Exhibit No.:	________________
Issue(s):	Rate Case Expense/Income Tax Compensation
Witness/Type of Exhibit:	Riley/Direct
Sponsoring Party:	Public Counsel
Case No.:	WR-2022-0303

DIRECT TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2022-0303

November 22, 2022

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DIRECT TESTIMONY

OF

JOHN S. RILEY

MISSOURI-AMERICAN WATER COMPNAY

CASE NO. WR-2022-0303

Q. What is your name and what is your business address?

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

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

A. I am employed by the Missouri Office of the Public Counsel ("OPC") as a Utility Regulatory Supervisor.

Q. What is your educational background?

A. I earned a B.S. in Business Administration with a major in Accounting from Missouri State University.

Q. What is your professional work experience?

A. I was employed by the OPC from 1987 to 1990 as a Public Utility Accountant. In this capacity I participated in rate cases and other regulatory proceedings before the Public Service Commission ("Commission"). From 1994 to 2000 I was employed as an auditor with the Missouri Department of Revenue. I was employed as an Accounting Specialist with the Office of the State Court Administrator until 2013. In 2013, I accepted a position as the Court Administrator for the 19th Judicial Circuit until April 2016 when I joined the OPC as a Public Utility Accountant III. I have also prepared income tax returns, at a local accounting firm, for individuals and small business from 2014 through 2017

Q. Are you a Certified Public Accountant ("CPA") licensed in the State of Missouri?

A. Yes. As a CPA, I am required to continue my professional training by attending Missouri State Board of Accountancy qualified educational seminars and classes. The State Board of Accountancy requires that I spend a minimum of 40 hours a year in training that continues my education in the field of accountancy. I am also a member of the Institute of Internal Auditors ("IIA") which provides its members with seminars and literature that assist CPAs with their annual educational requirements.

Q. Have you previously filed testimony before the Missouri Public Service Commission?

A. Yes I have. A listing of my case filings is attached as JSR-D-1.

Q. What is the purpose of your direct testimony?

A. The purpose of this direct testimony is to recommend reductions to the amount of rate case expense included in the revenue requirement. Missouri American Water Company ("MAWC" or the "Company") also enjoys annual compensation from its parent company for providing tax benefits in the consolidated tax return. This compensation should be recognized either as additional revenue in the revenue requirement or it should offset some expense that is included in this case.

<u>RATE CASE EXPENSE</u>

Q. For recovery of rate case expense, are you proposing something different than the 50/50 calculations established by the Commission in Case No. GR-2017-0216[1]?

A. In a sense I am because much of the expense of this general rate case should be the responsibility of the Company. There are several reasons for this argument. The first is that the Company has initiated a new general rate case only two years after its last case. Between Water and Sewer Infrastructure Rate Adjustment ("WSIRA") subsidies and negative Cash Working Capital ("CWC") requirements[2], there is little adverse regulatory lag that warrants

[1] The original case where the Commission ordered rate case expense to be shared was KCPL, Case No. ER-2014-0370.

[2] Negative CWC means that the Company receives revenues long before the expenses require payment. This beneficial arrangement includes an estimated $38 million of income tax expense that will be retained and not be paid out by the Company.

MAWC's early return to the Commission for a rate increase. This rate case benefits shareholders and most of the expense should be attributed to them.

Normally, the amount of rate case expense that the Commission determines is fair and reasonable is an amount split 50/50 between ratepayers and shareholders and the expected duration of the rates resulting from that rate case is three years. Here, the Company has returned for a rate increase in year two with WSIRA income already on the books. I do not believe the ratepayer should be responsible for half of the expense of a general rate case where the Company has benefited from interim WSIRA profits and abbreviated the expected tariff time frame by a third. Instead of a 50/50 split, the Company should bear two thirds of the cost deemed reasonable by the Commission. I would like to note that I am not proposing that the Commission permanently change its rate case sharing mechanism but due to the circumstances of this case I am proposing 2/3 shareholder – 1/3 ratepayer split here.

The Company should also bear the responsibility of the continued amortization of the rate case expense from the 2020 rate case, Case Number WR-2020-0344. The Company's workpapers indicate that it proposes to include approximately $300,000 of unamortized rate case expense in this case. Case Number WR-2020-0344 ended with a stipulated black box settlement. The black box settlement did not specify either a rate case expense amount or an amortization schedule. Any "unamortized" rate case expense should be the responsibility of the Company. MAWC made the choice to return to the Commission early even though interim WSIRA cases provide a large portion of the Company's revenue increase with pre tax revenues[3].

Finally, I am proposing that the $150,000 estimated legal expenses attributable to Barnes and Thornburg be removed from the revenue requirement calculations. The Company is

[3] Pre-tax revenues are calculated using a rate of return that has an income tax rate built into the percentage. For illustration, the Staff midpoint rate of return ("ROR") in the last case was 6.33%, however, the pre-tax ROR agreed to in the stipulation to calculate WSIRA revenues was 8.71%.

represented by Brydon, Swearengen & England and the firm is fully capable of representing MAWC before this Commission. Any additional legal fees are unnecessary.

Q. What amount of rate case expense would you include in the revenue requirement?

A. The projected expenses outlined by the Company are $890,000[4]. $150,000 of that amount is legal expenses attributed to Barnes and Thornburg, which I recommend that the Commission find unnecessary. Therefore, the resulting projected expense is $740,000. I also recommend that the Company bear 2/3 of the responsibility for this expense. Therefore, the amount to include in this case as rate case expense is $246,642.

<u>INCOME TAX COMPENSATION</u>

Q. Can you provide some background to help us understand income tax compensation?

A. Many multi-divisional companies, utilities included, share the consolidated company's tax burden among all the subsidiaries. Those that create a tax burden, often calculated by using pro forma tax returns as proxies, pay money into the parent company to cover its share of the tax burden. This occurs even when the consolidated company as a whole does not owe any income tax for the year. Subsidiaries that provide tax reductions to the overall consolidated tax return are compensated for the benefits they generate.

Q. Please explain how MAWC receives this income tax compensation.

A. Since at least 2011, American Water Works Company, Inc. ("American Water Works")—MAWC's parent company—has had a Tax Sharing Agreement in place with its subsidiaries. The Company's answer to OPC data request 1302 is a confidential Tax Sharing Policy (*see* Confidential Schedule JSR-D-02). The objective of this Tax Sharing Policy is to allocate income tax liability among American Water Works' subsidiaries. Due to extensive

[4] Regulatory Expense workpapers, Company Schedule CAS-13 Support.

infrastructure replacement (WSIRA) which creates elevated levels of accelerated depreciation and expense write offs, MAWC enjoys taxable losses every year.

Q. Without getting into any details of the Tax Sharing Policy, what amount of compensation are you proposing to include in the revenue requirement?

A. The adjustment to the revenue requirement would be different depending on how you frame the compensation and whether the amount is averaged over several years or if the last known annual amount is applied. MAWC's response to OPC data request 1303 indicates that the total compensation received in 2019 was $3,262,751, for 2020 was $18,646,087 and in 2021 the amount was $35,971,593. With MAWC WSIRA filings expected every six months, I would anticipate MAWC's pro forma taxable income to be at a negative level similar to the 2021 level. This would produce compensation levels similar to the $35.9 million in 2021.

Q. How would you recognize this in the rate case?

A. There are several possibilities and each method would create different monetary adjustments. One method would be to create a deferred liability and offset rate base. Another would be to include some level of additional income tax amount in the CWC calculations to recognize a further reduction in working capital needs for income taxes. Since the Company does not incur an income tax liability, these payments could be added to the income tax expense and the calculated CWC amount would be a further deduction to rate base. Finally, the payments could be included as income and reduce the revenue requirement for this rate case.

Q. Does this conclude your direct testimony?

A. Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri- American Water Company's Request for Authority to Implement General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas	)))))	Case No. WR-2022-0303

AFFIDAVIT OF JOHN S. RILEY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

John S. Riley, of lawful age and being first duly sworn, deposes and states:

1. My name is John S. Riley. I am a Utility Regulatory Supervisor for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my direct testimony.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

John S. Riley
Utility Regulatory Supervisor

Subscribed and sworn to me this 22nd day of November 2022.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI
TIFFANY HILDEBRAND
My Commission Expires
August 8, 2023
Cole County
Commission #15637121

Tiffany Hildebrand
Notary Public

My Commission expires August 8, 2023.