the Commission’s actions, in reflecting a full deduction of applicable

accelerated depreciation amounts *without* offset for an NOL amount in prior ISRS cases,¹ constituted a violation of the Code's normalization restrictions.² A finding by the IRS of a normalization violation can result in a utility losing the ability to utilize accelerated depreciation, which could ultimately result in higher rates for rate payers. Therefore, in order to account for NOL amounts consistent with the IRS ruling, and the corresponding impact to accumulated deferred income taxes associated with the eligible infrastructure system replacements included in MAWC's current ISRS, Staff has included MAWC's proposed NOL adjustment of \$35,328 to the appropriate pre-tax revenues to be collected in this ISRS.³

As explained in the direct testimony of Mark L. Oligschlaeger,⁴ within the PLR, the IRS indicates its concurrence with MAWC's prior arguments before the Commission that ISRS plant additions in fact did cause MAWC to suffer a tax loss that should be taken into account by the Commission in setting ISRS rates. In particular, it is Staff's position that the language wherein the IRS grants MAWC's requested ruling no. 9 effectively affirms MAWC's prior position taken in ISRS cases that the accelerated depreciation income tax ("ADIT") deductions associated with ISRS plant additions must be offset by assumed tax loss/NOL amounts in order to comply with the IRS Code.⁵ Specifically, as detailed on

¹ Commission Case Nos. WO-2018-0373, WO-2019-0184, and WO-2019-0389.

² However, the IRS also found that the Commission's treatment of reflecting a full deduction of applicable repair allowance amounts without offset by NOL amounts did not violate the normalization restrictions within the IRS Code. Oligschlaeger Direct, P. 8.

³ See the Direct and Rebuttal testimonies of Staff Witness Mark L. Oligschlaeger.

⁴ Oligschlaeger Direct, P. 8.

⁵ It is suggested in Mr. John R. Wilde's Direct Testimony (page 11) and rebuttal testimony (pages 12 – 13) that, if the Commission rejects MAWC's and Staff's position in this case regarding the applicability of Ruling 9 to this proceeding, the IRS' granting of Ruling 8 would have the same impact on the Commission's ratemaking for deferred tax expense in MAWC ISRS cases. However, for the reasons discussed in Mr. Oligschlaeger's Rebuttal Testimony at pages 8 - 12, Staff does not agree with MAWC's interpretation of Ruling 8 on this point.

pages 5 and 6 of the rebuttal testimony of Mark L. Oligschlaeger, within the PLR, in the section entitled “Facts,” the following language appears:

In the course of the Surcharge case, Taxpayer and other participants in the proceeding analyzed the expenditures for which Taxpayer sought recovery via the surcharge and debated the proper regulatory treatment of Taxpayer’s NOLC and tax loss incurred through the rate base determination date of the Surcharge case with respect to the costs incurred that are recoverable in the Surcharge case. The revenue requirement approved in the Commission’s order issued on Date 1 was lower than the revenue requirement sought by Taxpayer and is entirely attributable to the differing ADIT calculations with respect to the NOLC and the resulting effects on rate base and allowed return. The approved revenue requirement in the surcharge case was based on a rate base computation that reflects the gross ADIT liabilities associated with depreciation-related and repair-related book/tax differences, **but did not reflect an ADIT asset for any portion of the Taxpayer’s NOLC as of the date that rate base was determined (Date 9), including the tax loss resulting from the infrastructure expenditures addressed in the Surcharge Case.**⁶ (Emphasis added.)

Later, on the same page of the PLR:

...As of the date of the rate base determination, **none of the surcharge revenues had been billed to customers, and, thus, as of this date a taxable loss of approximately \$e had been incurred in respect to the plant-related expenditures with rates set by the Surcharge Case.**⁷ (Emphasis added.)

The bolded language indicates the IRS chose to accept MAWC’s claims that the inability of MAWC to capture customer revenues for ISRS plant additions prior to the ordering of new ISRS rates caused a tax loss for the utility. Understanding this point is necessary to interpret the IRS language adopting MAWC’s requested Ruling 9.

⁶ See the Rebuttal Testimony of John R. Wilde, Schedule JRW-2, P. 7 of 23.

⁷ *Id.*

MAWC's requested Ruling 9 is as follows:

Taxpayer requests that the Service also rule: in order to comply with the normalization method of accounting within the meaning of Section 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOL for the test period for the Surcharge Case that would not have arisen had Taxpayer not reported depreciation-related book/tax differences during the test period of the Surcharge case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without method. (Schedule JRW-2, pages 10 – 11 of 23).

Within the PLR the IRS granted MAWC's request for Ruling 9 using the same language suggested by MAWC above, at page 21 of 23 of Schedule JRW-2.

Further underscoring the IRS' acceptance of requested Ruling 9, the PLR states the following in respect to requested Ruling 10, which had been posed by MAWC as an alternative to granting Ruling 9:

Ruling request 10 is moot because we grant ruling 9 in accordance with Taxpayer's analysis. (Schedule JRW-2, page 21 of 23).

Therefore, it is Staff's position that the language of the PLR demonstrates IRS support for the applicable contentions made by MAWC in recent ISRS cases. While it was stipulated in Case No. WO-2019-0389 that disputed NOL amounts from prior ISRS cases should be deferred through an AAO in the event that the IRS found in MAWC's favor, because MAWC must cure past normalization violations at its *next available opportunity*,⁸ and because the past NOL amount to be provided to MAWC due to the PLR is relatively immaterial, Staff does not object to the Company's proposal for collecting this amount in this proceeding in lieu of deferring the amounts

⁸ See the Direct Testimony of John R. Wilde, P. 6.

through an AAO. Therefore, Staff recommends that the Commission include a total of \$35,328 in MAWC's incremental pre-tax revenue requirement in this matter in order to resolve any potential adverse consequences from violating the normalization requirements contained in the IRS Code.⁹

As such, Staff recommends the Commission approve Staff's recommended ISRS surcharge revenues in the incremental pre-tax revenue amount of \$9,725,687,¹⁰ and approve the following rates for each rate class:

<i>Rate A</i>	<i>\$0.96287</i>
<i>Rate B</i>	<i>\$0.01463</i>
<i>Rate J</i>	<i>\$0.01399¹¹</i>

ISSUE 2. Should MAWC's incremental pre-tax revenue requirement in this matter include recognition of deferred taxes associated with accelerated depreciation tax timing differences?

Staff's Position: Yes. Section 393.1000, RSMo, defines "Appropriate pretax revenues" as the revenues necessary to produce net operating income equal to:

- (a) The water corporation's weighted cost of capital multiplied by the net original cost of eligible infrastructure system replacements, **including recognition of accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system replacements which are included in a currently effective ISRS**; and
- (b) Recover state, federal, and local income or excise taxes applicable to such income; and
- (c) Recover all other ISRS costs;

Therefore, the amount of the required return on rate base for ISRS plant additions is required to be netted against the amount of booked accumulated deferred income taxes

⁹ Oligschlaeger Rebuttal, P. 8.

¹⁰ See the Direct Testimony of Ali Arabian, P. 2.

¹¹ Direct Testimony of Matthew J. Barnes, P. 2.

("ADIT") associated with the ISRS additions, to recognize that customers as well as the utility have invested capital related to the plant additions. However, in order to account for NOL amounts in MAWC ISRS cases consistent with the IRS ruling within the PLR, any associated ADIT for accelerated depreciation in this particular case must be offset by a corresponding NOL deferred tax asset.¹²

Respectfully submitted,

/s/ Mark Johnson

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile, or electronically mailed to all parties and or counsel of record on this 29th day of May, 2020.

/s/ Mark Johnson

¹² See Oligschlaeger Direct and Rebuttal Testimonies.