

# Exhibit No. 103

Staff – Exhibit 103  
Keith D. Foster  
Direct Testimony (Cost of Service)  
File No. WR-2022-0303

*Exhibit No.:*

*Issue(s): Report on Revenue  
Requirement Direct Filing;  
Overview of Staff's Filing;  
Current and Deferred Income Tax;  
ADIT; Tax Cut and Jobs Act of 2017*

*Witness: Keith D. Foster*

*Sponsoring Party: MoPSC Staff*

*Type of Exhibit: Direct Testimony*

*Case No.: WR-2022-0303*

*Date Testimony Prepared: November 22, 2022*

**MISSOURI PUBLIC SERVICE COMMISSION**

**FINANCIAL & BUSINESS ANALYSIS DIVISION**

**AUDITING DEPARTMENT**

**DIRECT TESTIMONY**

**OF**

**KEITH D. FOSTER**

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2022-0303**

*Jefferson City, Missouri  
November 2022*

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**KEITH D. FOSTER**

**MISSOURI-AMERICAN WATER COMPANY**

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1 **DIRECT TESTIMONY**

2 **OF**

3 **KEITH D. FOSTER**

4 **MISSOURI-AMERICAN WATER COMPANY**

5 **CASE NO. WR-2022-0303**

6 Q. Please state your name and business address.

7 A. Keith D. Foster, 200 Madison Street, Suite 440, Jefferson City, MO 65101.

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

9 A. I am a Utility Regulatory Supervisor for the Missouri Public Service  
10 Commission (“Commission”).

11 Q. Please describe your educational background and work experience.

12 A. I have been employed as a member of Commission Staff (“Staff”) since  
13 January 2008. After a 27-year career in the Information Systems (IS) industry, I returned to  
14 college and earned a Bachelor of Science degree in Business Administration, major in  
15 Accounting from Columbia College. I graduated summa cum laude in October 2007.

16 Q. Have you previously filed testimony before the Commission?

17 A. Yes, numerous times. Please refer to Schedule KDF-d1, attached to this  
18 Direct Testimony, for a list of the audits in which I have assisted and filed testimony with  
19 the Commission.

20 Q. What knowledge, skills, experience, training and education do you have in the  
21 areas of which you are testifying as an expert witness?

22 A. I have received continuous training at in-house and outside seminars on  
23 technical ratemaking matters since I began my employment at the Commission. I have been

1 employed by this Commission as a Regulatory Auditor for over 14 years, and have submitted  
2 testimony on ratemaking matters numerous times before the Commission. I have performed  
3 and led rate audits and prepared miscellaneous filings as ordered by the Commission.  
4 In addition, I reviewed all exhibits and testimony on assigned issues, developed accounting  
5 adjustments, and issued positions which are supported by workpapers and written testimony.  
6 For cases that did not require prepared testimony, I prepared Staff Recommendation  
7 Memorandums. I have also been responsible for the supervision of other Commission  
8 employees in rate cases and other regulatory proceedings.

9 **EXECUTIVE SUMMARY**

10 Q. Please summarize your direct testimony in this proceeding.

11 A. I am sponsoring Staff's Direct Accounting Schedules in this proceeding. I also  
12 provide in this direct testimony an overview of Staff's revenue requirement determination.  
13 Staff has conducted a review of all the components (capital structure, return on rate base, rate  
14 base, operating revenues, and operating expenses) that determine Missouri-American Water  
15 Company's ("MAWC's") revenue requirement. In addition, I will address Staff's positions on  
16 the issues of Current and Deferred Income Tax, Accumulated Deferred Income Tax ("ADIT"),  
17 and Excess ADIT ("EADIT") for the Tax Cuts and Jobs Act of 2017 ("TCJA").

18 **REVENUE REQUIREMENT DIRECT TESTIMONY**

19 Q. Please briefly describe the direct testimony Staff has filed for this rate case.

20 A. Each Commission Staff witness' Direct Testimony is organized by the issues  
21 she or he is sponsoring, providing an explanation or description of each specific area and  
22 Staff's adjustments to the test year ending June 30, 2022. The following table lists each  
23 Commission Staff witness and the issues they are sponsoring and discussing in their  
24 respective direct testimony:

1

<b>Staff Witness</b>	<b>Issues Sponsored</b>
Bolin, Kimberly K.	COVID-19 Accounting Authority Order (“AAO”) Amortization; Test Year/True-Up/Discrete Adjustments
Branson, Alexis L.	Contributions in Aid of Construction (“CIAC”) – Amortization of CIAC, Office Supply and Services Expense; Promotional Items; PSC Assessment Expense
Coffer, Amanda	Depreciation
Harris, Andrew	Main Breaks and Water Loss Reporting
Horton, Courtney	Employee Expenses; Lobbying Expenses; Payroll Expense, Payroll Taxes, and Employee Benefits; Incentive Compensation; Property Tax Expense; Rate Case Expense; Customer Commodity Revenues; Amortization of Regulatory Assets; Advertising Expense; Bad Debt Expense; Capitalized Depreciation; Outside Services Expense; Credit Card Fees
Jennings, Randall	Rate of Return
Lesmes, Sherrye	Dues and Donations Expense; Postage Expense; Penalties Expense; Other Rate Base Items (Materials and Supplies, Customer Advancements, and Prepayments)
McMellen, Amanda C.	Plant; Depreciation Reserve
Niemeier, Angela	Cash Working Capital; Building Maintenance Expense; Hydrant Painting; Main Break Expense; Maintenance Supplies and Services Expense; Miscellaneous Expenses; Tank Painting Expense; Valve Maintenance Expense; Insurance Expense (Other Than Employee Group Insurance); Injuries and Damages Expense; Lease Expense; Transportation Expense; Telecommunication Expense; Waste Disposal Expense
Robertson, Jarrod J.	Normalized Residential Customer Usage
Sarver, Ashley	Pensions and Other Post-Employment Benefits (“OPEBs”); Corporate Allocations and American Water Works Service Company, Inc. (“Service Company”) Expenses; District Allocations; System Delivery; Chemicals Expense; Fuel and Power Expense; Purchased Water Expense; Revenues; Rate Case Expense
Thomason, Charles Tyrone	Customer Service

2

1 Staff may have different or additional experts/witnesses for rebuttal or surrebuttal testimony as  
2 this case proceeds.

3 **OVERVIEW OF STAFF'S RECOMMENDED REVENUE REQUIREMENT**

4 Q. How does one determine the revenue requirement for a regulated utility?

5 A. The first step is to calculate the utility's cost of service.

6 Q. In its audit of MAWC for Case No. WR-2022-0303, has Staff examined all  
7 of the components comprising the cost of service for MAWC's water and sewer operations  
8 in Missouri?

9 A. Yes.

10 Q. What are the cost-of-service components that comprise the cost of service for a  
11 regulated, investor-owned public utility?

12 A. The cost of service for a regulated, investor-owned public utility can be defined  
13 by the following formula:

14 Cost of Service = Cost of Providing Utility Service

15 or

16  $COS = O + (V - D)R$  where,

17 COS = Cost of Service

18 O = Operating Costs (Fuel, Payroll, Maintenance, etc.), Depreciation  
19 and Taxes

20 V = Gross Valuation of Property Required for Providing Service  
21 (including plant and additions or subtractions of other rate base items)

22 D = Accumulated Depreciation Representing Recovery of Gross  
23 Depreciable Plant Investment

24  $V - D$  = Rate Base (Gross Property Investment less Accumulated  
25 Depreciation = Net Property Investment)

26  $(V - D)R$  = Return Allowed on Rate Base

1 In the past, the terms “cost of service” and “revenue requirement” have sometimes been used  
2 interchangeably. However, in this rate case, Staff will use the term “revenue requirement”  
3 to instead, only refer to the utility’s necessary incremental change in revenues based on  
4 measurement of the utility’s current total cost of service compared to its current revenue levels  
5 under existing rates.

6 Q. What is the objective of an audit of a regulated, investor-owned public utility for  
7 ratemaking purposes?

8 A. The objective of an audit is to determine the appropriate level of the components  
9 identified in my previous answer in order to calculate the revenue requirement for such a  
10 regulated utility. All relevant factors are examined and a proper relationship of revenues,  
11 expenses, and rate base is maintained. The process for making that revenue requirement  
12 determination can be summarized as follows:

13 (1) Selection of a test year. The test year income statement represents the  
14 starting point for determining a utility’s existing annual revenues, operating costs, and net  
15 operating income. Net operating income represents the return on investment based upon  
16 existing rates. The test year approved by this Commission for Case No. WR-2022-0303 is the  
17 twelve months ending June 30, 2022. “Annualization,” “normalization,” and “disallowance”  
18 adjustments are made to the test year results when the unadjusted amounts do not fairly  
19 represent the utility’s most current, ongoing, and appropriate annual level of revenues and  
20 operating costs. Annualization, normalization, and disallowance adjustments are explained in  
21 more detail later in this direct testimony.

22 (2) Selection of a “test year update period.” A proper determination of  
23 revenue requirement is dependent upon matching the rate base, return on investment, revenues,



1 and operating costs components at the same point in time. This ratemaking principle is  
2 commonly referred to as the “matching” principle. It is a standard practice in ratemaking  
3 in Missouri to utilize a period beyond the established test year in which to match the  
4 major components of a utility’s revenue requirement. By updating test year financial  
5 results to reflect information beyond the established test year, rates can be set based upon  
6 more current information. MAWC chose not to use an update period in this case; instead,  
7 MAWC proposed a true-up date with “discrete” adjustments- This is discussed in more detail  
8 in Staff witness Kimberly K. Bolin’s Direct Testimony.

9 (3) Selection of a “true-up date” or “true-up period.” A true-up date  
10 generally is established when a significant change in a utility’s cost of service occurs after the  
11 end of the test year update period, but prior to the operation-of-law date, and the significant  
12 change in cost of service is one the parties have recommended and the Commission has decided  
13 should be considered for cost-of-service recognition in the current case. In this proceeding, the  
14 true-up date approved by the Commission is December 31, 2022.<sup>1</sup>

15 (4) Determination of Rate of Return. A cost-of-capital analysis must be  
16 performed to allow MAWC the opportunity to earn a fair rate of return on its net investment  
17 (“rate base”) used in the provision of utility service. Staff witness Randall T. Jennings, of the  
18 Commission’s Financial Analysis Department, has performed a cost-of-capital analysis for  
19 which he explains and provides the results of his analysis in his direct testimony.

20 (5) Determination of Rate Base. Rate base represents the utility’s net  
21 investment used in providing utility service, on which the utility is permitted the opportunity to  
22 earn a return. For its direct filing, Staff has determined MAWC’s rate base as of June 30, 2022,

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<sup>1</sup> Case No. WR-2022-0303, *Order Setting Procedural Schedule*, August 17, 2022.

1 consistent with the end of the test year period established for this case. Rate base includes  
2 plant-in-service (plant fully operational and used for service), cash working capital, CIAC,  
3 materials and supplies, prepayments, accumulated reserve for depreciation, accumulated  
4 deferred income tax, etc.

5 (6) Net Operating Income from Existing Rates. The starting point  
6 for determining net income from existing rates is the unadjusted operating revenues,  
7 expenses, depreciation, and taxes for the test year, which is the twelve-month period ending  
8 June 30, 2022, for this case. All of the utility's specific revenue and expense categories are  
9 examined to determine whether the unadjusted test year results require adjustments in order  
10 to fairly represent the utility's most current level of operating revenues and expenses.  
11 Numerous changes occur during the course of any year that will impact a utility's annual level  
12 of operating revenues and expenses. The June 30, 2022, test year has been adjusted to reflect  
13 Staff's determination of the appropriate ongoing levels of revenues and expenses.

14 (7) Determination of Net Operating Income Required. The net operating  
15 income required for MAWC is calculated by multiplying Staff's recommended rate of return  
16 by the rate base. Net operating income required is then compared to net income available from  
17 existing rates discussed in Item 6 above. The difference, when factored-up for income taxes,  
18 represents the incremental change in the utility's rate revenues required to cover its operating  
19 costs and to provide a fair return on investment used in providing water and sewer service.

20 If a utility's current rates are insufficient to cover its operating costs and  
21 provide a fair return on investment, the comparison of net operating income required  
22 (Rate Base x Recommended Rate of Return) to net income available from existing rates  
23 (Operating Revenue less Operating Costs, Depreciation, and Income Taxes) will result in a

1 positive amount, which would indicate that the utility requires a rate increase. If the comparison  
2 results in a negative amount, this indicates that the utility's current rates may be excessive.

3 **Types of Adjustments**

4 Q. Please identify the types of adjustments that are made to unadjusted test year  
5 results in order to reflect a utility's current annual level of operating revenues and expenses.

6 A. The types of adjustments made to reflect a utility's current annual operating  
7 revenues and expenses are:

8 (1) Normalization adjustments. Utility rates are intended to reflect normal  
9 ongoing operations. Normalization adjustments are proposed to eliminate abnormally high or  
10 low individual revenue and expense amounts incurred within the test year in order to  
11 reflect only normal and ongoing levels of costs in setting prospective utility rates. One  
12 example of this type of adjustment is overtime expense; Staff may normalize overtime expense  
13 to remove the effects an unusual weather event that required higher than usual overtime expense  
14 to be incurred.

15 (2) Annualization adjustments. Annualization adjustments are required  
16 when changes have occurred during the test year, update and/or true-up period, which are  
17 not fully reflected in the unadjusted test year results. Annualization adjustments are proposed  
18 to reflect the most current trends evident for an individual expense or revenue item in  
19 setting utility rates. For example, MAWC's union employees receive wage increases per  
20 their respective collective bargaining agreements at different times of the year. Because  
21 MAWC's test year is for the twelve months ended June 30, 2022, any increases made between  
22 July 1, 2021, and June 30, 2022 are not fully reflected in its test year payroll totals. For example,  
23 if one union's employees had wage increases effective on January 1, 2022, six months of

1 the net increase would not be included in MAWC's test year expenses. As a result, in its  
2 calculation of payroll expense, Staff used payroll rates in effect at the end of the update period,  
3 June 30, 2022. An adjustment to the test year was made to capture the financial impact of payroll  
4 increases that occurred at varying times throughout the test year to reflect the annualized payroll  
5 expense in effect at June 30, 2022.

6 (3) Disallowance adjustments. Disallowance adjustments are made to  
7 eliminate costs in the test year results that are not considered prudent, reasonable, appropriate,  
8 and/or not of benefit to Missouri ratepayers and thus not appropriate for recovery from  
9 ratepayers. An example in this case is certain incentive compensation costs. It is Staff's position  
10 that a portion of these costs are incurred to primarily benefit shareholder interests and it is not  
11 appropriate policy to pass these costs on to customers in rates, since these costs do not benefit  
12 ratepayers. Therefore, these costs should be eliminated from the cost of service borne by  
13 ratepayers and Staff has proposed to disallow these costs from recovery in rates. Staff witness  
14 Courtney Horton addresses this in her direct testimony.

15 (4) Pro forma adjustments. Pro forma adjustments reflect the impact of  
16 items and events that occur subsequent to the test year and test year update period. These items  
17 or events significantly impact the revenue, expense, and rate base relationship and should be  
18 recognized to address the forward-looking objective of the test year. Caution must be exercised  
19 when including pro forma adjustments in a recommended cost of service to ensure that all items  
20 and events subsequent to the test year are also examined and any appropriate offsetting  
21 adjustments are included as well. In addition, some post-test year items and events may not  
22 have occurred yet and/or may not be capable of adequate quantification at the time of the case  
23 filing. As a result, quantification of pro forma adjustments may be more difficult than the

1 quantification of other adjustments. As a consequence, use of a true-up audit that considers a  
2 full range of auditable items and events that occur subsequent to the test year, and also attempts  
3 to address the maintenance of the proper relationship among revenues, expenses, and  
4 investment at a consistent point in time is generally a superior approach than considering  
5 stand-alone pro forma adjustments for inclusion in the cost of service.

6 **Staff's Recommendation**

7 Q. What rate increase amount, based on what return on equity ("ROE") percentage,  
8 did MAWC request from the Commission in this case?

9 A. MAWC requested that its annual revenues be increased by approximately  
10 \$99.6 million based on an ROE of 10.50%.

11 Q. Please describe Staff's direct case revenue requirement filing in this proceeding.

12 A. The results of Staff's audit of MAWC's rate case request can be found in  
13 the Staff's filed Accounting Schedules and is summarized on Accounting Schedule 1,  
14 Revenue Requirement. This Accounting Schedule shows that Staff's recommended  
15 revenue requirement for MAWC in this proceeding is \$57,184,414 based upon a mid-point  
16 recommended rate of return ("ROR") of 6.38%. Staff is recommending a mid-point ROE  
17 of 9.73% with a range of 9.48% to 9.98% as calculated by Staff witness Randall T. Jennings.  
18 Staff's revenue requirement at low and high is \$54,398,628 to \$59,970,200 based upon a  
19 ROR range of 6.28% to 6.48%.

20 Q. What items are included in the Staff's recommended rate base in this case?

21 A. All rate base items were determined as of the test year period ending  
22 June 30, 2022, either through a balance on MAWC's books as of that date or a 13-month  
23 average balance ending on June 30, 2022. Items in the Staff's rate base include:

1 Plant-in-Service, Accumulated Depreciation Reserve, CIAC), Customer Advances, Cash  
2 Working Capital, Materials and Supplies, Prepayments, Pension and OPEBs Trackers, and the  
3 ADIT reserve.

4 Q. What are the significant income statement adjustments Staff made in  
5 determining MAWC's revenue requirement for this case?

6 A. A summary of the Staff's significant income statement adjustments follows:

7 *Operating Revenues*

8 Retail revenues were adjusted for a five-year normalized level of residential customer  
9 usage, customer growth, and the elimination of unbilled revenue. Other water and sewer  
10 revenues were adjusted for late payment charges, rents, collection for others, non-sufficient  
11 fund check charges, application/initiation fees, the provision of usage data to other entities,  
12 reconnection fees, frozen meter fees, after hour charges, and miscellaneous service.

13 *Operating Expenses*

- 14 • Payroll expense annualized for all known wage increases through  
15 June 30, 2022, and changes in employee levels through June 30, 2022.
- 16 • Payroll taxes and Employee Benefit Costs consistent with the payroll  
17 annualization.
- 18 • Incentive compensation and restricted stock awards disallowances.
- 19 • Employee benefits including pensions and OPEBs.
- 20 • Maintenance.
- 21 • Purchased Water.
- 22 • Purchased Power.
- 23 • Chemicals.
- 24 • Rents and Leases.
- 25 • Insurance Expense.
- 26 • Property Tax Expense.
- 27 • Uncollectible Expense.

- 1 • Corporate Allocations.
- 2 • Rate case expense adjustment.
- 3 • Disallowance of certain dues and donations and miscellaneous expenses.
- 4 • Income Taxes.
- 5 • Depreciation Expense.

6 **Staff's Contribution**

7 Q. How do the various members of Staff contribute to a combined work product?

8 A. All of the Staff auditors, including myself, relied on the work from numerous  
9 other Staff members in calculating a revenue requirement for MAWC in this case. Normalized  
10 residential customer usage and the recommended rate of return are some examples of data and  
11 analysis supplied to the Auditing Department as inputs into the Staff's revenue requirement  
12 cost-of-service calculation. Each Staff member who contributed in calculating Staff's revenue  
13 requirement has submitted direct testimony in this case discussing the issues for which they  
14 were assigned and her or his recommendation. Signed affidavits and the qualifications for all  
15 Staff members who are responsible for issues addressed in Staff's direct testimony in this rate  
16 proceeding are attached to each Staff member's testimony.

17 **Differences Between Staff's and MAWC's Proposed Revenue Requirements**

18 Q. What are the biggest differences between the rate increase request filed by  
19 MAWC and the Staff revenue requirement recommendations being filed in this proceeding?

20 A. There are two primary revenue requirement differences.

- 21 • Return on Equity (ROE) and Capital Structure – Issue Value – (\$32.6 million).  
22 As previously stated, MAWC's return on equity recommendation is 10.50%, while  
23 Staff has developed a mid-point recommendation of 9.73%. The difference between  
24 MAWC's recommended ROE and capital structure and Staff's recommended

1 mid-point for ROE and capital structure is approximately \$32.6 million in revenue  
2 requirement, with MAWC having the higher revenue requirement value.

3 • Discrete Adjustments – Issue Value – (\$26.3 million). MAWC has proposed  
4 discrete adjustments to certain rate base, revenue, and expense items as of  
5 May 31, 2023, the operation of law date in this case. Staff has chosen not to make  
6 any discrete or isolated adjustments past the true-up date of December 31, 2022.  
7 MAWC’s proposed discrete adjustments result in a higher revenue requirement.  
8 Staff has estimated this value to \$26.3 million.

9 There are other significant differences between Staff and MAWC, based upon their  
10 respective direct filings. However, these items are less significant than the differences  
11 discussed above.

12 Q. Is it possible that significant differences exist between Staff’s revenue  
13 requirement positions and those of other parties besides MAWC in this proceeding?

14 A. Yes. However, the other parties are filing their prepared direct testimony, if any,  
15 concurrently with the Staff’s direct filing. Until Staff has a chance to examine the direct  
16 testimony of the other parties, it is impossible for Staff to determine what differences exist and  
17 how material they may be.

18 Q. Please identify the Staff experts/witnesses responsible for addressing each area  
19 where there is a known and significant difference between Staff and MAWC as addressed above  
20 in this direct testimony.

21 A. The Staff experts/witnesses for each listed issue are as follows:

<u>Issue</u>	<u>Staff Witness</u>
Return on Equity	Randall T. Jennings
Discrete Adjustments	Kimberly K. Bolin



1 Q. When will the Staff be filing its customer class cost of service and rate design  
2 direct testimony and report in this proceeding?

3 A. Staff's customer class cost of service and rate design direct testimony and report,  
4 including schedules, will be filed on December 16, 2022.

5 **CURRENT AND DEFERRED INCOME TAX EXPENSE**

6 **Current Income Taxes**

7 Q. Please explain the calculation of current income tax expense in this case.

8 A. Current income tax for this case has been calculated by Staff consistent with  
9 the methodology used in the five prior MAWC rate cases, Case Nos. WR-2010-0131,  
10 WR-2011-0337, WR-2015-0301, WR-2017-0285, and WR-2020-0344. Adjustments are  
11 made to net income to compute the current income tax expense. These adjustments are  
12 effectuated by taking adjusted net income and either adding to or subtracting from the net  
13 income various timing differences to obtain net taxable income for ratemaking purposes.  
14 (The term "timing differences" refers to the differences in time when certain costs can be  
15 deducted for purposes of determining financial statement net income and taxable  
16 income, respectively.) The adjustments are the result of various financial statement ("book")  
17 and tax timing differences, as well as their implementation under separate tax ratemaking  
18 methods: flow-through versus normalization. The resulting net taxable income for ratemaking  
19 is then multiplied by the appropriate federal and state tax rates to obtain the current provision  
20 for income taxes. Staff used the current federal tax rate of 21 (twenty-one) percent and the state  
21 income tax rate of 4 (four) percent, in calculating MAWC's income tax liability. The difference  
22 between the calculated current income tax provision and the per book income tax provision is  
23 the current income tax provision adjustment.

1 Q. What are the tax timing differences Staff used to calculate current income tax?

2 A. The tax timing differences used in calculating taxable income for computing  
3 current income tax are as follows:

4 Additions to Operating Income Before Taxes:

5 Book Depreciation Expense

6 Non-Deductible Expenses – Non-deductible meals and dues

7 Book Amortization

8 Subtractions from Operating Income:

9 Interest Expense – Weighted Cost of Debt times Rate Base

10 Tax Depreciation – Straight-Line

11 Tax Depreciation – Excess

12 Repairs Expense

13 **Deferred Income Taxes**

14 Q. Please explain deferred income tax expense as it relates to this case.

15 A. When a tax timing difference is reflected for ratemaking purposes in the  
16 deferred tax adjustment consistent with the timing used in determining taxable income for  
17 the calculation of current income tax payable to the IRS, the timing difference is given a  
18 “flow-through” treatment.

19 When a current year timing difference is deferred and recognized for ratemaking  
20 purposes consistent with the timing used in calculating pre-tax operating income in the  
21 financial statements, then that timing difference is given “normalization” treatment for  
22 ratemaking purposes. Deferred income tax expense for a regulated utility reflects the tax  
23 impact of “normalizing” tax timing differences for ratemaking purposes. Current IRS rules for  
24 regulated utilities essentially require normalization treatment for the timing difference related  
25 to accelerated depreciation.

1           For most utilities, it is necessary to break out a utility's tax depreciation into  
2 two separate components: tax straight-line depreciation and excess tax depreciation.  
3 Tax straight-line depreciation is different from book straight-line depreciation due to the  
4 different tax basis of property allowed under the tax code. Excess tax depreciation differs from  
5 straight-line book depreciation due to the higher depreciation rates allowed in the early years  
6 of an asset's life under the current tax code as compared to "straight-line" book depreciation  
7 rates. To calculate excess tax depreciation, Staff used the total tax depreciation amount  
8 included in MAWC's filing in this case. Most tax basis differences were eliminated for assets  
9 placed into service after 1986 due to the Tax Reform Act ("TRA") enacted that year.

10 **ACCUMULATED DEFERRED INCOME TAXES (ADIT)**

11           Q.     Please explain Accumulated Deferred Income Taxes ("ADIT").

12           A.     MAWC's ADIT represents, in effect, a net prepayment of income taxes by  
13 customers prior to tax payment by MAWC. For example, because MAWC is allowed to deduct  
14 depreciation expense on an accelerated basis for income tax purposes, the amount of  
15 depreciation expense used as a deduction for income taxes purposes by MAWC is considerably  
16 higher than the amount of depreciation expense used for ratemaking purposes. This results in  
17 what is referred to as a "book-tax timing difference," and creates a deferral of income tax  
18 reserves to the future. The net credit balance in the ADIT account's reserve represents a source  
19 of cost-free funds to MAWC. Therefore, MAWC's rate base is reduced by the ADIT balance  
20 to avoid having customers pay a return on funds that are provided cost-free to MAWC.  
21 Generally, deferred income taxes associated with all book-tax timing differences created  
22 through the ratemaking process should be reflected in rate base.

1 Q. What is the amount of ADIT Staff included in its rate base offset?

2 A. Staff has included the ADIT balance as of June 30, 2022, in the amount of  
3 \$514,228,249 in rate base.

4 **AMORTIZATION OF EXCESS ADIT FOR THE TAX CUTS AND JOB ACT OF 2017**  
5 **("TCJA")**

6 Q. Briefly describe TCJA.

7 A. The Tax Cuts and Job Act was signed into law in December 2017, and as part  
8 of that law a reduction in the federal corporate tax rate required the revaluation of accumulated  
9 deferred tax timing differences that were previously recorded assuming a 35% federal tax rate  
10 to be revalued at the new 21% federal tax rate. Also, effective January 1, 2020, the Missouri  
11 state corporate tax rate was reduced from 6.25% to 4%. This also caused a need for additional  
12 revaluation of accumulated tax timing differences.

13 Q. What impact did this have on customers?

14 A. The excess federal deferred tax value is required to be returned to customers  
15 over a time period based on whether the excess deferred taxes are protected or unprotected.  
16 Protected excess ADIT is the portion associated with accelerated depreciation tax timing  
17 differences that must be "normalized" for ratemaking purposes. The flow back of protected  
18 excess ADIT cannot be returned to a customer any more quickly than over the estimated  
19 remaining life of the assets that gave rise to the ADIT. Unprotected federal excess ADIT is the  
20 portion of the deferred tax reserve that resulted from normalization treatment of tax timing  
21 differences other than accelerated depreciation. Unprotected federal excess ADIT is to be  
22 flowed back to customers over a period of time set by the Commission at its discretion.

1           There is no distinction between protected and unprotected status for state excess ADIT,  
2 and the entire balance of that amount can be flowed back to customers over a period of time set  
3 by the Commission at its discretion.

4           Q.     What did the Commission order in MAWC's prior rate cases?

5           A.     In the Stipulation and Agreement filed March 1, 2018, in Case No.  
6 WR-2017-0285, MAWC agreed to create a tracker that would capture the flow back of  
7 excess ADIT that would have occurred starting on January 1, 2018, and continuing until  
8 the next rate case (Case No. WR-2020-0344). At that time, the tracker balance would  
9 be amortized over five years. Recovery of the deferred EADIT beyond the next rate case  
10 (Case No. WR-2020-0344) was not addressed. On April 7, 2021, the Commission ordered this  
11 in its Order Approving Stipulation and Agreement.

12           In the Stipulation and Agreement filed March 5, 2021, in the previous rate case  
13 (Case No. WR-2020-0344), a "stub period" of EADIT beginning January 1, 2018, through the  
14 date in which rates went into effect for that case (May 28, 2021), would be amortized over  
15 two and a half years beginning May 28, 2021, and unprotected EADIT would be amortized  
16 over ten years. In addition, it was agreed that a tracker would be created to capture the  
17 differences between protected EADIT returned to the customers as a part of the revenue  
18 requirement for Case No. WR-2020-0344, and the actual amortization period for the non-stub  
19 period unprotected EADIT balances.

20           Q.     What does Staff recommend in this case?

21           A.     In this case, Staff recommends continuing the amortization of the unprotected  
22 excess ADIT (plant and non-plant) over a ten-year period, similar to what was ordered in the  
23 previous case.

1 Q. What amortization amounts is Staff including in this case?

2 A. The following are the amortization amounts included in Staff's cost of service  
3 and reflected on the Income Tax Schedule in Staff's Accounting Schedules:

4	Federal Protected Plant	\$935,300
5	Federal Protected Non-Plant	\$(105,832)
6	Federal Unprotected Plant	\$6,992,007
7	State Unprotected Plant	\$2,809,244
8	Federal Unprotected Non-Plant	\$(1,712,021)
9	State Unprotected Non-Plant	<u>\$(516,665)</u>
10	Total	\$8,402,033

11 The above table shows that a net return to customers of excess federal and state ADIT of  
12 approximately \$8.4 million has been included in Staff's case. Pursuant to the agreement in the  
13 last rate case, this \$8.4 million also includes the five-year amortization of a tracker to capture  
14 the differences between protected EADIT returned to the customers as a part of the revenue  
15 requirement for Case No. WR-2020-0344, and the actual amortization period for the non-stub  
16 period unprotected EADIT balances.

17 Q. Does Staff have a recommendation regarding the 2.5 year amortization of the  
18 "stub period" established in the Case No. WR-2020-0344 Stipulation and Agreement?

19 A. Yes it does. The 2.5 year amortization of the "stub period" EADIT was included  
20 in rates that went into effect for Case No. WR-2020-0344 on May, 28, 2021. The operation of  
21 law date for the current case, Case No. WR-2022-0303, is May 28, 2023. By that time,  
22 two years of the 2.5 years of "stub period" amortization will have been returned to the  
23 ratepayers, leaving one-half year to be returned. MAWC has proposed to return the remaining

Direct Testimony of  
Keith D. Foster

1 six months amortization to the ratepayers as a one-time credit on its customers' bills. Staff is  
2 not opposed to this and, therefore, has excluded the remaining six months "stub period"  
3 amortization from its revenue requirement. Staff further recommends that MAWC be required  
4 to issue the credit to ratepayer bills and notify Staff when it has done so, within six months of  
5 the effective date of an order issued by the Commission in this case.

6 Q. Does this conclude your prepared direct testimony in this proceeding?

7 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

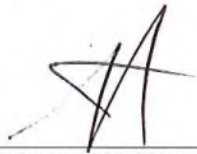
In the Matter of Missouri-American Water )  
Company's Request for Authority to ) Case No. WR-2022-0303  
Implement General Rate Increase for Water )  
and Sewer Service Provided in Missouri )  
Service Areas )

**AFFIDAVIT OF KEITH D. FOSTER**

STATE OF MISSOURI )  
 ) ss.  
COUNTY OF COLE )

**COMES NOW KEITH D. FOSTER** and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Direct testimony of Keith D. Foster*; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.



\_\_\_\_\_  
**KEITH D. FOSTER**

**JURAT**

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 18<sup>th</sup> day of November 2022.

D. SUZIE MANKIN  
Notary Public - Notary Seal  
State of Missouri  
Commissioned for Cole County  
My Commission Expires: April 04, 2025  
Commission Number: 12412070

  
\_\_\_\_\_  
Notary Public



## Schedule KDF-d1 - Keith D. Foster

### Summary of case participation:

Case/Tracking Number	Company Name - Issue
QW-2008-0010	<b>Tri-States Utility, Inc.</b> - Property Taxes; Fuel & Electricity Expense; Telephone Expense; Rent Expense; Plant in Service; Depreciation Schedule, Reserve, Rates, and Expense; Transportation Expense; Chemicals Expense; Waste Disposal; Insurance Expense; Contractual Services; Bad Debt Expense; Miscellaneous Expenses
WR-2008-0311	<b>Missouri-American Water Company</b> - Advertising & Promotional Items; Dues and Donations; Cash Working Capital; Plant in Service; Depreciation Expense; Depreciation Reserve; Franchise Tax; Property Taxes; Fuel & Electricity Expense; Telephone Expense; Postage Expense; Purchased Water; Prepayments; Materials & Supplies; Customer Advances; Contributions in Aid of Construction (CIAC)
WR-2009-0098	<b>Raytown Water Company</b> - Materials & Supplies; Prepayments; Customer Deposits; Revenues; Insurance Expense; Utilities Expense; Directors Fees; Office Supplies Expense; Postage Expense; Laboratory Fees; Transportation Expenses; Rate Case Expense; Regulatory Commission Expense
GO-2009-0302	<b>Missouri Gas Energy</b> - Infrastructure Service Replacement Surcharge (ISRS)
SA-2009-0319	<b>Mid-MO Sanitation, LLC</b> – Certificate Case; All Revenue and Expenses; Plant in Service; Depreciation Reserve; Other Rate Base Items
GR-2009-0355	<b>Missouri Gas Energy</b> – Payroll, Payroll Taxes, 401(k), and Other Employee Benefit Costs; Incentive Compensation and Bonuses; Medical and Dental Expense; Bad Debt Expense; Rate Case Expense; Pension Expense; FAS106/OPEBs; Prepaid Pension Asset (PPA); Franchise Tax Expense; Income Tax Expense
SR-2010-0095	<b>Mid-MO Sanitation, LLC</b> – Full Audit of All Revenue and Expenses; Plant in Service; Depreciation Reserve; Other Rate Base Items
ER-2010-0130	<b>Empire District Electric</b> – Fuel and Purchased Power; Fuel Inventories; Gas Stored Underground; Off-System Sales; Transmission Revenue; Payroll, Payroll Taxes, and 401(k) Benefit Costs; Incentive Compensation; Maintenance Normalization Adjustments

## Schedule KDF-d1 - Keith D. Foster

Case/Tracking Number	Company Name - Issue
WR-2010-0304	<b>Raytown Water Company</b> – Revenues; Rate Case Expense; Regulatory Commission Expense; Utilities Expense; Purchased Water; Insurance Expense; Laboratory Fees; Communication Expense; Transportation Expense
GO-2011-0003	<b>Missouri Gas Energy</b> - Infrastructure Service Replacement Surcharge (ISRS)
ER-2011-0004	<b>Empire District Electric</b> – Fuel and Purchased Power; Fuel Inventories; Gas Stored Underground; Maintenance Normalization Adjustments; Miscellaneous Revenues (SO2 Allowances and Renewable Energy Credits); Operations and Maintenance (O&M) Expenses for Iatan 2 and Plum Point; Transmission Revenue; Entergy Transmission Contract; Reconciliation
WR-2011-0337	<b>Missouri-American Water Company</b> – Belleville Lab Allocations; Chemical Expense; Corporate and District Allocations; Fuel & Electricity Expense; Service Company Management Fees; Business Transformation Program; Reconciliation
WR-2012-0300	<b>Empire District Electric (Water)</b> – Plant-in-Service; Depreciation Reserve; Depreciation Expense; Materials and Supplies; Property Tax Expense; Customer Advances; Operations and Maintenance (O&M) Adjustment
WM-2012-0335	<b>Moore Bend Water Company</b> – Acquisition Case – Plant-in-Service; Depreciation Reserve; Depreciation Expense
ER-2012-0345	<b>Empire District Electric</b> – Fuel and Purchased Power; Fuel Inventories; Gas Stored Underground; Maintenance Normalization Adjustments (Operations and Maintenance Expense); Operations and Maintenance (O&M) Expense Trackers for Iatan 2, Iatan Common, and Plum Point; Entergy Transmission Contract; Reconciliation
WR-2013-0461 SR-2013-0459	<b>Lake Region Water &amp; Sewer</b> – Executive Management Fees; Current Income Taxes; Deferred Income Taxes; Payroll and Benefits; Payroll Taxes; Allocation Factors; Sludge Removal; Accounting Fees; Legal Fees (Other Than Rate Case Expense); Billing Expense; Outside Services; Travel & Entertainment Expense; Transportation Expense
GR-2014-0086	<b>Summit Natural Gas</b> – Acquisition Costs; Affiliate Transactions; Fuel Expense; Property Taxes; Other Miscellaneous Expenses; Income Taxes; Deferred Taxes; and Reconciliation

## Schedule KDF-d1 - Keith D. Foster

Case/Tracking Number	Company Name - Issue
WA-2015-0049 SA-2015-0107	<b>Branson Cedars Resort</b> – Certificate Case - All Revenue and Expenses; Plant in Service; Depreciation Reserve; Other Rate Base Items
WA-2015-0108	<b>Missouri-American Water Company (Redfield Water)</b> – Acquisition Case – Plant-in-Service; Depreciation Reserve; Depreciation Expense
WO-2015-0077	<b>Woodland Manor Water Company</b> – Acquisition Case – Plant-in-Service; Depreciation Reserve; Depreciation Expense; CIAC; Customer Deposits
WR-2015-0192	<b>Ozark International, Inc.</b> – Plant-in-Service; Depreciation Reserve; Depreciation Expense; CIAC; Customer Deposits; Chemicals Expense; Legal Expense; Office Expense; Postage; Water Testing Expense; Gas & Oil Expense
ER-2016-0023	<b>Empire District Electric</b> – Fuel and Purchased Power; Fuel Inventories; Gas Stored Underground; Software Maintenance Expense; Corporate Allocations; Outside Services; Iatan and Plum Point Carrying Costs
WR-2017-0110 SR-2017-0109	<b>Terre Du Lac Utilities Corporation</b> – Maintenance Expense; Rate Case Expense; Internet Service Expense; Telephone Expense; Payroll and Benefits; Payroll Taxes; Outside Services; Mileage Expense
WR-2017-0285 SR-2017-0286	<b>Missouri-American Water Company</b> – Central Lab Allocations; Corporate, Service Company, and Jurisdictional Allocations; Hydrant Painting; Income Taxes; Main Break Expense
HR-2018-0341	<b>Veolia Energy Kansas City</b> – Plant in Service; Accumulated Deferred Income Taxes; Fuel Expense; Consumables Expense; Insurance Expense; Outside Services; Property Taxes.
GO-2019-0115 GO-2019-0116	<b>Spire Missouri</b> – Infrastructure Service Replacement Surcharge (ISRS)
SA-2019-0334	<b>Missouri-American Water Company (Hillers Creek Sewer)</b> – Acquisition Case – Lead Auditor
SA-2020-0132	<b>Missouri-American Water Company (Clinton Estates Sewer)</b> – Acquisition Case – Lead Auditor
SA-2020-0067	<b>Liberty Utilities (Saver’s Farm Sewer)</b> – Acquisition Case – Lead Auditor

**Schedule KDF-d1 - Keith D. Foster**

Case/Tracking Number	Company Name - Issue
ER-2019-0374	<b>Empire District Electric</b> – Accumulated Deferred Income Tax (ADIT); Current and Deferred Income Tax; Southwest Power Pool (SPP) Revenues and Expenses; Corporate Allocations; Corporate Expenses.
WM-2020-0156	<b>Liberty Utilities (Missouri Water), LLC (Empire District Electric (Water))</b> – Acquisition Case – Lead Auditor
ER-2020-0311	<b>Empire District Electric</b> – FAC Case
WR-2020-0344 SR-2020-0345	<b>Missouri-American Water Company</b> – Pensions & OPEBs; Defined Contribution Plan (DCP) Expense; Accumulated Deferred Income Taxes (ADIT); Income Taxes
SA-2021-0120	<b>Missouri-American Water Company (City of Taos Sewer)</b> – Acquisition Case – Lead Auditor
WA-2021-0116	<b>Missouri-American Water Company (Table Rock Estates Water)</b> – Acquisition Case – Lead Auditor
SR-2021-0372	<b>Mid-MO Sanitation, LLC</b> – Lead Auditor
WO-2021-0343	<b>Missouri-American Water Company</b> – Infrastructure Service Replacement Surcharge (ISRS)
ET-2020-0259	<b>Empire District Electric</b> – Community Solar Application
ER-2021-0312	<b>Empire District Electric</b> - Accumulated Deferred Income Tax (ADIT); Current and Deferred Income Tax; Southwest Power Pool (SPP) Revenues and Expenses; Low Income Pilot Program (LIPP) Amortization; Plant in Service Accounting (PISA) Amortization.
GR-2021-0320	<b>Empire District Gas</b> – Co-Case Coordinator - Accumulated Deferred Income Tax (ADIT); Current and Deferred Income Tax; Rate Case Expense Sharing.
WM-2022-0186	<b>Foxfire Utility Co.</b> – Merger Case – Lead Auditor