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 Infrastructure System Replacement Surcharge (ISRS)	))))))	Case No. WO-2020-0190

BRIEF OF THE MISSOURI OFFICE OF THE PUBLIC COUNSEL

John A. Clizer (# 69043)
Senior Counsel
Missouri Office of the Public Counsel
P.O. Box 2230
Jefferson City, MO 65102
Telephone: (573) 751-5324
Facsimile: (573) 751-5562
E-mail: john.clizer@opc.mo.gov

June 8, 2020

PUBLIC

COMES NOW the Office of the Public Counsel ("OPC") and for its *Brief*, states as follows:

Issue 1: <u>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?</u>

No. MAWC's proposal is unnecessary as there have been no normalization violations that require addressing. MAWC's claim regarding a normalization violation is premised entirely on its belief that it has a net operating loss associated with its ISRS replacements. MAWC does not have a net operating loss with regard to its ISRS replacements. If there is not a net operating loss, then there is no normalization violation. If there is no normalization violation, then there is nothing that needs to be addressed and no adjustment that needs to be made.

Initial Considerations

Let us begin our analysis with an examination of the S*tipulation and Agreement* that underlies this case. The direct testimony of MAWC witness Brian W. LaGrand provides what is really the only relevant portion of the S*tipulation and Agreement*, which is as follows:

> If the IRS PLR indicates that the Commission's treatment of the Deferred Tax Asset (NOL) has created a normalization violation, MAWC will file an application for an Accounting Authority Order (AAO), and Staff and OPC agree to support such AAO application, to permit MAWC to record a regulatory asset to capture the rate differential in an amount

as may be necessary to cure such normalization violation, if any, identified by the PLR.

LaGrand, *Direct,* pg. 6 lns. 1 – 7. There are a few issues regarding this *Stipulation and Agreement* that might otherwise be worth mentioning (such as the fact that the S*tipulation and Agreement* actually contemplates an AAO and not the proposed adjustment, or the fact that the OPC was not actually a signatory to the S*tipulation and Agreement*), but those points do not form the central focus of the OPC's case and so will be disregarded for now. Instead, the OPC will focus on the really important point here, which is that the S*tipulation and Agreement* was meant to "cure" the "normalization violation, if any, **identified** by the PLR." *Id.* ln. 7 (emphasis added). The central problem to MAWC's case is that the IRS was never asked to identify whether a normalization violation had occurred and consequently never did.

That last statement is probably a little confusing, so let us consider it further. In the private letter ruling ("PLR") request, MAWC asked the IRS to make twelve separate and specific rulings. *See* Wilde, *Schedule JRW-2*, pgs. 9 – 12. Those twelve rulings described what the normalization rules **required** based on certain, **specific** circumstances. *Id*. At no point did MAWC ask the IRS to issue a ruling that said "a normalization violation has occurred in this case" and, consequently, the IRS never issued such a ruling. *Id.* Instead, all the rulings stated was, again, simply and solely what was **required** to avoid a normalization violation. *Id.*

Now the reader is probably curious as to why the OPC has put so much emphasis on the fact that the PLR only stated what was required, and the OPC will

explain itself in short order. First, though, the OPC wants to truly hammer home the point it is making with a citation to one of the rulings. The one ruling that has garnered the most attention, and which ultimately lies at the heart of this case, is ruling number nine. *See* Oligschlaeger, *Direct*, pg. 8 lns. 6 – 7. That ruling reads as follows:

> Under the circumstances described, in order to comply with the normalization method of accounting within the meaning of § 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 which would not have arisen had Taxpayer not reported depreciation-related book/tax differences during the text period for 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.

Wilde, *Schedule JRW-2*, pg. 21. As one can plainly see, the OPC's insistence that the rulings only described what the normalization rules **required** based on certain, **specific** circumstances is quite literal. The ruling itself states that it operates only "under the circumstances described" and further only states what is necessary "in order to comply with the normalization method of accounting within the meaning of § 168(i)(9)." Based on this. We can now confront the OPC's main point.

So far we have discussed how the *Stipulation and Agreement* that forms the legal backbone of this case is triggered only if the PLR **identified** a normalization violation while the PLR itself only described what the normalization rules **required** (based on certain, **specific** circumstances) and never explicitly **identified** that a violation existed. Now, in case the reader thinks that the OPC is trying to make a

hyper-technical argument regarding the lack of an explicit identification of a normalization violation in the PLR, do not worry; that is not what the OPC is focusing on. Instead, the OPC's whole point here is that, in order for the Commission to make a determination that the PLR identified a normalization violation, it becomes absolutely necessary that the Commission determine: (1) that the specific circumstances identified in the PLR were present and (2) that the requirements outlined in the PLR were not met.

Because ruling number nine explicitly states that it applies only "under the circumstances described" in the PLR, if the Commission determines that circumstances described in the PLR do not represent an accurate picture of reality, then it cannot possibly be said that the PLR has **identified** that a normalization violation has occurred. In the same vein, if the Commission determines that the requirement set forth in ruling number nine have already been met, then the PLR has not **identified** that a normalization violation has occurred. These two factors are what breaks MAWC's case.

As explained in the very first paragraph addressing this issue, MAWC's case – and the PLR's determination – are based on the existence of a net operating loss (sometimes referred to as an "NOL"). In other words, the circumstances described in the private letter ruling include the existence of a net operating loss and the requirement set forth in ruling number nine addresses the application of a net operating loss. *See* Wilde, *Schedule JRW-2*, pgs. 7, 21. The problem for MAWC, though, is that the company has suffered no net operating loss. Because the company

PUBLIC

did not suffer a net operating loss, the circumstances described in the PLR are not consistent with reality, so the PLR has not identified that a normalization violation has occurred. Further, because the PLR ruling nine required an offset to account for a net operating loss but MAWC did not actually **have** a net operating loss, then the requirement of ruling nine has already been met. This, again, means that the PLR has not identified that a normalization violation has occurred.

The preceding discussion is so important to this case that the OPC is going to take a minute to repeat itself here. The circumstances upon which ruling number nine is premised include the existence of a net operating loss. *See* Wilde, *Schedule JRW-2*, pg. 7. If the Commission determines that MAWC did not have a net operating loss, then the circumstances upon which ruling number nine is premised is not consistent with reality, and the ruling itself becomes irrelevant. At the same time, ruling number nine requires an offset to ADIT to account for a net operating loss. *See* Wilde, *Schedule JRW-2*, pg. 21. If the Commission determines that MAWC did not have a net operating loss, then the requirement has obviously already met, so the ruling again becomes irrelevant. This is really just two different ways of saying the same thing: if the Commission determines that MAWC did not have a net operating loss, then PLR ruling number nine becomes irrelevant to the consideration of this case.

Everything up to this point has been leading to this one simple conclusion: In order for the Commission to find that the PLR identified a normalization violation, **the Commission** has to find that MAWC suffered a net operating loss. If the

Commission finds that MAWC has not suffered a net operating loss, then the PLR did not identify a normalization violation because the rulings found in the PLR are all dependent on the existence of a net operating loss. As is readily apparent, therefore, this case comes down to the question of whether MAWC had a net operating loss. Moreover, the truly decisive aspect of this case is the fact that this Commission has already made that determination. But we are getting ahead of ourselves. First, we must deal with a few slight digressions that need to be addressed.

Before delving into the details regarding whether MAWC had a net operating loss, there are three related points that need to be discussed. The first is simply the fact that the problems presented by this case would not exist but for the decisions that MAWC made. As Staff witness Mark Oligschlaeger states in his direct testimony, the primary question raised in the past three ISRS cases was:

> whether ISRS plant additions **actually caused** a tax loss (i.e., net operating loss) to occur due to no revenues being collected by MAWC for the plant additions until the plant could be incorporated directly into ISRS rates. MAWC argued a tax loss occurred; Staff and OPC argued it did not.

Oligschlaeger, *Direct*, pg. 8 lns. 8 – 12 (emphasis added). MAWC therefore **knew** that these cases revolved entirely around whether a NOL loss **actually existed**. As such, MAWC could have easily structured its PLR request to specifically address the central question to these cases. But MAWC chose not to.

Instead of directly asking the IRS whether ISRS plant additions **actually caused** a net operating loss to occur, the Company asked the IRS to **assume** that

fact and then asked twelve questions **based** on that fact. *See* Wilde, *Schedule JRW-2*, pgs. 7, 9 – 12.[1] It is difficult, if not impossible, to believe that this was anything but a careful choice on the part of the Company. Moreover, the Company's deliberate decision to frame its PLR request in this manner has perpetuated the problems surrounding these ISRS cases. This brings us to the next point to discuss, which is the fact that MAWC's decisions have undermined every assumption that OPC had when it decided not to oppose the prior *Stipulation and Agreement*.

MAWC closed its opening statements during the evidentiary hearing by quoting at length from the attorney who represented the OPC during the prior ISRS case. *See*, Tr. pg. 19 ln. 9 – pg. 20 ln. 17. In doing so, the Company obviously wished to portray the OPC as attempting to back-track on its previous assertions. The problem with MAWC's attempt, however, is that everything the OPC's attorney said and every decision the OPC made with regard to the prior ISRS case was premised on the understanding that MAWC's PLR request was going to seek guidance as to the **central issue in the cases**. Stated differently, the OPC believed that MAWC's

---

[1] The Company is sure to argue that it did not ask the IRS to assume a taxable loss because it included the fact that the Commission found that no net operating loss had occurred. However, an examination of the phrasing actually employed by the Company in its PLR request reveals the problem with this claim. What the Company told the IRS was this: **____ ** Wilde, *Schedule JRW-1*, pg. 22. In response, the IRS included the following in its fact section: "Differing assertions were made as part of the Surcharge Case. Ultimately the Commission in its final order determined that because there was not an NOL expected to be generated Year 4, no portion of the NOLC deferred tax asset can be associated with the Surcharge property." *Schedule JRW-2*, pg. 9. But the issue at stake in these cases was not whether a net operating loss **carryforward** (NOL**C**) could be associated with the Surcharge property; but rather, whether a net operating loss was being **generated** as part of the surcharge case. Moreover, the inclusion of the fact that the Commission had issued a contrary opinion was completely overshadowed by MAWC's unqualified assertion that a taxable loss (*i.e.* a net operating loss) had occurred. *Schedule JRW-2*, pg. 7.

PUBLIC

private letter ruling was going to ask the IRS to address the question of whether ISRS plant additions **actually caused** an NOL to occur and not simply **assume** that fact. If the OPC had known that the Company was going to ask the IRS to just **assume** what had been quite literally the single largest point of debate over the last three ISRS cases, then the OPC would have opposed the stipulation and would not have supported it before the Commission.

In a similar manner to the foregoing, the third point of digression the OPC wants to address also deals with a statement made by MAWC during its opening. MAWC framed the OPC's position as a request for this Commission to disagree with the IRS. Tr. pg. 15 lns. 23 – 25. That is simply not true. The OPC is not asking this Commission to determine that the IRS got the PLR wrong; rather, the OPC is asking this Commission to determine that the PLR does not **apply** because the facts underlying the PLR are not applicable to MAWC's situation. This is perfectly consistent with how PLRs are treated by the IRS itself.

As will be explained in greater detail later in this brief, when the IRS receives a request for a PLR, the Service does not question or verify the facts. Instead, the IRS accepts the facts presented in the PLR request at face value and issues its rulings based on those facts. Riley, *Direct,* pg. 3, lns 15-16. However, when it comes time for the IRS to process the taxpayer's return, one of the things the IRS must do is actually check if the facts described in the PLR are accurate. 26 CFR § 601.201(l)(2); Rev. Proc.

PUBLIC

2019-1, I.R.B. 2019-01 § 11.03 (I.R.S. January 2, 2019).[2] If the IRS ultimately determines that the facts of the PLR are not accurate, then the IRS will revoke the PLR and can even make that revocation retroactive. 26 CFR § 601.201(l)(2),(4),(5); Rev. Proc. 2019-1, I.R.B. 2019-01 §§ 11.03,11.04,11.05 (I.R.S. January 2, 2019).

What the OPC is seeking in this case is for the Commission to effectively hold itself to the same standards as those used internally by the IRS. The Commission must examine the facts assumed by the IRS in the private letter ruling and determine if those facts are accurate. And, as already laid out above, if the Commission determines that the facts are not accurate – because MAWC has suffered no net operating loss for example – then the Commission must determine that the PLR does not apply and thus no normalization violation has been identified.

We are now back to where we were before we began the digression. The central question to these cases remains whether MAWC suffered a net operating loss. The answer to that question, as will soon be irrefutably demonstrated, is no. Because there has not been a net operating loss, the PLR ruling number nine is irrelevant and the PLR has identified no normalization violation in this case. Let us now consider why.

[2] The second citation is to the IRS's internal revenue procedure bulletin 1 for 2019. A copy from the IRS official website can be found here: https://www.irs.gov/irb/2019-01_IRB. The IRS publishes the procedures and user fees for obtaining a private letter ruling annually in the first revenue procedure of each calendar year. IRS, *Frequently Asked Questions: Code Revenue Procedures Regulations Letter Rulings*, https://www.irs.gov/faqs/irs-procedures/code-revenue-procedures-regulations-letter-rulings/code-revenue-procedures-regulations-letter-rulings (last visited June 8, 2020). The 2020 version can be found here: https://www.irs.gov/irb/2020-01_IRB. The cited section remains unchanged.

Examination of why MAWC did not Suffer a Net Operating Loss

The best place to start when explaining why MAWC has not suffered a net operating loss is with the definition of net operating loss. When considered for tax purposes (as used by the IRS), the definition of net operating loss is found in Title 26 of the United States Code: Internal Revenue Code, Subtitle A: Income Taxes, Chapter 1: Normal Taxes and Surtaxes, Subchapter B: Computation of Taxable Income, Part VI: Itemized Deductions for Individuals and Corporations, Section 172: Net Operating Loss Deductions, Parenthesis C: Net Operating Loss Defined. That definition is as follows, "[f]or purposes of this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income."[3] 26 USC § 172(c). One of the most important aspects of this definition – and one that it appears many of those previously involved with these ISRS cases have overlooked – is the fact that this definition concerns the excess of deductions over the taxpayer's **gross income**. The term "gross income" is itself defined by the Internal Revenue Code in Part I of the same subchapter where the definition of net operating loss is found. Specifically, the definition of gross income is found at 26 USC § 61 and is as follows:

> Except as otherwise provided in this subtitle, gross income means **all income from whatever source derived**, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;

[3] This is, incidentally, the same definition found in the *Stipulation of Facts*. Ex. 100 pg. 2.

PUBLIC

(2) Gross income derived from business;
(3) Gains derived from dealings in property;
(4) Interest;
(5) Rents;
(6) Royalties;
(7) Dividends;
(8) Annuities;
(9) Income from life insurance and endowment contracts;
(10) Income from life insurance and endowment contracts;
(11) Pensions;
(12) Income from discharge of indebtedness;
(13) Distributive share of partnership gross income;
(14) Income in respect of a decedent; and
(15) Income from an interest in an estate or trust.

(emphasis added). This definition presents a critical problem to MAWC's position in these ISRS cases.

Based on what was just stated, we know the following: a net operating loss is the excess of the deductions allowed by chapter one of the Internal Revenue Code over a taxpayer's gross income and gross income means all income from whatever source derived. 26 USC §§ 61, 172(c). Putting those two definitions together, we can easily see that a net operating loss is the excess of the deductions allowed by chapter one of the Internal Revenue Code over **all** of a taxpayer's income **from whatever source derived**. 26 USC §§ 61, 172(c) (emphasis added). This should all be very simple and straightforward to understand given the plain language of these statutes. Unfortunately, MAWC has seriously misinterpreted theses definitions as part of its persistent arguments in these ISRS cases.

MAWC has taken the position that it is incurring a net operating loss due to the addition of ISRS plant for which "no revenues" are collected until the plant has

been incorporated directly into ISRS rates. To re-state the position, the Company is arguing that, at the time of the ISRS case, it has a net operating loss because it has incurred expenses (related to accelerated depreciation) but has not yet started receiving revenue identifiable specifically to the ISRS projects. *See Mo. Am. Water Co. v. Mo. Pub. Serv. Comm'n*, No. WD83067, 2020 Mo. App. LEXIS 498, at *12 (App. WD Apr. 21, 2020) ("Missouri-American further argues that the Commission ignored evidence that related specifically to the 'eligible infrastructure system replacements,' particularly the new deductions related to the ISRS period infrastructure investments (including depreciation and interest expense, accelerated depreciation, and repairs) taken against the ISRS revenue (none since the last general rate case)"). The whole problem with MAWC's argument, though, is that, according to the plain language of the statutory definition of net operating loss found in 26 USC § 172(c), a net operating loss must be calculated by comparing the available deductions to the taxpayer's **gross income**. That means **all** the Company's income **from whatever source derived**, and not just the ISRS related income, has to be considered. 26 USC § 61.

This misinterpretation of the Internal Revenue Code represents effectively the crux of these past four ISRS cases. To reiterate the problem, MAWC is attempting to claim a net operating loss based on an isolated income source: the surcharge approved in the ISRS case. But in reality, a net operating loss must be calculated based on **all** income the company generates, which includes the income that it is currently generating in base rates. The statutory definitions presented in the Internal Revenue

Code simply do not permit a company to claim an "isolated" net operating loss in the manner that MAWC maintains, hence the problem.

There are so many ways to express and demonstrate the truth behind the fact that MAWC cannot claim an "isolated" net operating loss, and the Commission has already found and agreed with several of them. For example, in WO-2019-0184 (the last fully litigated MAWC ISRS case) the Commission found that "NOL's are calculated on an overall basis" and that "NOL's are not split out for accounting purposes by the various tax deductions that may contribute to an NOL situation." WO-2019-0184, *Report and Order*, pg. 9. These excerpts were taken from the Rebuttal testimony of Staff witness Karen Lyons who testified in that case. *Id.* When Staff witness Mark Oligschlaeger was presented with the same statements in the present case, he fully agreed with them. Tr. pg. 108 ln. 17 – pg. 109 ln. 18. This all makes perfect sense, because these statements are consistent with the definition of a net operating loss from the Internal Revenue Code that we just discussed.

Why is it that "NOL's are calculated on an overall basis?" Net operating losses are calculated on an overall basis for the obvious reason that a net operating loss is, **by definition**, calculated against gross income and gross income is, **by definition**, a taxpayer's income calculated on an overall basis (*i.e.* **all** income). 26 USC §§ 61, 172. Using these definitions, a company could never have a net operating loss in any way other than "on an overall basis," which is consistent with this Commission's own findings.

In addition to the testimony elicited by Staff witnesses, the Commission's *Report and Order* in WO-2019-0184 also found that "MAWC has not filed their claimed $34 million NOL on any income tax filing nor has MAWC recorded such NOL on its books." WO-2019-0184, *Report and Order*, pg. 8. The Commission then further found that "MAWC's submitted Exhibit Number 3C, a 2017 Form 1120 US Corporation income tax return, . . . does not break down the estimated NOL to specific projects . . . [and] was not a part of American Water Works 2017 tax return." *Id*. Both of these findings (though related to the past case) point out a single important point: despite all its claims regarding the "isolated" net operating loss, MAWC has not reported such a net operating loss to the IRS. **____________________

____

____

____

____

____

__________ ** Thus all of these findings remain consistent with the understanding of net operating losses being based on **<u>company-wide</u>** income as per the definitions found in the Internal Revenue Code. 26 USC §§ 61, 172.

Once one has discarded MAWC's obviously erroneous legal position that a net operating loss can be calculated based on an isolated transaction and instead look to the Company as a whole, the question remains: did MAWC have a net operating loss?

This Commission has already determined the answer to that question is no. In case WO-2018-0373, the Commission's determination was simple and unambiguous: "No net amount of net operating loss has actually been generated for income tax purposes by MAWC on an aggregate basis since January 1, 2018, the beginning of the 2018 ISRS Period." WO-2018-0373, *Report and Order*, pg. 6. Just in case that wasn't clear enough, the Commission went on to find that "MAWC did not generate any NOL in the 2018 ISRS Period." *Id.* MAWC then chose to appeal this decision to the Westen District Court of Appeals, who affirmed the Commission's conclusion, stating as follows:

> The Commission found that MAWC provided no evidence to support that it would have an NOL in 2018, and the evidence showed that, because MAWC was generating more revenue for 2018 than it was generating expenses qualifying for deductions, MAWC would be utilizing prior NOL carryovers to offset its taxable income in 2018 and 2019. The Commission found that, because no NOL was generated during the 2018 ISRS Period, the question of whether an NOL is associated with the proposed ISRS is moot. We agree. Had there been evidence of an NOL, Section 393.1000 would have necessarily required inquiry into whether the NOL generated could be linked to eligible infrastructure system replacements.

Mo.-American Water Co. v. P.S.C. of Mo., 591 S.W.3d 465, 477 (Mo. App. WD 2019). There is thus no ambiguity to the fact that the Commission has already determined the MAWC did not have a net operating loss during the 2018 ISRS period.

As if the foregoing was not enough, the Commission again returned to this question in WO-2019-0184. In that case, the Commission found as follows:

PUBLIC

> MAWC also seems to argue that apart from the NOL carryover, it experiences an NOL every time it invests in ISRS plant up until the ISRS rate for that ISRS plant is implemented and collected.
>
> On the contrary, the record indicates that NOLs are not specifically tracked as to origin. The record also indicates that an NOL is an accounting item, not a regulatory item, and that it is a term encompassing an annual or longer period. The record further shows that prior instances of NOL are addressed in full rate cases, as MAWC's pre-December 2017 NOL was addressed in its most recent full rate case.
>
> Since the IRS Private Letter Rulings only address periods where an NOL is generated, and none involve single-issue ratemaking, there is no legal support for MAWC's position that an exclusion of an NOL would violate normalization requirements of the IRS Code.
>
> The Commission, for the reasons discussed herein, finds there is not sufficient evidence to show an NOL being generated in the ISRS Period.

WO-2019-0184, *Report and Order*, pg. 12. Again, MAWC took an appeal and again the Western District affirmed the Commission's decision:

> Nevertheless, Missouri-American asks us to conclude that the Commission ignored evidence that the company experiences an NOL every time it makes an infrastructure replacement or improvement until the ISRS rate is implemented by the Commission. But, Missouri-American's method for calculating an NOL associated with an ISRS--which subtracts the expenditures that will be incurred for eligible infrastructure replacements and improvements (including related accelerated depreciation) from zero revenue that will be generated from those expenditures during the ISRS period--was expressly rejected in *Missouri-American I*. We reiterate that "direct rate recovery of investment by a utility can only occur ***after*** that investment is in service." *Missouri-American I*, 591 S.W.3d at 477 (emphasis added) (citing *State ex rel. Union Elec. Co.*, 765 S.W.2d at 622).
>
> Further, just as we concluded in *Missouri-American I*, we cannot fault the Commission for relying "on actual data from [Missouri-American] which reflects that [the company] as a whole . . . during the relevant time period" would not be generating an NOL, while rejecting as

PUBLIC

> irrelevant Missouri-American's hypothetical calculation of an NOL based solely on anticipated expenses for, and revenues from, ISRS improvements and repairs during the ISRS period. *Id.* Missouri-American bore the burden of proof with respect to the appropriate amount of the ADIT to be used in calculating the ISRS rate. *See Matter of Application of Laclede Gas Co. v. Mo. Pub. Serv. Comm'n*, Nos. WD82199 & WD82299, 593 S.W.3d 582, 2019 WL 6119758, at *8 (Mo. App. W.D. Nov. 19, 2019) (citing section 393.150.2). The Commission did not err in concluding that Missouri-American failed to meet its burden.

Mo. Am. Water Co. v. Mo. Pub. Serv. Comm'n, No. WD83067, 2020 Mo. App. LEXIS 498 *16 – 17 (Mo. App. WD Apr. 21, 2020). And yet, despite all of this prior litigation, we have somehow managed to return to the exact same issue for a third time.

Hopefully it goes without saying that a PLR issued by the IRS does not have the power to overturn the decision of either this Commission or the Appellate Courts of the State of Missouri. Moreover, if the Commission were to attempt to revoke its prior determinations now, it would effectively be making an unlawful collateral attack on both its own prior decisions as well as both appellate decisions. *See, E.R. v. T.B. (In re A.R.B.)*, 586 S.W.3d 846, 860 (Mo. App. WD 2019) ("Where a judgment is attacked in other ways than by proceedings in the original action to have it vacated or reversed or modified or by a proceeding in equity to prevent its enforcement, the attack is a collateral attack."' *In the Interest of K.R.T.*, 505 S.W.3d 864, 868 (Mo. App. W.D. 2016) (quoting *Reimer v. Hayes*, 365 S.W.3d 280, 283 (Mo. App. W.D. 2012)). "Generally, a judgment must be challenged via direct appeal and not by a collateral attack." *Id.* If the judgment was rendered by a court that had both subject-matter jurisdiction and personal jurisdiction, then the judgment is not open to attack. *Id.*");

Mo. Rev. Stat. § 386.550 ("In all collateral actions or proceedings the orders and decisions of the commission which have become final shall be conclusive."). This is obviously improper and should not be done. Nor should the Commission ever consider it necessary, as the evidence presented in this case affirmatively prove the Commission's prior findings were right.

If there was ever even a shred of doubt concerning whether MAWC had a net operating loss for the 2018 taxable year, it can now safely be put to bed. **__________

____

____

____

____

____

______________________________ ** There is nothing more to it than that.

This is it; the final nail in the coffin. MAWC did not have a net operating loss in 2018 and there is nothing the Company can say or do to get around that fact. Moreover, because the Company did not have a net operating loss, there is nothing to offset the ADIT calculated in these ISRS cases. To quote this Commission's own *Report and Order* from the WO-2018-0373 case: "although the ISRS statute requires recognition of ADIT, which might include reflection of an NOL, we cannot allow MAWC to reduce its ADIT balance to reflect an NOL that does not exist." WO-2018-0373, *Report and Order*, pg. 8.

Everything up to this point should be easy to understand. The statutory definitions found in the Internal Revenue Code are plainly written, the Commission and Appellate Court's prior findings are clear, **______________________________ ______________** Given all of that, why then are we still fighting this case? In particular, why has the Commission's own Staff ("Staff") decided to agree with the Company despite all the clear and obvious evidence to the contrary (to say nothing of its own prior position)? The answer, sadly, has to do with a simple misunderstanding about how a private letter ruling actually works.

Staff's entire position in this case is dependent on its conclusion that the IRS "determined" the existence of a net operating loss because of facts stated in the private letter ruling. Tr. pg. 118 ln. 24 – pg. 119 ln. 9; Oligschlaeger, *Direct*, pg. 8 lns. 13 – 16; Oligschlaeger, *Rebuttal*, pg. 5. lns. 5 – 32. In particular, the Staff focuses on the following statement from the "fact" section of the PLR:

> The revenue requirement related to the Surcharge Case is approximately $c (pursuant to the rate order). Taxpayer asserts that the revenue requirement should have been computed to be $d. The difference in the revenue requirement computations relates entirely to the exclusion of Taxpayer's NOLC from rate base. As of the date of the rate base determination, none of the Surcharge revenues had been billed to customers and, thus, as of such date, a taxable loss of approximately $e had been incurred with respect to the plant-related expenditures with rates set by the Surcharge Case.

Oligschlaeger, *Rebuttal*, pg. 5. lns. 25 – 29. However, Staff's understanding of the importance of the inclusion of this statement in the fact section of the private letter ruling is fatally flawed.

As explained by the direct testimony of the OPC's witness Mr. John Riley, the IRS does not question or verify the facts presented to it in a PLR request letter. Instead, "[t]he IRS takes the facts presented by the taxpayer at face value and applies them to the situations that the taxpayer wishes to have the Service clarify." Riley, *Direct*, pg. 3, lns. 15 – 16. The truth behind this claim should be readily apparent because the IRS goes out of its way to literally state as much in the private letter ruling itself.

The sentence preceding the recitation of facts found in the private letter ruling clearly states: "[t]he relevant facts **as represented in your submission** are set forth below." Wilde, *Schedule JRW-2*, pg. 4 (emphasis added). As if that is not enough, the private letter ruling comes back at the end to once again state "[t]his ruling is based upon information and representations submitted by Taxpayer." Wilde, *Schedule JRW-2*, pg. 22. Then, to cap it all off, the IRS explicitly states: "**While this office has not verified any of the material submitted in support of the request for rulings**, it is subject to verification on examination." *Id* (emphasis added). It is hard to see how this could be made much clearer. The IRS does not test, it does not question, and it does not verify any of the facts being presented to it by a taxpayer in a private letter ruling request. The only thing the IRS ever does is to accept those facts at their face value and then provide its ruling based on those facts and the applicable law. Riley, *Direct*, pg. 3.

In addition to being found written into the private letter ruling itself, the truth that the IRS does not verify any of the facts upon which it bases its decision can also

be found in guidance offered on the IRS's website. For example, one page dedicated to providing private letter ruling information in the context of tax exempt bonds includes a broad analysis of the subject and states "a private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws **to the taxpayer's represented set of facts**." IRS, *Tax Exempt Bonds Private Letter Rulings: Some Basic Concepts*, https://www.irs.gov/tax-exempt-bonds/teb-private-letter-ruling-some-basic-concepts (last visited June 8, 2020). One can quickly see how this statement is consistent with the language employed in MAWC's own private letter ruling. Another page from the IRS website that is simply titled "Understanding IRS Guidance - A Brief Primer" provides the following explanation of private letter rulings:

> A private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts. A PLR is issued to establish with certainty the federal tax consequences of a particular transaction before the transaction is consummated or before the taxpayer's return is filed. A PLR is issued in response to a written request submitted by a taxpayer and is binding on the IRS **if the taxpayer fully and accurately described the proposed transaction in the request and carries out the transaction as described**. A PLR may not be relied on as precedent by other taxpayers or IRS personnel. PLRs are generally made public after all information has been removed that could identify the taxpayer to whom it was issued.

IRS, *Understanding IRS Guidance - A Brief Primer*, https://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer (last visited June 8, 2020) (emphasis added). The key point to understand here is that a private letter ruling is only ever binding **if the facts were accurately described**

by the taxpayer; a corollary that is only made necessary by the fact that the IRS does not verify the facts when the private letter ruling is first requested.

This last idea actually deserves some more attention as it helps explain just how the whole concept of a private letter ruling is supposed to work. Most private letter rulings arise because a taxpayer is considering some proposed transaction and wants to know what the tax consequences of that transaction will be. *Id.* To get certainty, the taxpayer goes to the IRS and provides a description of the proposed transaction to learn how the IRS would interpret it. *Id.* The IRS takes the proposed transaction **exactly as it is presented without verifying anything** and then tells the taxpayer "if you undertake the transaction exactly as you described it, the tax consequences will be X." However, this is not the end of the story.

The next step in the course of a private letter ruling occurs once the taxpayer has engaged in the proposed transaction and then filed his tax returns. At that point, the IRS then goes back to the letter ruling and asks whether the facts presented are consistent with what **actually occurred**. 26 CFR § 601.201(l)(2); Rev. Proc. 2019-1, I.R.B. 2019-01 § 11.03 (I.R.S. January 2, 2019). If the IRS determines that the facts are **not** as they were presented by the taxpayer, than the IRS will revoke the letter ruling and potentially even make that revocation **retroactive**, meaning that taxpayer is not entitled to rely on it for protection even if the transaction has already been consummated. 26 CFR § 601.201(l)(2),(4),(5); Rev. Proc. 2019-1, I.R.B. 2019-01 §§ 11.03,11.04,11.05 (I.R.S. January 2, 2019).

PUBLIC

The existence of all this fact-checking that occurs **after** the taxpayer files his or her tax return is the direct result of the facts not being verified by the IRS when it first issues the private letter ruling. There would simply be no point to the IRS going out of its way to verify everything that a taxpayer says in a private letter ruling request, especially since the vast majority of private letter ruling requests involve transactions that have not even happened yet. It is also the reason that OPC witness Mr. Riley is correct when he explains how the IRS answered the questions posed without questioning the facts that frame those questions and instead "took what was given to them and made a determination." Riley, *Direct*, pg. 7 ln. 11. This position is further supported by case law as well as generally available guidance provided by lawyers and law firms who regularly operate in this area of the law. *United States v. All Assets Held at Bank Julius Baer & Co.*, 315 F.R.D. 103, 114 (D.D.C. 2016) ("[T]he Court is not persuaded by Claimant's suggestion, unsupported by any citation to direct authority, that a PLR request may not be shared with other IRS employees as needed. Indeed, the relevant Revenue Procedure expressly contemplates IRS field offices using a taxpayer's factual and legal representations made in a PLR request to determine the taxpayer's liability."); *In re HILLSBOROUGH HOLDINGS CORP. v. United States*, 179 B.R. 728, 736 (Bankr. M.D. Fla. 1995) ("Private Letter Rulings issued by the National Office of the Internal Revenue Service are binding on the Service's district office in its determination of a taxpayer's liability for the specific transaction discussed for the particular year at issue. However, such a ruling is not binding where there has been a misstatement or omission of material fact in the

ruling request.") (internal citations omitted); *Neale v. Healthcare Mgmt. Sevs. Grp., LLC (In re Ne. Conference Nursing Home, Inc.)*, Nos. 02-30073 (CGM), 05-9036, 2006 Bankr. LEXIS 481, at *37 (Bankr. S.D.N.Y. Mar. 2, 2006) ("The Private Letter Ruling held that as of June 15, 1994 the Pension Plan was a church plan; it is not dispositive of whether and when the Pension Plan ceased to be a church plan. It should be noted that, other than the historical information as to the establishment of Victory Lake and the Pension Plan, practically every other fact relied upon by the IRS in the Private Letter Ruling had changed by the time the Management Agreement became effective on March 10, 2003."); Anthony P. Daddino, P.C., *The IRS Private Letter Ruling: When 100% Tax Certainty (or 100% Tax Relief) is a Must*, MC TALKS TAX: THE MEADOWS COLLIER TAX BLOG (April 17, 2019) https://www.meadowscollier.com/the-irs-private-letter-ruling-when-100-tax-certainty-or-100-tax-relief-is-a-must ("A private letter ruling (PLR) is a written decision by the IRS in response to a taxpayer's request for guidance or relief. . . . The IRS will interpret and apply the tax laws to certain "assumed" facts – i.e., those facts represented as true by the taxpayer. . . . And in instance of a taxpayer seeking relief, the IRS is bound by its determination so long as the facts presented by the taxpayer are true and correct."); Sorrell Law, *What is the difference between an IRS Determination Letter, a Private Letter Ruling, and a TAM?* https://sorrelllawfirm.com/faqs/estate-planning-faqs/differences-between-an-irs-determination-letter-a-private-letter-ruling-and-a-tam/ (last visited June 8, 2020) ("A taxpayer may seek a PLR by written request. In essence, it is the response to a taxpayer's question: 'If I do thus-and-so, what are the tax consequences?'. It provides

the IRS's interpretation of tax law as it applies to a particular set of facts. It is binding on the IRS with respect to the taxpayer to whom it was issued if (and only if) the taxpayer completely and accurately described the facts of the situation.").

It was rather difficult for the OPC to find a case that was truly analogous to the present situation, but one was ultimately found. The case in question is *Cleary v. Cty. of Alameda*, 127 Cal. Rptr. 3d 340 (Cal. Ct. App. 2011). This case is multi-faceted, but the relevant part for our purposes is laid out by the Court as follows:

> The County contends that it must report landlord TIN information to the IRS pursuant to section 6041(a) of the Internal Revenue Code (26 U.S.C. § 6041(a) (section 6041(a))),
>
> [. . .]
>
> The County further contends that landlord vendor payments do not fall within an exception to the section 6041(a) reporting requirement, which is set forth in 26 Code of Federal Regulations part 1.6041-1(e) (2011). Under this regulation, a "person that makes a payment in the course of its trade or business on behalf of another person" has a reporting obligation *only* if he or she either "[p]erforms management or oversight functions in connection with the payment" or "[h]as a significant economic interest in the payment." Like the parties, we will refer to the exception created by this regulation as the "Middleman exception."
>
> The County does not claim any significant economic interest in the landlord vendor payments. It does, however, maintain that the Agency performs management or oversight functions in connection with these payments which precludes it from invoking the Middleman exception to the section 6041(a) reporting requirement. A few days before the hearing on the petition for writ of mandate, the County attempted to support this position by filing a declaration from Malinda Jones-Williams, the division chief of the county's auditor-controller's office. Attached as exhibits to this declaration were a September 8, 2009, "Private Letter Ruling Request" that Jones-Williams sent to the IRS and a December 10, 2009, response from the IRS (the December 2009 private ruling).

PUBLIC

Cleary, 127 Cal. Rptr. 3d at 357-58. As can be seen from the excerpt, the County was making a claim regarding what it was required to do under the IRS statutes and regulations and sought to bolster its case with the inclusion of a private letter ruling that had been requested from the IRS by Malinda Jones-Williams, the division chief of the County's auditor-controller's office.

Regarding the private letter ruling itself, the Court in the *Cleary* case noted as follows:

> In her Private Letter Ruling Request, Jones-Williams asked the IRS to confirm that (1) the section 6041(a) reporting requirements apply to the County's landlord vendor payments and (2) the Middleman exception does not apply to those payments even though they are made on behalf of GA recipients, who would not have a reporting requirement if they made the payments directly to their landlords, because the Agency performs management or oversight functions in connection with the payments.
>
> Jones-Williams proffered a "statement of law" and "analysis" supporting her position that rent payments made by the County on behalf of GA recipients are subject to the reporting requirement. She also repeatedly stated that the County performs management and oversight functions in connection with its payments to landlords. For example, the letter states: "Direct payments made to the welfare recipients' landlords by the County represent gross income to the landlords. The County performs management or oversight functions in connection with payments to the landlords, and the County is required to file an information return with the Service and to furnish an information statement to the landlord on Form 1099-MISC."
>
> The December 2009 private ruling was prepared by a "Senior Technician Reviewer" employed by the IRS. The very brief letter states, in part: "Under the facts provided, it appears that the County exercises management or oversight functions with respect to payments made to landlords on behalf of the Program recipients. … [¶] Accordingly, if the County makes a direct payment to a landlord pursuant to the Program,

> the County is required to file an information return with the Service and to furnish an information statement to the landlord."
>
> The December 2009 private ruling expressly states that the rulings contained therein are based on information and representations submitted by the taxpayer which have not been independently verified by the IRS. The letter also expressly states that the private ruling may not be used or cited as precedent.
>
> At the December 14 hearing on the petition for writ of mandate, the parties and the court spent significant time discussing whether the section 6041(a) reporting requirement applies to the vendor landlord payments. County counsel conceded that, if there is no IRS reporting obligation, the W-9 policy is "likely" arbitrary and capricious. At the conclusion of the hearing, after the court granted the petition for writ of mandate, it made an express finding that the section 6041(a) reporting requirement does not apply to landlord vendor payments because the Agency does not perform any management function in connection with those payments.

Cleary, 127 Cal. Rptr. 3d at 358-59. Based on this excerpt, we see that one of the main tax questions was whether the county exercised "management or oversight functions with respect to payments made to landlords on behalf of the Program recipients," which would have affected the question of whether the so-called middleman exception applied. *Id.* The private letter ruling represented to the IRS that county did exercise "management or oversight functions with respect to payments made to landlords on behalf of the Program recipients" and the IRS thus issued a ruling at the county's request that said, on that basis, that County had to "file an information return with the Service and to furnish an information statement to the landlord" pursuant to the section 6041(a) reporting requirement. *Id.* However, the trial court overhearing the case nevertheless determined that "the section 6041(a) reporting requirement does

not apply to landlord vendor payments because the Agency does **not** perform any management function in connection with those payments." *Id.* (emphasis added).

On appeal, the County unsurprisingly challenged "the trial court's *factual* determination that Agency employees do not perform management functions in connection with the landlord vendor payments." *Id.* at 359. However, the county was unable to find "any actual evidence that the Agency performs a management or oversight function[s]" and so instead tried to argue that "the December 2009 private ruling [w]as compelling evidence that the Agency performs a management function in connection with the landlord payments and then argue[] that the trial court erred by refusing to defer to the IRS." *Id.* at 361. Hopefully the Commission can see the analogy between this case and the present one. In both instances at least one of the parties to the case is attempting to argue that a private letter ruling established a factual basis necessary to the underlying case. In the *Cleary* case, it was the factual basis that the Agency in question performed a management or oversight function. In our case, it is the issue of whether MAWC actually suffered a net operating loss. So how did the California Court of Appeals respond to this argument? The Court considered the argument "legally and factually erroneous." *Id.*

Specifically, the California Court of Appeals had this to say regarding the County's attempt to rely on the private letter ruling to establish a factual basis:

> Private letter rulings "may not be used or cited as precedent." (26 U.S.C. § 6110(k)(3); see also *Vons Companies, Inc. v. U.S.* (2001) 51 Fed.Cl. 1, 12, and authority cited therein.) Indeed, the December 2009 private ruling expressly states that "[t]his ruling is directed only to the taxpayer

requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent."

Amici curiae, the California Tax Reform Association and the Asian Law Alliance, highlight the importance of this rule. They point out, among other things, that **the private letter ruling is a "rapid and tentative response from the IRS to a taxpayer request for the IRS's blessing of the taxpayer's desired tax treatment."** (Citing Saltzman, IRS Practice and Procedure (rev. 2d ed. 2005) ¶ 3.03[3][b].) In addition, before the IRS issues a ruling which is adverse to the taxpayer, it gives that taxpayer the opportunity to withdraw the letter ruling request. (See Rev. Proc. 2010-1, 2010-1 I.R.B. 1, § 8.06.) **Finally, and perhaps most important for the purpose of our analysis, the private letter ruling is based on factual information provided by the taxpayer which is not independently verified by the IRS**.

In the present case, the IRS relied on the factual representations made by Malinda Jones-Williams, including, in particular, the representation that the Agency performs management and oversight functions in connection with the landlord vendor payments. The County has not identified, nor have we found, any evidence in the record to support this representation. **On the other hand, there is substantial evidence to support the trial court's express finding that Ms. Jones-Williams's representation to the IRS that the Agency performs a management and oversight function is "untrue."** During her deposition in this case, Jones-Williams testified that she did not have any knowledge as to whether the Agency performs any management or oversight function with respect to landlord vendor payments.

Many other circumstances in this case reinforce our conclusion that the December 2009 private ruling is simply not relevant to the issue at hand. The Private Letter Ruling Request, which was the only source of factual information provided to the IRS, did not convey any of the relevant facts which led the trial court to conclude that the Agency does not perform a management function. **Furthermore, the ruling Ms. Jones-Williams sought was, in essence, an adverse ruling in that she asked the IRS to find that the County was subject to a reporting requirement. Thus, by making an express representation that the Agency "is performing management and oversight functions in connection with a payment to a landlord," Jones-Williams essentially dictated her own response and undermined the potential value of an objective determination by the IRS.** Finally, the very brief private letter ruling that the IRS issued does not contain any analysis or reasoning and does not even provide a definitive response, but ultimately concludes only that "it

PUBLIC

> appears that the County exercises management or oversight functions with respect to payments made to landlords."
>
> For all these reasons, we affirm the trial court's finding that the Agency does not perform a management or oversight function in connection with vendor payments to landlords of GA recipients.

Cleary, 127 Cal. Rptr. 3d at 361-62 (emphasis added). Obviously many of the same things that the California Court of Appeals had to say about the private letter ruling in that case are equally applicable here. For example, the Court's conclusion that the ruling being sought "was, in essence, an adverse ruling in that she asked the IRS to find that the County was subject to a reporting requirement[,]" and that this, in turn, meant the applicant had "essentially dictated her own response and undermined the potential value of an objective determination by the IRS" can equally be said of MAWC in the present case. *Id.* However, the most important aspect is the part where the Court found that:

> the IRS relied on the factual representations made by Malinda Jones-Williams, including, in particular, the representation that the Agency performs management and oversight functions in connection with the landlord vendor payments. The County has not identified, nor have we found, any evidence in the record to support this representation. On the other hand, there is substantial evidence to support the trial court's express finding that Ms. Jones-Williams's representation to the IRS that the Agency performs a management and oversight function is "untrue."

Id. This is the direct analogy to the position that the OPC has now expressed repeatedly throughout this case.

**____

____________ ** Wilde, *Schedule JRW-1*, pg. 19. Therefore, the IRS did not make a "determination" that MAWC had a net operating loss any more than it made a "determination" that the agency in question in *Cleary* performed management and oversight functions in connection with the landlord vendor payments. Instead the IRS simply **relied** on the factual representations made by the Company exactly as they were presented. But just because the IRS relied on those factual representations **does not make the factual representations true**. That is what Staff has failed to understand.[4]

A cursory comparison between the private letter ruling request and the private letter ruling itself will show that the IRS copied and pasted almost all of its facts in the private letter ruling (and the section on which Staff relies in particular) from the request. *Compare* Wilde, *Schedule JRW-1*, pg. 19 *and* Wilde, *Schedule JRW-2*, pg. 7. This is not a problem, but rather, is exactly what the IRS always does. That is just how a private letter ruling works. The OPC has presented the language of the letter ruling itself, testimony, citations to IRS guidance, citations to regulation, and

---

4 It should be noted that by the end of the evidentiary hearing, even Staff's own witness began to seriously doubt Staff's position:

> Q. Do you have any reason to believe the IRS did not take those into consideration?
>
> A. My concern would be -- Well, first of all, they don't even mention the Staff's comments in the PLR so certainly they don't indicate they took it into consideration. Plus, the PLR, maybe this is standard for all PLRs, is totally -- almost totally silent as to why the IRS has drawn the conclusions that it did. I think OPC is correct in a limited sense that they appeared to take certain factual assertions made by Missouri-American and accept them as opposed to other assertions that might have been found in the Staff comments. Again, they didn't talk about that. So I don't know what they took into account.

Tr. Pg. 124 lns. 4 – 17.

PUBLIC

citations to case law to prove that point. A problem only arises if one attempts to do as Staff has done and cite to the "facts" section of a private letter ruling as having made any sort of determination. To do so would be inconsistent with all available authorities and be supported by absolutely nothing. Consequently, the Commission should pay absolutely no heed to the "facts" section of the private letter ruling as evidence of anything.

To review, we have so far seen how the plain language of the Internal Revenue Code requires a net operating loss be determined on an aggregate basis and not, as MAWC would have the Commission believe, on an isolated basis. 26 USC §§ 61, 172(c). We have seen how the Commission has previously acknowledged this very fact and further found that MAWC suffered no net operating loss on an aggregate basis. WO-2018-0373, *Report and Order*, pg. 6; WO-2019-0184, *Report and Order*, pg. 12. **____

____

____

________________ _** And finally, we have now seen how Staff erred in basing its entire case on the statements made in the fact section of a privet letter ruling that also expressly stated those facts were the unverified representations of the Company seeking the request and nothing more. Based on all of this information, there is only one possible, logical conclusion, which is that MAWC did not have a net operating loss.

Consequences

Taking the legal basis laid out in the first sub-heading of this issue and combining them with the factual determinations expressed in the second quickly yields the result expressed at the beginning of this issue. Because MAWC had no net operating loss, the circumstances upon which ruling number nine is premised is not consistent with reality, and the ruling itself becomes irrelevant. Alternatively, because MAWC had no net operating loss, the requirement of ruling number nine to provide an offset to ADIT to account for a net operating loss has obviously already been met, so the ruling again becomes irrelevant. In either case, the result is the same. No net operating loss means no normalization violation, and hence, no adjustment that need be made. What is left now is to consider the two major consequences surrounding this case.

The first concern is one that the Commission repeatedly addressed to witnesses during the evidentiary hearing in discussions regarding "an ounce of prevention." *See*, *e.g.* Tr. Pg. 87 lns. 19 – 25. The general idea is this: if a normalization violation occurs, it could have a significant impact on ratepayers and the approximately $35,000 at stake in this case is a small price to pay to avoid such a potential normalization violation. *Id*. There are several problems with this line of thinking that need to be addressed. First, this Commission should focus on making sure its application of the law is correct and not seek to circumvent the law in order to achieve desired ends. Second, this line of thinking assumes that the IRS will determine a normalization violation and strip MAWC of its ability to utilize accelerated deprecation without

giving either the Company or the Commission notice or a chance to cure the violation, which is almost certainly incorrect. Third, and perhaps most important, there simply is almost no risk of the IRS determining a normalization violation has occurred. Let us take a moment to consider why.

When a utility thinks that a regulatory agency has done something that will force it to violate its normalization requirements, the utility is required to report itself to the IRS. 26 CFR § 1.167(I)-1(h)(5). MAWC has already done this. Wilde, *Schedule JRW-2*, pg. 8. The next step will be for the IRS to investigate. That means that the IRS will have to determine whether the ADIT reducing rate base approved by the Commission in the ISRS cases was properly reduced by a net operating loss. This, in turn, means that the IRS will have to determine whether MAWC had a net operating loss. Where does the reader suppose the IRS is going to look to determine whether MAWC had a net operating loss? **____

____

____

____ ** No net operating loss means no normalization violation, end of the story.

At the end of the day, the IRS is in the same boat as the Commission. In both instances, in order to find that a normalization violation occurred due to the failure to offset ADIT by a net operating loss, **<u>one must first find that MAWC had a net operating loss</u>**. However, the net operating loss that MAWC continues to pretend it has suffered is neither recorded on the Company's books nor reported to the IRS. *See*

WO-2019-0184, *Report and Order*, pg. 8. That is because it is nothing more nor less than a figment of the utility's imagination. And without any documentation regarding the supposed net operating loss, how could the IRS (or this Commission for that matter) ever determine that a normalization violation occurred? The answer is simple: it cannot.

Having considered the risk of an actual normalization violation being found, let us now consider the counter-point. What happens if the Commission determines that a net operating loss can occur in isolation, despite the plain language of the Internal Revenue Code? The OPC's witness Mr. Riley laid out the major potential consequences of allowing such a thing to happen on the stand:

> What would happen if this argument is believed and that there's actually an NOL prior to ratemaking, that you're going to have a utility come in after three years and claim we have a net operating loss for all this plant that hasn't been put into rates and we're going to offset accumulated deferred income tax against this from what I believe bogus NOL. So the ratepayer is going to, of course, going to pay for this, because if you're offsetting all that accumulated deferred income tax you're raising rate base and this is rate base rate of return, you're going to see rates just skyrocket. I mean, this would be huge.
>
> You know, you've got a company coming in with, you know, $600 million worth of wind, you've got Missouri-American going to come in with even more plant that isn't ISRS qualified. They can claim a net operating loss for a lot of things. You've got all these companies can come in and say we haven't had a rate case in three years, we put all this stuff into service and we've got a net operating loss. You know, that tears at the very core of rate base rate of return ratemaking. It would probably require federal, some sort of federal law changes.

Tr. pg. 99 ln. 5 – pg. 100 ln. 3. Now Staff witness Mr. Oligschlaeger Responded to Mr. Riley's concerns on the stand by outlining Staff's position on the narrowness of the private letter ruling. Tr. Pg. 111 ln. 12 – pg. 112 ln. 7. The OPC admits that it is glad to hear Staff take this position, but the Office remains highly skeptical of whether this ruling can truly be contained so easily. The Commission can therefore rest assure that the OPC will continue to raise these arguments in all future MAWC ISRS cases.

Moving on from that issue, let us now consider the other major consequence of this case: a possible appeal. If the Commission makes a decision to reverse its own to prior decisions and declare a net operating loss that is supported by neither fact nor law actually exists, and the OPC appeals that issue, then the OPC is going to be backed by the plain language of the Internal Revenue Code, the Commission's own two prior orders, the Western District decisions affirming those two prior orders and expressly rejecting MAWC's argument, and **__________________________________ ____________________ ** If MAWC appeals the issue of whether there is a net operating loss, then it will have its private letter ruling argument, and nothing more. Moreover the private letter ruling on which MAWC will have to rely:

- Was never asked to determine if a net operating loss existed;
- Never explicitly made a ruling that net operating loss existed;
- Included facts that have since been directly contradicted by both Commission and Appellate Court findings;
- Copied and pasted facts from MAWC's request regarding the existence of a net operating loss;
- Expressly stated that it was based on the representations and information provided by the company;
- Expressly stated that none of the facts had been verified by the IRS personnel preparing it;

- Can be revoked at any time by the IRS and can have that revocation made retroactive if the IRS determines that material misstatements or omissions of facts occurred; and,
- Was made following the presentation of legal analysis by the Company that directly contradicts the plain language of the Internal Revenue Code statutes.

The correct choice between these two alternatives should be clear; all the statutes, case law, and prior precedent support the OPC.[5]

Should the Commission ultimately agree with the OPC, then only the following need be determined in any *Report and Order*:

- The private letter ruling issued by the IRS determined that a portion of any net operating loss MAWC suffered that would not have arisen had MAWC not reported depreciation-related book/tax differences during the test period for the ISRS Case must be used to offset the ADIT that reduced rate base used to determine the revenue requirement for the ISRS case.
- The IRS was not asked to determine and the IRS did not rule on whether the Company suffered a net operating loss.
- This Commission has previously determined that MAWC did not suffer a net operating loss during the 2018 ISRS period.
- MAWC has presented no evidence to show that it has suffered a net operating loss at any point since then.
- Because MAWC has not shown that is suffered a net operating loss at any point during the 2018 ISRS period or beyond, the requirement to offset ADIT by a net operating loss found in the private letter ruling is moot.

---

[5] On the subject of appeals, there was some brief discussion during the evidentiary hearing regarding the OPC's ability to challenge or appeal the PLR. *See* Tr. pg. 113 lns. 16 – 17. To be clear, there is no mechanism in place to challenge a private letter ruling available to anyone other than the taxpayer who requested it. This is primarily because private letter rulings are prohibited by statute from being cited as precedential authority by **anyone** including the IRS itself. 26 USC §6110(k)(3) ("Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent."). Without any precedential value, there is no point to a third party challenging an IRS private letter ruling, so no mechanism to do so was ever developed.

These conclusions would be fully consistent with both the Commission and Western District's prior decisions, and, based on these conclusions, the Commission's decision not to award any adjustment would be effectively unassailable. *See Mo. American Water Co. v. P.S.C. of Mo.*, 591 S.W.3d 465, 477 (Mo. App. WD 2019) ("The Commission found that, because no NOL was generated during the 2018 ISRS Period, the question of whether an NOL is associated with the proposed ISRS is moot. We agree.").

Other Considerations

During the evidentiary hearing, the Commission did an excellent job of summing up the OPC's position as follows:

> So as I understood your testimony then, kind of the first points in your testimony was, and I'm summarizing, that the PLR is basically meaningless because the IRS assumed the facts that there was a net operating loss and just went from there. · Second, if the Commission you don't believe that, I would argue that the Company didn't include CAIC and that should be included in order to come up with the number and then third is the Company hasn't correctly included all of the revenues, for example, revenues that start when the pipe is placed in service and water is running through it even though those revenues are from the previous case.

Tr. pg. 86 ln. 15 – pg. 87 ln. 2. As the Commission is thus already aware, the OPC's argument does not simply end with the fact that there is no net operating loss. Even if the Commission were to ignore the overwhelming evidence as to that point, there are still errors with the calculation of the adjustment proposed in this case to cure the purely fictitious normalization violation. Those errors concern contributions in

aid of construction ("CIAC") and the failure to account for the revenues generated by the sale of water flowing through the ISRS related pipe prior to the ISRS rates being set.

Let us begin with CIAC. Since the passage of the 2017 Tax Cuts and Jobs Act, CIAC is considered taxable income for utilities. Riley, *Rebuttal*, pg. 5 lns 7 – 8. Normally this would not be of much concern during an ISRS case, but because of MAWC's argument it takes on new importance. Recall that MAWC's argument regarding the existence of a net operating loss as to its ISRS cases stems entirely from its claim that there was **no revenues** to offset the expense created by accelerated depreciation. *See Mo. Am. Water Co. v. Mo. Pub. Serv. Comm'n*, No. WD83067, 2020 Mo. App. LEXIS 498 *16 (Mo. App. WD Apr. 21, 2020) ("Missouri-American's method for calculating an NOL associated with an ISRS [] subtracts the expenditures that will be incurred for eligible infrastructure replacements and improvements (including related accelerated depreciation) from zero revenue that will be generated from those expenditures during the ISRS period[.]"). We can see all of this being calculated in the attachments to Mr. Riley's amendment to rebuttal testimony.

Beginning on page two, line forty-two of the schedule attached to Mr. Riley's amendment to rebuttal testimony, we can see MAWC's calculations of the net operating loss it *thinks* it has for the WO-2018-0373 ISRS (#17 ISRS) case. Riley, *JSR-AR-1*, pg. 2. The real action, however, is found on lines sixty through sixty-three. *Id*. Observing these, one can easily see how MAWC is calculating the accelerated

depreciation expense for these cases by subtracting the Accelerated Tax Depreciation amount from the Method Life Book Depreciation amount to arrive at what MAWC has labeled "NOL Related to Method Life." *Id*. We can further see how MAWC has then had this exact same amount flow through into the final part of the spreadsheet, which reads "Total NOL for ISRS Purposes." *Id*. This is very important.

Because MAWC's calculation of the "Total NOL for ISRS Purposes" is the exact same amount as the "NOL Related to Method Life" that is, itself, the exact same amount as the difference between Accelerated Tax Depreciation and Method Life Book Depreciation (*i.e.* the accelerated depreciation expense), we can tell that MAWC is calculating its "Total NOL for ISRS Purposes" by subtracting the accelerated depreciation expense from a calculated ISRS revenue of $0. In case that was not clear, here is the math worked out as an equation. First is the calculation of the accelerated depreciation expense:

$189,373 (Method Life Book Depreciation)
− $515,799 (Accelerated Tax Depreciation)
($326,427) (Accelerated Depreciation Expense)

The next step is to calculate the supposed net operating loss by applying the accelerated depreciation expense against assumed ISRS revenue of $0:

$0 (ISRS Revenue)
− $326,427 (Accelerated Depreciation Expense)
($326,427) (Total NOL for ISRS Purposes)

PUBLIC

The exact same calculations hold true for the next two ISRS cases on pages four and six except, on those pages, the Company has made the situation even clearer by having the "Total NOL for ISRS Purposes" amount flow through into a new entry simply labeled "taxable income." *Id*. at pgs. 4,6.

So, one might ask, where is all this math going? The reason we just discussed all this math was to hammer home a single, simple point: MAWC is claiming a net operating loss in each ISRS case that is equal to the accelerated depreciation expense applied to ISRS income of $0. The problem, though, is that this calculation is not taking into account the CIAC that is being accrued by the Company long before ISRS rates are collected. Riley, *Rebuttal*, pg. 5 lns. 13 – 14. These CIAC costs "can and should be matched to the accelerated depreciation that Company claims as the expense causing the NOL." Riley, *Rebuttal*, pg. 5 lns. 14 – 15.Therefore, even if the Commission were to determine that a net operating loss *could* be calculated for the isolated ISRS period (which it should not do), the CIAC would still need to be included in that calculation.

In the WO-2018-0373 case (indicated as ISRS #17 in the workpapers), the total net CIAC for the period was $1,054,368 while the calculated accelerated depreciation expense (or net operating loss as the company claimed) was $326,247. Riley, *JSR-AR-1*, pgs. 1,2. Simple math therefore tells us that instead of having a "net operating loss" as the Company claims, it was actually making taxable income from the ISRS of about $728,121 long before the ISRS rates ever went into effect. Case WO-2019-0389 (ISRS #19 in the workpapers) shows a similar outcome with a calculated accelerated

depreciation expense (or net operating loss) of $189,442 compared to a total net CIAC of $228,496. *Id.* at pgs. 5,6. Only case WO-2019-0184 (ISRS #18 in the workpapers) could ever possibly have a net operating loss under MAWC's own theory because the amount of accelerated depreciation expense (or net operating loss) was $330,086 compared to a total net CIAC of $309,178. *Id.* at pgs. 3,4. Of course, even then, the total net operating loss falls from $330,086 to just $20,908. Therefore, between the three prior ISRS cases, the most net operating loss that could ever need to be adjusted for if MAWC's erroneous legal theory was accepted is just $20,908 in case WO-2019-0184. Given that MAWC was previously claiming it needed an approximate $35,000 adjustment to deal with combined net operating losses of $845,775, some quick and dirty math shows that, once CIAC is taken into account, the real amount of the adjustment would only be about $900.

Now MAWC made an attempt during the evidentiary hearing to undercut the whole CIAC issue, and that need to be addressed. Specifically, the OPC is referring to the line of questioning MAWC asked of OPC witness Mr. Riley during cross-examination. Basically, MAWC sought to draw the Commission's attention to the fact that CIAC already showed up in the schedules attached to Mr. Riley's amendment to rebuttal. Tr. pg. 78 lns. 2 – 18. However, this fact is completely irrelevant to the discussion.

The schedules attached to Mr. Riley's amendment to rebuttal included calculations related to two completely separate components. The top of each of the workpapers (lines one through forty-one for ISRS #17, for example), is devoted to

calculating the "Book/Tax Depreciation Temporary Difference" as clearly identified in line one. Riley, *JSR-AR-1*, pg. 2. It is in this calculation that CIAC has been included (see line seven). *Id.* But that is not where our investigation lies. On the contrary, we are concerned with the <u>**second half**</u> of the schedule; the part clearly labeled "Net Operating Loss" that begins at line forty-two and continues to the end at line sixty-seven. *Id.* In other words, MAWC is simply asking the Commission to look at the wrong part of the page. The same holds true for the two other ISRS cases included in Mr. Riley's schedule. *Id*. at pgs. 4,6.

The Commission must remember that all of this discussion is premised on the Commission ignoring the overwhelming evidence that MAWC did not have a net operating loss. If the Commission were to make that mistake by finding an "isolated" net operating loss could exist for the ISRS period, then it is still necessary to correctly calculate that supposed net operating loss. Because a net operating loss is defined as the excess of deductions over gross income and because CIAC now counts as income, CIAC must be included in these calculations. CIAC is not currently being included in the calculations of MAWC's net operating losses. Tr. pg. 104 lns. 13 – 17. Therefore, even if the Commission were to disregard everything else that the OPC has argued so far, it should still order its Staff to re-calculate the adjustment meant to "cure" the supposed normalization violation so as to include CIAC.

The next issue to discuss is the Company's failure to account for the revenues generated by the sale of water flowing through the ISRS related pipe. MAWC's entire claim as to a net operating loss arises from the idea that the pipes being installed in

an ISRS are generating no “revenue” because they have not been incorporated into “rates.” The problem is that there is a wide difference between plant being in “rates” and a utility generating “revenue.” Revenue, simply refers to income. Almost all of a utility’s revenue comes from the sale of the commodity that the utility deals in (in this case water). Once the water is flowing and customers are paying, the Company has begun collecting revenue. Therefore, the question of whether any given piece of plant is generating revenue depends on whether that plant is being used to facilitate the sale of the commodity in question. To put the matter simply, once plant is placed in service it is helping the utility generate revenues by facilitating the sale of the utility’s commodity.

The OPC’s witness Mr. Riley summed up the whole issue in his rebuttal testimony with the following excerpt:

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

Riley, *Rebuttal*, pg. 7 lns. 7 – 12. MAWC is asking that the Commission simply ignore this very simple point, but the Commission cannot simply ignore it. Again, as Mr. Riley pointed out:

> The ISRS functions as a means of replacing current assets with new assets, not as a means of installing or connecting brand-new customers.

> These current assets are already in rate base and are already producing revenues for the utility. If you claim a loss because of accelerated depreciated on the new assets prior to ISRS rates being set, how can you turn a blind eye to the revenue those assets are already helping to provide by stepping into the shoes, so to speak, of the now retired prior assets that are already in rates? To put it simply, **it is ridiculous for a company to claim it is "operating at a loss" because it is not immediately collecting the cost of new pipes that are in service while simultaneously ignoring the fact that it is still collecting revenues for pipes that have now been retired.**

Riley, *Rebuttal*, pg. 7 lns. 15 – 23. The truth to this statement should be self-evident.

Much as with the CIAC issue, the problem surrounding existing revenues is one that only arises if the Commission makes the mistake of ignoring the plain, uncontroverted evidence that MAWC does not have a net operating loss. If the Commission makes the unfortunate decision to go down that route, then it should still make it a point to calculate that supposed net operating loss correctly. To do that, the Commission will need to consider the revenues associated with the new ISRS pipe that the Company is collecting prior to the ISRS case. The easiest way to do this would be for the Commission to order its Staff to re-calculate the adjustment meant to "cure" the supposed normalization violation so as to include the revenues being collected in base rates for the pipes that were retired and replaced as part of the ISRS project.

Ruling Number Eight

Before we wrap up the discussion of this first issue, it is necessary to briefly address ruling number eight. The Company has taken the position that ruling

number eight would require the $35,328 adjustment proposed in this issue regardless of whether the Commission determines there is a net operating loss. Wilde, *Rebuttal*, pg. 12 lns 13 – 15. The Company is, of course, obviously wrong.

Staff witness Mr. Oligschlaeger does an excellent job of explaining why the Commission should disregard the Company's position on ruling number eight in his rebuttal testimony. Oligschlaeger, *Rebuttal*, pg. 8 ln. 17 – pg. 12 ln. 12. The OPC fully supports and agrees with everything that Mr. Oligschlaeger says in this regard, and believes it is sufficient on its face to warrant dismissal of this idea. However, there is actually an even bigger and more important legal reason for why ruling number eight is irrelevant to this case that Mr. Oligschlaeger does not address. That is the simple fact that the *Stipulation and Agreement* entered into by Staff and the Company (on which this proposed adjustment is based) does not include provision for an adjustment related to ruling number eight.

As previously discussed, the only relevant portion of the S*tipulation and Agreement*, to this case reads as follows:

> If the IRS PLR indicates that the Commission's treatment of the Deferred Tax Asset (NOL) has created a normalization violation, MAWC will file an application for an Accounting Authority Order (AAO), and Staff and OPC agree to support such AAO application, to permit MAWC to record a regulatory asset to capture the rate differential in an amount as may be necessary to cure such normalization violation, if any, identified by the PLR.

LaGrand, *Direct,* pg. 6 lns. 1 – 7. The critical point here is that the stipulation is dependent on the IRS's private letter ruling determining "that the Commission's

treatment of the Deferred Tax Asset (**NOL**) has created a normalization violation." Ruling number eight does not involve the Commission's treatment of a net operating loss, and hence does not trigger the application of the S*tipulation and Agreement*. The Commission should thus disregard this ruling in its entirety, as it is irrelevant to the question at hand.

Conclusion

To summarize, here are the main points that the Commission needs to remember:

- The proposed adjustment in this case is dependent on a S*tipulation and Agreement* that permitted correction if the IRS's private letter ruling determined a normalization violation had occurred based on a net operating loss;
- At best, the IRS's private letter ruling determined a normalization violation **would** occur if the company's ADIT was not offset by a portion of the Company's net operating loss;
- The statutory definitions of net operating loss prove that a net operating loss can only be determined on an aggregate basis;
- The Commission has already determined that the Company has no net operating loss on an aggregate basis;
- **____ ____ **
- The recitation of unverified facts as presented by the Company in the private letter ruling proves nothing;
- Even if you disregard the facts and law regarding the lack of a net operating loss on an aggregate basis, the Commission must still re-calculate the adjustment to account for CIAC;
- Even if you disregard the facts and law regarding the lack of a net operating loss on an aggregate basis, the Commission must still re-calculate the adjustment to account for the revenues included in base rates to account for the pipes being replaced in the ISRS; and,
- Ruling number eight is irrelevant as it does not trigger the S*tipulation and Agreement*.

Based on all of this, the conclusion should be clear. MAWC does not have a net operating loss with regard to its ISRS replacements. If there is not a net operating loss, then there is no normalization violation. If there is no normalization violation, then there is nothing that needs to be addressed and no adjustment that needs to be made.

As one final note, the OPC would simply direct the Commission once again to the conclusion that it itself reached at the end of the first case that arose concerning this issue: "although the ISRS statute requires recognition of ADIT, which might include reflection of an NOL, we cannot allow MAWC to reduce its ADIT balance to reflect an NOL that does not exist." WO-2018-0373, *Report and Order*, pg. 8. This simple, basic logic has remained true throughout these cases and is no different here. Thus, all this Commission truly needs to do is re-affirm the exact same conclusion it reached almost two years ago.

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?

Yes. While the first issue dealt with a "cure' that MAWC claimed was necessary for the past three cases, this issue deals exclusively with the present case. In the present ISRS case, Staff made the following adjustment as explained in Mr. Oligschlaeger's testimony: "consistent with its understanding of the IRS' rulings in the recent PLR, Staff has removed any deduction for accelerated depreciation associated with ISRS plant additions from its calculation of MAWC's ISRS revenue

requirement in this case." Oligschlaeger, *Direct*, pg. 9, lns 4 – 7. Staff should not have done this. Riley, *Rebuttal*, pg. 6 lns 9 – 10. These removals were done to prevent a normalization violation. Oligschlaeger, *Direct*, pg. 9, lns 3 – 4. For all the reasons stated above for the prior issue, there was no normalization violation in these cases because MAWC has not suffered an NOL related to these ISRS projects. Again, no NOL means no normalization violation occurs and hence no adjustment is needed. MAWC's incremental pre-tax revenue requirement in this matter therefore should include recognition of deferred taxes associated with accelerated depreciation tax timing differences.

WHEREFORE, the Office of the Public Counsel respectfully requests the Commission accept this *Brief* and rule in the Office of the Public Counsel's favor on all matters addressed herein.

Respectfully submitted,

By: /s/ John Clizer

John Clizer (#69043)
Senior Counsel
Missouri Office of the Public Counsel
P.O. Box 2230
Jefferson City, MO 65102
Telephone: (573) 751-5324
Facsimile: (573) 751-5562
E-mail: john.clizer@opc.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the forgoing have been mailed, emailed, or hand-delivered to all counsel of record this eighth day of June, 2020.

/s/ John Clizer

PUBLIC