BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Petition of Missouri-American Water Company for Approval to Establish a Water and Sewer Infrastructure Rate Adjustment (WSIRA)	))))	Case No. WR-2025-0345

POST-HEARING BRIEF

Comes now, the Office of the Public Counsel (the "OPC") and offers this initial post hearing brief.

I. Background

In this case, the OPC requests that the Public Service Commission of the State of Missouri (the "Commission") not allow Missouri-American Water Company ("MAWC") to recover the income tax gross-up[1] that could be calculated on the income tax associated with its Water and Sewer Infrastructure Rate Adjustment ("WSIRA") revenues in this case. The OPC makes this request as MAWC does not currently remit payment[2] for income taxes to the Internal Revenue Service ("IRS").[3] Because MAWC does not remit payment for income taxes, no need exists for it to collect the income tax gross up.

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[1] The OPC's argument is limited to the income tax gross up and does not concern the income taxes themselves.

[2] MAWC argues that the "Corporate Alternative Minimum Tax [('CAMT')] was recently implemented and will require MAWC to make cash payments (current tax expense) to the parent to be paid to the government." (Ex. 3 "Schlessman Direct Testimony" 5, Doc. 33). However, changes to MAWC's general tax position should be considered in a general rate case where all relevant factors can be analyzed. (Ex. 301 "Riley Rebuttal Testimony" 4, Doc. 40). This analysis should not be done in an interim rate case, such as this WSIRA case. (*Id.*).

Should the Commission wish to consider this argument substantively, Ms. Schlessman identifies MAWC's portion of the 2024 CAMT as $16.0M. (Ex. 4 "Schlessman Rebuttal Testimony" 5, Doc. 34). As shown in MAWC's 2024 Annual Report, the most recent Annual Report available, MAWC's federal income taxes are -$35,972,471. (Ex. 302 "Excerpt of MAWC 2024 Annual Report" 3, Doc. 41). This is significantly more than the $16.0M Ms. Schlessman identifies in her testimony.

[3] MAWC also does not remit payment for state income taxes to the State of Missouri. (*See* Excerpt of MAWC 2024 Annual Report 3 (showing negative income taxes for both state and federal)). For simplicity the OPC will refer to the IRS only, but the same arguments apply to the State of Missouri.

A. Procedural History of This Matter

This case substantively began when MAWC filed its Petition to Establish a Water and Sewer Infrastructure Rate Adjustment (WSIRA) and Motion for Approval of Customer Notice. (Doc. 2). The Commission then consolidated the water case with the sewer case on a motion from MAWC. (Docs. 4, 5). The Staff of the Commission ("Staff") then issued its initial Recommendation and later amended that Recommendation (the "Amended Recommendation"). (Docs. 7-8). MAWC responded to Staff's Amended Recommendation stating that it did not oppose Staff's Amended Recommendation. (Doc. 10).

The OPC also responded to Staff's Amended Recommendation, requesting that the Commission impose a disallowance of approximately $430,535, equal to the amount of the income tax gross up. (Doc. 9). The OPC attached a verified memorandum from Mr. John Riley, CPA in support of its Response to Staff Recommendation. (*See id.*). The case then proceeded quickly with the filing of testimony and a hearing over the span of approximately one month. (Docs. 15-18, 21-24, 29). A single issue exists for the Commission's determination.

II. Issue 1: Should the gross-up on income taxes be included in the WSIRA revenue requirement?

No, the Commission should not include the gross-up on income taxes in the WSIRA revenue requirement in this case because MAWC does not remit payment for income taxes to the IRS and does not require the tax gross-up to be made whole. MAWC and Staff's argument that the OPC's 8.12% pretax rate of return does not allow MAWC to earn its 7% post tax rate of return is incorrect because it relies on a chart in Ms. Schlessman's testimony that fails to recognize that MAWC will not remit payment for income taxes to the IRS. The OPC's 8.12% pretax rate of return complies with the WSIRA statutes and allows MAWC to collect appropriate WSIRA revenues. Each of these points are addressed further below. For these reasons, the Commission should disallow $430,535 from the WSIRA revenue requirement Staff calculated in its Amended Recommendation (Ex. 202 "Staff's Amended Recommendation," Doc. 38).[4]

A. Background

A discussion of the income tax gross up as well as the role that it plays in setting a utility's rates is helpful background to understand the OPC's argument. A short discussion of the rates of return presented in this case is also helpful. The OPC will address each in turn.

1. <u>The Income Tax Gross Up</u>

The income tax gross up is a regulatory tool created to solve a problem. Specifically, the problem that arises because the IRS considers the amounts utilities collect to pay the income taxes associated with their revenues to be additional taxable income to the utility. The income tax gross up allows the utility to collect an additional amount from its customers to pay additional income tax generated by its collection of the initial income tax. Though the income tax gross up is itself collected to pay income taxes, it is helpful to think of it as a separate "bucket" of money from the amount collected to pay income taxes. For purposes of this discussion, the three "buckets" are: (1) base revenues, (2) income taxes, and (3) the income tax gross up.

"Bucket"	Item
(1)	Base Revenues
(2)	Income Taxes
(3)	Income Tax Gross Up

[4] This would result in the following revenue requirements for each of MAWC's rate districts: STL County Water is $11,956,304, Other Water $2,976,761, Arnold Sewer $1,673 and Other Sewer $201,878. (Riley Direct Test. Schedule JSR-D-02 "Riley Memorandum" 3, Doc. 39).

Perhaps the best way to explain the income tax gross up is to work through a simplified example. For instance, consider a circumstance where the Commission authorizes a utility to recover $100,000 in revenues from its customers.

Step	Item	Amount
(1)	Base Revenues	$100,000

To calculate the income taxes associated with those revenues, one simply multiplies the $100,000 by the composite tax rate of 23.84%. This lends a result of $23,840.

Step	Item	Amount
(1)	Base Revenues	$100,000
(2)	Income Taxes ($100,000 * 23.84%)	$23,840

Because the IRS considers this $23,840 to be taxable income to the utility, in some circumstances it then becomes necessary to calculate the additional tax generated from this $23,840. To do this, one multiplies the $23,840 by the composite tax rate of 23.84%. This results in $5,683.

Step	Item	Amount
(1)	Base Revenues	$100,000
(2)	Income Taxes ($100,000 * 23.84%)	$23,840
(3)	Income Tax Gross Up ($23,840 * 23.84%)	$5,683

Again, the IRS considers this $5,683 to be additional taxable income to the utility, so in some circumstances it again becomes necessary to calculate the income taxes due as a result of this $5,683. To do this, one multiplies the $5,683 by the composite tax rate. This results in $1,355.

Step	Item	Amount
(1)	Base Revenues	$100,000
(2)	Income Taxes ($100,000 * 23.84%)	$23,840
(3)	Income Tax Gross Up ($23,840 * 23.84%)	$5,683
(4)	Income Tax Gross Up ($5,683 * 23.84%)	$1,355

This process continues until the amount of additional tax added is negligible.

Step	Item	Amount
(1)	Base Revenues	$100,000
(2)	Income Taxes ($100,000 * 23.84%)	$23,840
(3)	Income Tax Gross Up ($23,840 * 23.84%)	$5,683
(4)	Income Tax Gross Up ($5,683 * 23.84%)	$1,355
(5)	Income Tax Gross Up ($1,355 * 23.84%)	$323
(6)	Income Tax Gross Up ($323 * 23.84%)	$77
(7)	Income Tax Gross Up ($77 * 23.84%)	$18
(8)	Income Tax Gross Up ($18 * 23.84%)	$4
Total to collect		**$131,300**

Ultimately, this process leads to $7,460 being added to the utility's $100,000 revenues and $23,840 collected for income tax. This $7,460 represents the income tax gross up, as shown in the chart below.

“Bucket”	Item	Amount
(1)	Base Revenues	$100,000
(2)	Income Taxes ($100,000 * 23.84%)	$23,840
(3)	Income Tax Gross Up	$7,460
Total to collect		**$131,300**

2. The Rates of Return

There are three rates of return to keep in mind in this case. First, in MAWC’s most recent rate case, Case Number WR-2024-0320, parties, including the OPC, agreed that a 7% *post-tax* rate of return should be used for purposes of the WSIRA. (Ex. 1 “LaGrand Direct Testimony” 5, Doc. 31).

Second, MAWC and Staff suggest that the Commission utilize a *pretax* rate of return of 8.47%. (Schlessman Direct Test. 7; *see* Ex. 201 “McMellen Rebuttal Testimony” 3, Doc. 37).[5] Third, the OPC suggests that the Commission utilize an 8.12% *pretax* rate of return. (Riley Rebuttal Test. 5-6). The inclusion of the income tax gross up explains the difference in these rates of return. (*See* Ex. 303 “OPC Calculation of Pretax Rate of Return” 1, Doc. 42).

In summary, the rates of return are:

Rate of Return	Pretax/Post-Tax and Sponsoring Party
7%	Post-Tax, as agreed in MAWC’s rate case, WR-2024-0320
8.12%	OPC Pretax
8.47%	MAWC/Staff Pretax

Difference = Inclusion of Tax Gross Up

[5] Though Staff references only its use of the 7% post-tax weighted average cost of capital, it agrees that MAWC should collect the income tax gross up. (McMellen Rebuttal Test. 3). The inclusion of the income tax gross up leads to an 8.47% pretax rate of return. (Ex. 303 “OPC Calculation of Pretax Rate of Return” 1, Doc. 42).

B. Applicable Legal Standard: The WSIRA Statutes

This WSIRA case is governed by the WSIRA statutes, §§ 393.1500-393.1509 RSMo. In particular, the statutes provide that certain water or sewer corporations can request authority from the Commission "to establish or change a WSIRA that will provide for the recovery of the appropriate pretax revenues associated with the eligible infrastructure system projects, less the appropriate pretax revenues associated with any retired utility plant that is being replaced by the eligible infrastructure system projects." § 393.1506.1 RSMo.

In general, the WSIRA statutes define "appropriate pretax revenues," as including the defined rate base multiplied by the "pretax weighted cost of capital," income or excise taxes, depreciation expense, and certain property taxes. § 393.1503(1) RSMo. Importantly, in describing the income or excise taxes to include the statute refers only to "[t]he state, federal, and local income or excise taxes applicable to such revenues." § 393.1503(1)(b) RSMo.

C. Analysis

Because MAWC does not remit payment for income taxes to the IRS, no need exists for the Commission to require its customers to pay an income tax gross up. MAWC is made whole upon its collection of the revenues and income taxes. Collection of the income tax gross up would result in MAWC collecting even more for income taxes that it will not remit payment for. MAWC and Staff's argument that the OPC's 8.12% pretax rate of return will not allow MAWC an opportunity to earn its 7% post-tax rate of return relies on a chart that fails to address the fact that MAWC will not remit payment for the taxes at issue in this case. The OPC's 8.12% pretax rate of return complies with the WSIRA statutes while allowing MAWC the opportunity to earn its 7% post tax rate of return. The OPC will address each in turn.

1. <u>Because MAWC Will Not Remit Payment for Income Taxes to the IRS No Need Exists to Allow it to Recover an Income Tax Gross Up</u>

MAWC is in a unique position in that it does not currently remit any payment to the IRS for income taxes because it does not owe income tax. (*See* Riley Direct Test. 7). This will be the situation for the foreseeable future. (*Id.*). Because MAWC does not remit payment for income taxes to the IRS, no need exists to allow it to recover an income tax gross up.

MAWC's taxable position is shown in the accounting schedules the Staff completed in MAWC's most recent general rate case, Case Number WR-2024-0320. (*See* Riley Direct Test. Schedule JSR-D-04 1). Specifically, in those schedules Staff identifies MAWC's "Required Income Tax" as -$13,142,418 and its "Current Income Tax Available" as -$24,476,359. (*Id.*). These negative numbers mean that MAWC will remit no payment for income taxes to the IRS because it will owe no income taxes. MAWC's 2024 Annual Report—its most recent—filed with the Commission also shows a negative amount for both state and federal current income taxes in 2024. (Excerpt of MAWC 2024 Annual Report 3).

Again, an income tax gross up exists to solve a problem: namely that the IRS considers the amount a utility collects to pay income taxes ("Bucket" 2 in the simplified example above) to be additional taxable income to the utility. (Riley Direct Test. 3). This generates additional tax owed to the IRS. (*See id.*). Assuming that the utility will actually remit payment for income taxes to the IRS, to assure that the utility will have the opportunity to earn its full Commission-authorized revenues, the Commission must allow the utility to collect an additional amount ("Bucket" 3 in the simplified example above). (*Id.* 7). Otherwise, the utility will not have the opportunity to earn its full revenues. (*Id.*).

However, MAWC is not in this position. (*Id.*). Rather, MAWC will not remit payment for income taxes to the IRS. (*Id.*). Therefore, the Commission need not allow it to collect this additional amount ("Bucket" 3).

2. <u>MAWC and Staff's Argument that MAWC Will Not Have the Opportunity to Earn its 7% Post-Tax Rate of Return Fails to Consider That MAWC Will Not Remit Payment for Income Taxes to the IRS</u>

MAWC and Staff argue that if the Commission does not allow MAWC to recover the income tax gross-up, then MAWC will not have an opportunity to earn its 7% post-tax rate of return, as parties agreed to in MAWC's last rate case. (Schlessman Direct Test. 6-7; McMellen Rebuttal Test. 3). This argument centers on a chart Ms. Schlessman included in her Direct Testimony. (*Id.*). However, this argument ignores the fact that MAWC will remit no payment for income taxes to the IRS.

In her Direct Testimony MAWC witness Ms. Schlessman makes the argument that the OPC's 8.12% *pretax* rate of return results in a 6.73% *post tax* rate of return, meaning that MAWC will not have the opportunity to earn its 7% post tax rate of return. (Schlessman Direct Test. 6). Staff agrees with this argument. (McMellen Rebuttal Test. 3). To make this point, Ms. Schlessman includes the chart below in her Direct Testimony. (Schlessman Direct Test. 6).

The problem with this chart arises because it presumes that MAWC is *actually* remitting payment for income taxes to the IRS, which, as discussed above, MAWC does not actually do. (*See* Riley Direct Test. 7). This presumption is shown in the seventh line of the chart—circled in red below—where Ms. Schlessman subtracts the entire Income Taxes balance (Item F) from the Taxable Income (Item E) to achieve what she identifies as Net Income (Item G).

Ms. Schlessman's Chart

			OPC	MAWC
A	Rate Base		$123,010,057	$123,010,057
B	Pre-Tax Rate of Return		8.12%	8.47%
A x B = C	Pre-Tax Return		$9,988,417	$10,418,952
A x 2.3% = D	Interest Expense	2.30%	$2,829,231	$2,829,231
C - D = E	Taxable Income		$7,159,185	$7,589,721
E x 23.84% = F	Income Taxes	23.84%	$1,706,750	$1,809,389
E - F = G	Net Income		$5,452,436	$5,780,331
D	Interest Expense		$2,829,231	$2,829,231
G + D = H	After Tax Return		$8,281,667	$8,609,562
H / A	**After Tax Rate of Return**		**6.73%**	**7.00%**

The OPC's Exhibit 303 shows how the OPC reached its 8.12% pretax rate of return. (Ex. 303). It shows that the OPC used a 7% post tax rate of return.[6] (*Id.*). This chart shows that the OPC agrees that MAWC should recover a 7% post tax rate of return, as it agreed to in MAWC's rate case. (*See Id.* (showing how the OPC used a 7% post tax rate of return to calculate its 8.12% pretax rate of return)).

OPC Exhibit 303

OPC Calculation of Pre-Tax Rate of Return

		OPC	Staff/MAWC
A	Rate Base	$ 123,010,057.00	$ 123,010,057.00
B	Post-Tax Rate of Return per last Order	7.00%	7.00%
A x B = C	Post-Tax Return	$ 8,610,703.99	$ 8,610,703.99
A x 2.3% = D	Interest Expense	$ 2,829,231.31	$ 2,829,231.31
C-D = E	Taxable Income	$ 5,781,472.68	$ 5,781,472.68
E x 23.84% = F	Income Tax Expense	$ 1,378,303.09	$ 1,378,303.09
E x 7.46% =G	Income Tax Gross Up (MAWC only)	0	$ 431,297.86
E + F + G = H	Net Income	$ 7,159,775.77	$ 7,591,073.63
D	Interest Expense	$ 2,829,231.31	$ 2,829,231.31
H + D = I	Revenue Requirement on Capital	$ 9,989,007.08	$ 10,420,304.94
I / A	Pre-Tax Rate of Return	8.12%	8.47%

Gross Up Proof	
E x 1.313 = Z	$ 7,591,073.63
Z - E - F =	$ 431,297.86

[6] Importantly, the OPC's calculation is similar to how Staff calculated the revenue requirement in MAWC's most recent rate case. (*Compare* Ex. 303, *with* Riley Direct Test. Schedule JSR-D-04 1 (Staff's Revenue Requirement Calculation Chart from Case No. WR-2020-0324)). Specifically, both begin with the applicable rate base and use a *post tax* rate of return to calculate an income requirement. (*Id.*). They also both separately calculate the required income tax before arriving at a revenue requirement. (*Id.*).

As can be seen, the OPC and MAWC's charts have many similarities. First, they both start with the same rate base amount: $123,010,057. Second, the OPC's Post Tax Return is substantially similar to[7] the After Tax Return[8] MAWC calculated in its own column in Ms. Schlessman's chart (OPC: $8,610,703.99 v. MAWC: $ 8,609,562).[9] Third, the Interest Expense is also substantially the same between the two charts (OPC: $2,829,231.31 v. MAWC $2,829,231). Fourth, the OPC's Net Income in both columns of the OPC's chart is substantially similar to the Taxable Income in both columns of MAWC's chart (OPC (OPC Column): $7,159,775.77 v. MAWC (OPC Column): $ 7,159,185 and OPC (Staff/MAWC Column): $7,591,073.63 v. MAWC (MAWC Column): $7,589,721).[10] Finally, both columns for the OPC's Revenue Requirement on Capital are substantially the same as both column's in MAWC's Pre-Tax Return (OPC (OPC Column): $9,989,007.08 v. MAWC (OPC Column): $ 9,988,417 and OPC (Staff/MAWC Column): $10,420,304.94 v. MAWC (MAWC Column): $10,418,952).

There is one large difference between the OPC's Exhibit 303 and MAWC's chart though: the inclusion of the income tax gross up. As can be seen in the OPC's Exhibit 303, the OPC has excluded the income tax gross up in calculating its pretax rate of return. (Ex. 303). The OPC has done so in recognition of its argument that because MAWC does not remit payment for this amount to the IRS it need not collect it from its customers. (*See* Riley Direct Test. 7). However, in

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[7] The slight differences throughout this discussion are due to rounding errors.

[8] A post tax rate of return does not include income taxes. (*See* LaGrand Direct Test. Schedule BWL-3 (showing how MAWC calculated the 7% post tax rate of return, which includes recognition of only the percentages of debt and equity and the cost of each)). Therefore, a post tax return and an after tax return mean the same thing.

[9] This amount is different from the amount that MAWC calculates in the OPC column of its chart (OPC: $8,610,703.99 v. MAWC (OPC Column): $8,281,667). This difference results because the OPC has excluded the income tax gross up in its calculation of the 8.12%, but MAWC has calculated the After Tax Return in Ms. Schlessman's chart as if it were included. (*Compare* Ex. 303, *with* Schlessman Direct Test. 6).

[10] This is not surprising. The OPC's chart is forward looking and shows how the OPC used the 7% post tax rate of return to arrive at its 8.12% pretax rate of return. (Ex. 303). MAWC's chart works in the opposite order of the OPC's chart by utilizing the pretax rates of return to attempt to arrive at an after tax return. (Schlessman Direct Test. 6).

MAWC's chart, Ms. Schlessman makes no allowance for this recognition. (*See* Schlessman Direct Test. 6). Rather, she deducts the entire amount of income tax from the taxable income, as if MAWC will remit payment for the entire amount of income taxes to the IRS. (*See id.*). This fails to recognize that MAWC will not remit payment for the income tax gross up to the IRS, but will instead retain that amount as an interest free loan.[11] (*See* Riley Direct Test. 7, 10). Ms. Schlessman's chart suggests that the Commission should automatically include the income tax gross up without consideration of whether the utility remits payment for income taxes to the IRS. (*See* Schlessman Direct Test. 6). The OPC's Exhibit 303, on the other hand, shows that the Commission should consider its inclusion on a case-by-case basis. (*See* Ex. 303; Riley Direct Test. 7-8). When, as in the case of MAWC, the utility does not remit payment for income taxes to the IRS, the Commission should not include an income tax gross up. (*See id.*).

In relying on the chart in Ms. Schlessman's Direct Testimony MAWC and Staff have failed to consider that MAWC will not remit payment for income taxes to the IRS. As the OPC's Exhibit 303 shows, in calculating its 8.12% pretax rate of return the OPC utilized the 7% post tax rate of return parties to MAWC's most recent rate case agreed to. (Ex. 303).

3. **The OPC's 8.12% Pretax Rate of Return Complies with the WSIRA Statutes**

The WSIRA statutes describe how the Commission is to calculate the WSIRA. The OPC's 8.12% pretax rate of return complies with those statutes.

The WSIRA statutes describe how to calculate a WSIRA, saying that it shall include "recovery of the appropriate pretax revenues associated with the eligible infrastructure system

[11] Mr. Riley points out that this is an interest-free loan from MAWC's ratepayers. (Riley Direct Test. 10). Ms. Schlessman argues that it is an interest-free loan from the government. (Schlessman Rebuttal Test. 8). The Commission need not decide this disagreement. The important point is that MAWC has free use of this money. (Riley Rebuttal Test. 7).

projects, less the appropriate pretax revenues associated with any retired utility plant that is being replaced by the eligible infrastructure system projects." § 393.1506.1 RSMo. The statutes define "appropriate pretax revenues" as calculated by, in part, two things: (1) the "pretax weighted cost of capital multiplied by the net original cost of eligible infrastructure system projects" and (2) "[t]he state, federal, and local income or excise taxes applicable to such revenues." § 393.1503(1) RSMo.

The OPC requests that the Commission calculate the WSIRA in this case using an 8.12% pretax rate of return, which consists of the 7% post tax rate of return and recognition of the 23.84% composite tax rate. (Riley Rebuttal Test. 5-6). It excludes the income tax gross up. (Ex. 303). Using this 8.12% pretax rate of return results in a reduction of approximately $430,535. (*See* Ex. 303; Riley Direct Test. 2). The OPC's argument centers on the word appropriate, which Webster's Dictionary defines to mean "especially suitable or compatible."[12] *Appropriate*, Webster's Dictionary (2026), https://www.merriam-webster.com/dictionary/appropriate (last accessed Feb. 6, 2026). Because MAWC will not remit payment for this amount to the IRS, it is not *appropriate* for the Commission to allow its recovery in this WSIRA.

The WSIRA statutes also do not specifically require recovery of the income tax gross up. *See* § 393.1503; 393.1506.1 RSMo. As Mr. Riley also points out, the gross up "calculation is not mandated by the IRS." (Riley Direct Test. Schedule JSR-D-02 "Riley Memorandum" 3, Doc. 39). Rather, as explained above, it is a ratemaking tool that can be used when necessary. (*See* Riley Direct Test. 7-8). Because MAWC will not remit payment for taxes to the IRS, it is not necessary in this case. (*Id.*).

[12] Similarly, the American Heritage Dictionary defines "appropriate" as "[s]uitable for a particular person, condition, occasion, or place." *Appropriate*, The American Heritage Dictionary (2d ed. 1985).

As Exhibit 303 shows, the OPC's 8.12% pretax rate of return allows MAWC to recover for the income taxes associated with the WSIRA revenues, without allowing for the additional income tax gross up. (Ex. 303). This calculation complies with the WSIRA statutes.

III. Conclusion

The WSIRA statutes describe how the Commission is to calculate MAWC's WSIRA recovery. The OPC's use of an 8.12% pretax rate of return complies with these statutes while recognizing that MAWC will not remit payment for income taxes to the IRS. For this reason, the Commission should utilize the OPC's 8.12% pretax rate of return in this case, which results in a reduction of Staff's proposed revenue requirement of $430,535.

WHEREFORE, the OPC respectfully requests that the Commission reduce Staff's proposed revenue requirement, as specified in Staff's Amended Recommendation, by $430,535.[13]

Respectfully submitted,

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[13] This would result in the following revenue requirements for each of MAWC's rate districts: STL County Water is $11,956,304, Other Water $2,976,761, Arnold Sewer $1,673 and Other Sewer $201,878. (Riley Memorandum 3).

CERTIFICATE OF SERVICE

I hereby certify that copies of the forgoing will be emailed to all counsel of record this 9th day of February 2026.

/s/ Lindsay VanGerpen