MEMORANDUM

Date: December 9, 2025

To: The Missouri Public Service Commission Official Case File
Case No. WR-2025-0345

From: John Riley, Utility Regulatory Supervisor

Subject: Office of the Public Counsel's (the "OPC") Response to Staff's Recommendation Regarding Missouri American Water Company's ("MAWC") Request to Establish a Water and Sewer Infrastructure Adjustment ("WSIRA")

I. Background

MAWC petitioned the Commission to establish a WSIRA to recover approximately $16 million[1].

Staff performed a thorough review of MAWC's supporting documentation and developed its own revenue calculations. Staff found:

> Based upon its investigation and calculations, Staff concludes the Company's actual WSIRA rates should be designed to recover annual WSIRA revenues of $12,279,215 from St. Louis County water customers, $3,079,305 from All Other water customers, $1,861 from Arnold sewer customers, and $206,769 from All Other sewer customers for a total of $15,567,151.
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> Staff's calculations reflect the overall weighted average cost of capital of 7.00% (tax grossed up rate of return) and MAWC's current depreciation rates, as reflected in the Stipulation and Agreement the Commission approved and ordered on May 7, 2025, in Case No. WR-2024-0320.
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> Staff's calculations reflect the actual WSIRA eligible investment placed in service from May 31, 2025 through October 31, 2025. In addition, no property taxes have been included in Staff's calculation, as there will be no property tax liability from MAWC due within the next 12 months related to these WSIRA investments.[2]

[1] Updated revenue request from MAWC mentioned in Staff Conclusion paragraph, page 7
[2] Staff Memorandum 7-8.

II. Public Counsel's Response

The OPC does not dispute Staff's calculations of rate base, depreciation, or its exclusion of property taxes from the WSIRA revenue requirement calculations. The OPC's only adjustment to Staff's findings is to exclude the associated gross up calculation on the income tax expense.

Because the Internal Revenue Service ("IRS") considers the amount companies collect to pay their income taxes as additional revenues, tax generally is calculated on this added revenue (the income taxes themselves) so the company is able to collect the net income authorized by the Commission. The gross-up factor is an additional component that attempts to capture the amount the company must collect to pay the taxes due on top of the original income tax calculation plus all the iterations on that amount collected. This is a tax-on-tax calculation. The gross-up formula is 1/(1-tax rate). The current composite tax rate is 23.84% and the formula is then 1/(1-.2384)=1/(.7616)=<u>1.313</u>

For instance, if the Commission authorized MAWC to collect $1 million, it must collect an additional $238,400 to pay the taxes on that amount. However, because the IRS considers the $238,400 as additional income, MAWC must collect even more to ensure it can pay the full amount of taxes and still collect the initial $1 million. Here, that would mean that MAWC must collect $1,313,000, where the difference between the $1,238,400 (initial revenues + taxes) and $ 1,313,000 (initial revenues + taxes + tax gross up) is the $74,600 collected for the tax gross up.

The Return on Equity ("ROE") is the portion of the ratemaking calculation that is actually taxed[3]. Both Staff and MAWC applied the gross-up factor to the ROE here. Applying the gross-up factor of 1.313 instead of just the tax rate of 23.84%, (or 1.2384) raises the pre-tax rate of return from 8.12% to 8.47%

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[3] The interest portion of the rate of return ("ROR") is also a tax deduction so the interest cancels out the taxability.

However, the OPC's position is that the tax gross up should not be included in this case. In the most recent MAWC general rate case, Case No. WR-2024-0320, Staff accounting schedules display a Required Current Income Tax of negative $13,142,418.[4] Staff's Schedule 8, Cash Working Capital, also displays a negative amount of income tax offset. These indicate that MAWC will have no income taxes due during the duration of the rates set in the case.

Though I am not an attorney, it is my understanding that the WSIRA statutes require an income tax calculation.[5] However, it is my understanding that they do not require the additional tax gross up calculation. The calculation is not mandated by the IRS. Staff should not include the additional income tax (the tax gross up factor), beyond what is required by the WSIRA statutes (the initial tax calculation). Because MAWC will not pay income taxes during the time that it will collect these WSIRA revenues and nothing requires the inclusion of the tax gross up no additional tax should be included. Including such additional income tax calculation results only in additional income to MAWC as it collects an amount to pay income taxes that it will not pay.

Based on Staff's recommendations, using the correct pretax ROR (8.12%), the total revenue requirement for STL County Water is $11,956,304, Other Water $2,976,761, Arnold Sewer $1,673 and Other Sewer $201,878. The combined total <u>current</u> revenue requirement would then be $15,136,615. This change in ROR represents a total reduction of $430,535 from Staff's calculation

[4] Case No. WR-2024-0320. Staff Total Company Accounting Schedule 1, Revenue Requirement.
[5] §§ 393.1500 – 393.1509 RSMo.