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Exhibit No. 311

OPC – Exhibit 311
Testimony of John S. Riley
Cross-Rebuttal
File No. WR-2024-0320

Exhibit No.:

Issue(s): Income Tax Calculations/
Cash Working Capital/Rate Case Expense

Witness/Type of Exhibit: Riley/Cross-Rebuttal

Sponsoring Party: Public Counsel

Case No.: WR-2024-0320

CROSS-REBUTTAL TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

FILE NO. WR-2024-0320

**

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Denotes Confidential Information that has been redacted.

January 10, 2025

PUBLIC

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CROSS-REBUTTAL TESTIMONY

OF

JOHN S. RILEY

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2024-0320

Q. What is your name and business address?

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

Q. Are you the same John S. Riley who prepared and filed direct/rebuttal testimony in this case on behalf of the Office of the Public Counsel?

A. Yes.

SUMMARY

Q. What is the purpose of your Cross-Rebuttal?

A. I will be responding to Staff witness Ms. Ashley Sarver concerning income tax calculations, Ms. Angela Niemeier's Cash Working Capital ("CWC") calculations as well as her beginning level of rate case expense to normalize in this case.

INCOME TAX CALCULATIONS

Q. What issue do you take with Ms. Sarver's calculation of income tax in this rate case?

A. To be more accurate, my issue is not so much with Ms. Sarver's calculations as I take issue with Staff's presentation of the line "Additional Current Tax Required" on the Revenue Requirement, Schedule 1. Both the water and sewer cases display an additional tax that is calculated using a gross-up factor. I argue that the additional tax should not be grossed-up.

1 **Q. Could you please explain the term “gross-up”?**

2 A. Gross-up is the calculation of adding income tax onto the original calculation of income tax.
3 It is a tax on tax. When the rate case dust settles and the Commission’s decisions are applied
4 to total operating income requirements, income tax is applied to the additional income that is
5 needed to bring the total profits up to the Commission’s calculated operating income
6 requirement. To illustrate: Staff’s mid-point revenue requirement calculations for this case
7 is \$190,161,770. Staff has projected a revenue shortfall and that an additional \$37,682,392
8 of net income is needed to reach that \$190,161,770 level. As we know, tax calculations on
9 income are always needed so Staff applies a tax rate to the \$37,682,392. The additional tax
10 would be \$37,682,392 multiplied by the composite tax rate of 23.84% or an additional
11 \$8,983,482 in taxes.

12 Here is where the tax on tax occurs. The IRS treats the additional tax that Staff included as
13 additional taxable revenues for MAWC. Therefore, income tax needs to be calculated on the
14 additional revenues to offset that additional tax expense. This will in turn increase the taxable
15 revenue even more, thus resulting in even more income tax expense being added. This cycle
16 repeats until the addition to the income tax expense becomes so small that it no longer registers
17 as causing additional taxable income for the IRS. The bulk of this increase to taxable income
18 is the tax gross-up.

19 In this case, Staff increased the \$8.9 million income tax expense it calculated by grossing it
20 up to \$11,795,623. I’ve included Schedule JSR-Cross-01 detailing the tax calculations but
21 essentially the gross-up calculation is the original tax multiplied by 1.313. However, Staff’s
22 inclusion of the income tax gross-up in this case is inappropriate. There is no additional tax
23 due and the original calculated tax of \$8,983,482 should be the full amount of further tax
24 expense.

1 **Q. Isn't a second income tax calculation necessary to allow the Company to receive the**
2 **amount authorized by the Commission?**

3 A. In theory, yes. But in the case of some companies and specifically MAWC, no secondary
4 calculation is needed due to the fact that MAWC enjoys accelerated expenses on its tax return
5 and therefore doesn't owe an income tax, even on the added income tax expense.

6 **Q. To be clear then, the initial income tax calculation on the calculated income shortfall**
7 **does not need a gross-up?**

8 A. That is correct. Because MAWC will not have to pay income taxes for the foreseeable future¹
9 it is not necessary to calculate the income tax that will be owed on the non-existent income
10 taxes so no tax gross-up needs to be applied.

11 **CWC CALCULATIONS**

12 **Q. Ms. Niemeier questioned some of the findings presented in the Company Lead/lag study.**
13 **She proposed that the revenue lag be reverted to the prior case calculation of 45.7. Do**
14 **you agree?**

15 A. Yes. Ms. Niemeier questioned the accounts receivable data and suggested that the known and
16 accurate calculations from the last rate case, WR-2022-0303, be used instead. I specifically
17 questioned the billing lag in my direct/rebuttal testimony. Either argument leads to the
18 acceptance of the previous 45.7 revenue lag from 2022. As stated in my direct testimony, the
19 45.7 day revenue lag should be the choice.

¹ Missouri-American specific Income Schedules in the annual consolidated income tax returns for the parent company, American Water Works Company, have indicated taxable losses for seven of the last eight years. The Company's annual filing indicates negative income tax (losses) as well.

Q. What other CWC calculations did you review?

A. I reviewed the income tax calculations within the CWC schedule. Staff breaks out income taxes and interest payments from the other expenses that comprise the CWC schedule and list them at the bottom of the schedule. I found two errors in the line items. I noticed that the Federal and State tax offsets were negative which is consistent with the tax value included on the Revenue Requirement schedule, however, as a CWC calculation, if the income tax were truly negative then a zero should be inserted in the expense amount.

Q. Why should the amount be zero?

A. Remember that CWC is the amount of cash a company needs to pay its day-to-day bills. A negative tax amount would not be collected from the ratepayer and the Company would not have to compute a CWC amount to address the balance. The balance for CWC would be zero.

Q. You mentioned a second error. What is the error?

A. Normally, there is a positive amount listed in the income tax expense lines. It has been my contention and that of the Commission that a company that collects tax yet does not pay that amount to a taxing authority should have an expense lag of 365 days. The Staff is recognizing quarterly payments in its CWC Schedule as if the Company is making payments to the IRS. The Company is not required to make quarterly payments. The 365 day lag is necessary to recognizes collection yet no payout.² As I pointed out earlier, Staff has inserted a negative amount for tax. If at the end of this rate case, the Commission provides MAWC with a positive amount of income tax expense, then the lag should reflect the nonpayment.

² Spire Missouri, Case NO. GR-2021-0108, Amended R&O pages 27-31.

RATE CASE EXPENSE

Q. What is your issue with Staff's rate case expense amount?

A. As Ms. Niemeier states in her original testimony. "Staff included 50% of the rate case expense costs incurred thus far for the current rate case...."³ After discussing at great lengths the shortcomings of the CWC Lead/Lag study conducted by the Company's consultants,⁴ Ms. Niemeier makes no adjustment to rate case expense for the unnecessary CWC study performed just two years after the last rate case.

Q. What are you proposing as a reduction to the starting rate case expense the Staff would use to apply a 50-50 sharing?

A. Company confidential answer to OPC data request 1310 (Schedule JSR-Cross-02) is that approximately **_____** will be the expected cost of Mr. Walker's testimony and studies. This amount should be deducted from rate case expense prior to Staff's 50% reduction.

Q. Does this conclude your Cross-Rebuttal Testimony?

A. Yes, it does.

³ Case No. WR-2024-0320, Direct/Rebuttal Testimony page 29, line 1 and 2

⁴ Niemeier Direct/Rebuttal, page 8-15

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

In the Matter of Missouri-American Water)
Company's Request for Authority to Implement)
a General Rate Increase for Water and Sewer)
Service Provided in Missouri Service Areas)


Case No. WR-2024-0320

AFFIDAVIT OF JOHN S. RILEY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

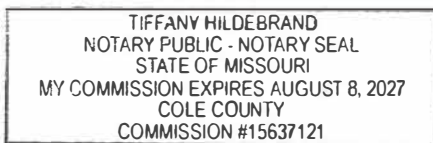
John S. Riley, of lawful age and being first duly sworn, deposes and states:

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 cross-rebuttal 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.

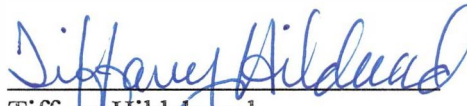


John S. Riley
Utility Regulatory Supervisor

Subscribed and sworn to me this 9th day of January 2025.



My Commission expires August 8, 2027.



Tiffany Hildebrand
Notary Public