

FILED<sup>3</sup>

MAY 25 2000

Missouri Public  
Service Commission

*Exhibit No.:*

*Issue:* *Deferred Income Taxes*  
*Corporate Allocations*

*Witness:* *DOYLE L. GIBBS*

*Sponsoring Party:* *MoPSC Staff*

*Type of Exhibit:* *Surrebuttal Testimony*

*Case No.:* *WR-2000-281 et al.*

FILED<sup>3</sup>  
MAY 25 2000  
Missouri Public  
Service Commission

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**DOYLE L. GIBBS**

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2000-281 et al.**

*Jefferson City, Missouri*  
*May, 2000*

1

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Surrebuttal Testimony of  
Doyle L. Gibbs

1           A.     No, not if a literal interpretation is made. A book/tax basis difference does  
2 not normally generate deferred income tax for ratemaking purposes. What generates  
3 deferred income tax expense, and the balance that is accumulated over time, is the  
4 difference between the accelerated depreciation expense deduction that is allowed for tax  
5 purposes and "tax straight line" depreciation expense. Tax straight line is the  
6 depreciation expense that is the result of applying book depreciation rates to the tax basis  
7 of the property, and accelerated depreciation expense results from applying accelerated  
8 depreciation rates to the tax basis of the property.

9           Q.     Mr. Salser also states on page 8 of his testimony that investment tax credit  
10 (ITC) created by Missouri Cities investment in utility plant is another component of the  
11 deferred income taxes. Would you please comment?

12          A.     There was accumulated deferred ITC on the books of Missouri Cities  
13 when it was acquired by the Company, however none of that ITC has been used by the  
14 Staff in this case to reduce rate base. Schedule 1, attached to my surrebuttal testimony, is  
15 the Company's response to Staff Date Request No. 41. As can be seen on this schedule,  
16 deferred ITC of \$582,242 is not included in the total deferred income tax balance that  
17 Staff has used in the determination of rate base.

18          Q.     What reasons has Mr. Salser provided to support his position that these  
19 deferred income taxes should not be used by the Staff to determine rate base?

20          A.     Mr. Salser states on page 8, lines 15 through 16, of his rebuttal testimony  
21 that these deferred income taxes should not be used to determine rate base because past  
22 actions by the Commission indicate that this should not be an issue and the Staff's  
23 proposed treatment is not allowed by Internal Revenue Service rules.

Surrebuttal Testimony of  
Doyle L. Gibbs

1           He describes, at lines 18 through 22 of page 8, two past actions of the  
2 Commission to support his position. The first being that the Company did not acquire the  
3 deferred taxes as part of the acquisition and the Commission knowingly approved the  
4 acquisition and secondly, the Company has completed two rate cases since the  
5 acquisition of Missouri Cities in which these deferred taxes were not an issue.

6           He describes his support for his position based on Internal Revenue Service (IRS)  
7 rules on page 9, lines 1 through 12, including reference to an IRS letter ruling attached to  
8 his rebuttal testimony as schedule JES-1.

9           Q.    Are these past actions of the Commission sufficient support of the  
10 Company position?

11          A.    No. If an issue has been litigated and a decision handed down on that  
12 issue by the Commission, there might be sufficient precedent assuming the underlying  
13 facts have not changed. That is not the current situation. The Commission has not made  
14 a decision concerning the Company on this issue because it has not been litigated before  
15 them.

16          Q.    Mr. Salser stated that the Commission knew when it approved the  
17 acquisition, that as part of the agreement, the deferred taxes would not be acquired by the  
18 Company. Would you agree?

19          A.    I can not speak to what the Commission knew specifically with regard to  
20 deferred income taxes when the acquisition was approved. However, at page 28 of the  
21 Order approving the acquisition it states:

Surrebuttal Testimony of  
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1 The Commission would add, as this was a concern of the intervenors, the Staff,  
2 and the Office of Public Counsel, that the issues of the potential merger of  
3 MCWC and MAWC, the responsibility for the resultant costs of acquisition, and  
4 any resultant rate increases, are not before the Commission in this case, and no  
5 finding will be made in that regard.  
6

7 It is fairly obvious from that statement that no commitment to ratemaking was being  
8 advanced by the approval of the acquisition.

9 Q. Should the fact that the Staff did not present deferred taxes as issues in the  
10 Company's two prior cases have any significance?

11 A. No. The Company seems to imply that there is a "statute of limitations"  
12 that applies to this issue. The Staff is not foreclosed from bringing this issue to the  
13 Commission simply because it has not been addressed in the past.

14 Q. Mr. Salser states on page 9 of his rebuttal testimony that the inclusion of  
15 these deferred income taxes in rate base is in violation of several sections of the Internal  
16 Revenue Code (IRC or Code) and he provides an IRS letter ruling in support of those  
17 assertions. What is your response?

18 A. First, I would like to point out that on the last page of the IRS letter ruling  
19 attached to Mr. Salser's rebuttal testimony it states that "This ruling is directed only to  
20 the taxpayer that requested it. Section 6110 (j) (3) of the Code provides that it may not  
21 be used or cited as precedent". [Emphasis added] As MAWC did not request the ruling  
22 that Mr. Salser referred to, the ruling is not "directed to" MAWC, and MAWC may not  
23 cite it as precedent. Furthermore, the ruling that Mr. Salser referred to was addressed to  
24 the parent company of a group of corporations that files a consolidated return; whereas  
25 MAWC is the subsidiary of its nonregulated parent, American Water Works Company,  
26 Inc., which files a consolidated return. The two situations are not analogous.

1           Secondly, all references by Mr. Salser to Section 46 are irrelevant because it  
2           pertains to ITC and, as previously stated, the Staff has not considered the ITC in the  
3           development of rate base.

4           Q.     Has this issue ever been presented to the Commission?

5           A.     The issue has appeared before the Commission, but it has not been  
6           litigated. In Case No. GM-94-40 involving the sale of the Missouri properties of Western  
7           Resources, Inc. to Southern Union Company, this particular issue was addressed in the  
8           Stipulation and Agreement that was presented and accepted by this Commission.

9           Q.     How was this issue addressed in Case No. GM-94-40?

10          A.     The Staff filed testimony in the case addressing ratepayer detriments with  
11          regard to the proposed sale/purchase due to the "loss" of the deferred taxes that were  
12          recorded on the books of the seller, Western Resources, Inc. In the Unanimous  
13          Stipulation and Agreement, Southern Union agreed to use an additional offset to rate base  
14          to compensate for the rate base deductions that were eliminated by the purchase  
15          transaction. The rate base reduction would be ratably reduced each year over the ten  
16          years following the purchase. In addition, regulatory income tax expense would be  
17          reduced in any general non-gas rate increase case completed within ten years of the date  
18          of closing of the subject transaction. The regulatory tax expense reduction is to  
19          compensate for the loss of the ITC amortization that would no longer occur as a result of  
20          the acquisition.

21          Q.     Do you perceive that the deferred tax issue will be a recurring item for this  
22          Company?

1           A.     Yes, I do. This could very well be an ongoing issue considering the recent  
2 purchases of St. Louis County Water Company and United Water Company by the  
3 Company.

4     **CORPORATE PLANT ALLOCATIONS**

5           Q.     Company rebuttal witness William M. Stout has taken exception to the  
6 Staff's allocation of Corporate plant. Please summarize the difference in allocation  
7 methodologies used by you and Mr. Stout to allocate corporate plant.

8           A.     There is essentially no difference in methodologies regarding the  
9 allocation of corporate plant. Mr. Stout and I both use the allocated corporate payroll as  
10 the basis for the allocation. (Because the Staff allocated corporate administrative and  
11 general (A&G) labor on the overall labor composite, the corporate labor allocation factor  
12 would be the same as the composite labor allocation factor.) Our difference, therefore,  
13 lies in the allocation of corporate labor, not the allocation of the corporate plant.

14          Q.     How did Mr. Stout allocate corporate A&G labor?

15          A.     Mr. Stout distinguishes A&G labor as fitting into five categories and  
16 allocates those categories on different factors, as seen on Table 1-B, Page 2 of 4 attached  
17 to his direct testimony.

18          Q.     Is it possible to break down A&G payroll into the categories identified by  
19 Mr. Stout?

20          A.     It would require some assumptions to be made for each employee's job  
21 responsibilities. The Company's chart of accounts does not provide for such  
22 identification and the Company's workpapers, provided to the Staff in support of its  
23 filing, do not include any such summary.



Surrebuttal Testimony of  
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1 sewer operations with any direct labor or any allocation of the corporate labor,  
2 labor-related benefit expense, fuel or power, management fees, regulatory expense,  
3 insurance or customer accounting. It is difficult to imagine how the sewer operations  
4 could function without support and some resulting expense. Sewer operations are  
5 minimal compared to water operations, but they cannot be totally ignored in the  
6 allocation of corporate costs.

7 Q. Mr. Stout states that the allocation of expenses to the St. Joseph district,  
8 based on the number of bills, reflects quarterly billing. Is he correct in his assertion?

9 A. In the Staff's filing of its direct testimony and Accounting Schedules, the  
10 allocation of costs to St. Joseph reflected the status quo as of the end of the test year with  
11 regard to billing practices. Staff now proposes that monthly billing be instituted.  
12 Accordingly, the cost allocation that the Staff presents in its testimony regarding true-up  
13 will be changed to reflect that position.

14 Q. Does this conclude your surrebuttal testimony?

15 A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**

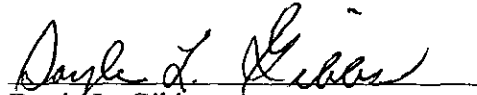
**OF THE STATE OF MISSOURI**

In the Matter of )  
Missouri-American Water Company's ) Case No. WR-2000-281 et al.  
Tariff Sheets Designed to Implement )  
General Rate Increases for Water and )  
Sewer Service provided to Customers in )  
the Missouri Service Area of the Company. )

**AFFIDAVIT OF DOYLE L. GIBBS**

STATE OF MISSOURI )  
 ) ss.  
COUNTY OF COLE )

Doyle L. Gibbs, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 8 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

  
Doyle L. Gibbs

Subscribed and sworn to before me this 25th day of May 2000.



SHARON S WILES  
NOTARY PUBLIC STATE OF MISSOURI  
COLE COUNTY  
MY COMMISSION EXP. AUG. 23, 2002

MISSOURI-AMERICAN WATER COMPANY  
CASE NO. WR - 00-281  
Missouri Public Service Commission  
Data Request #1

Requested From: Jim Salser  
Date Requested: 10/27/99  
Requested By: Doyle Gibbs  
Information Requested:

What was the deferred tax balances on the books of the Missouri Cities system that were "written down" to zero after the acquisition of the Avatar properties?

Information Provided:

Deferred Credits

Deferred Income Taxes	\$1,100,694
Deferred Investment Tax Credits	582,242
Regulatory Liability Income Tax Refundable Three Rates	829,832

Deferred Debits

Regulatory Asset-Income Tax Recoverable Three Rates	\$103,082
Other	954,119

726,750  
1,527,444 (1)

(1) Appears reasonable. DIT ratebase reduction in MCWC WR-92-207 was \$1,719,635

The attached information provided to the Missouri Public Service Commission Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the Missouri Public service Commission Staff if, during the pendency of Case No. WR-00-128 before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information.

If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the MISSOURI-AMERICAN WATER COMPANY office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title, number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies of data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control within your knowledge. The pronoun "you" or "your" refers to MISSOURI-AMERICAN WATER COMPANY and its employees, contractors, agents or others employed by or acting in its behalf.

Data Response Received:

3/16/2000 *DS*

Signed By:

*Jim Salser*

Prepared By:

*Jim Salser*