

Exhibit No.:
Issues: Income Taxes
Witness: Carl R. Meyers
Exhibit Type: Surrebuttal
Sponsoring Party: Missouri-American Water
Company
Case No.: WR-2015-0301
SR-2015-0302
Date: March 4, 2016

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2015-0301
CASE NO. WR-2015-0302**

SURREBUTTAL TESTIMONY

OF

CARL R. MEYERS

ON BEHALF OF


MISSOURI-AMERICAN WATER COMPANY

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

IN THE MATTER OF MISSOURI-AMERICAN)		
WATER COMPANY FOR AUTHORITY TO)		
FILE TARIFFS REFLECTING INCREASED)		CASE NO. WR-2015-0301
RATES FOR WATER AND SEWER)		CASE NO. SR-2015-0302
SERVICE)		

AFFIDAVIT OF CARL R. MEYERS

Carl R. Meyers, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of Carl R. Meyers"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony, he would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of his knowledge.



Carl R. Meyers

State of New Jersey
County of Camden
SUBSCRIBED and sworn to
Before me this 18 day of February 2016.



Notary Public

My commission expires:

BEVERLY A. VAZQUEZ
NOTARY PUBLIC OF NEW JERSEY
ID # 50014203
My Commission Expires 4/20/2020

SURREBUTTAL TESTIMONY

CARL R. MEYERS

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

My name is Carl R. Meyers and my business address is 131 Woodcrest Road,
Cherry Hill, New Jersey 08003.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by American Water Works Service Company, Inc. (“Service
Company”) as the Director of Income Tax. The Service Company is a subsidiary
of American Water Works Company, Inc. (“American Water” or “AWW”) that
provides support services to American Water’s subsidiaries, including Missouri-
American Water Company, Inc. (“MAWC”, or the “Company”).

Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS CASE?

A. Yes. I have submitted Direct Testimony and Rebuttal Testimony in this
proceeding.

**Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS
PROCEEDING?**

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimonies
of Charles R. Hyneman, submitted on behalf of the Office of the Public Counsel
(OPC), and Kofi A. Boateng, submitted on behalf of the Missouri Public Service
Commission Staff (Staff).

1 **Q. PLEASE EXPLAIN WHAT PART OF MR. HYNEMAN'S TESTIMONY TO**
2 **WHICH YOU ARE RESPONDING.**

3 **A.** I am responding to the claim he makes on pages 46 through 49 that the
4 Company has a different treatment for the capital structure and ROE (stand-
5 alone company basis) than for calculating income taxes (consolidated company
6 basis). I will also address Mr. Hyneman's misplaced recommendation that
7 MAWC should be subjected to affiliate rules because OPC could not impute
8 bonus depreciation to the Company.

9
10 **Q. IS MR. HYNEMAN CORRECT THAT THE COMPANY TREATS INCOME**
11 **TAXES DIFFERENTLY THAN OTHER AREAS OF THE RATE CASE?**

12 **A.** No. MAWC treats them as required and on a stand-alone basis.

13
14 **Q. HOW DOES THE COMPANY RECORD INCOME TAXES ON ITS BOOKS AND**
15 **RECORDS?**

16 **A.** MAWC treats income taxes on a stand-alone basis. Let me explain. First,
17 American Water starts with Pre-tax Income or Loss based on the stand alone
18 results of each individual legal entity in the consolidated group. Second, based
19 on the book transactions of each individual company, including MAWC, we make
20 necessary tax adjustments to those entities based on the rules of the IRS, such
21 as for depreciation, to come up with Taxable Income or Loss for each legal entity.
22 American Water is required to consolidate taxable income for federal income tax
23 reporting purposes and file one return for the whole group. If the consolidated

1 group has a net operating loss, then that amount can be carried forward and
2 used in future years.

3 The allocation of the net operating loss is based on a long standing Tax Sharing
4 Agreement among the companies that make up the consolidated group of
5 American Water. Under that agreement, the individual company taxable income
6 or loss is first determined as described above. The consolidated loss is then
7 allocated to the companies generating the loss to the extent of their portion of
8 that total loss. The net operating loss is then reclassified from a current year tax
9 benefit/tax receivable to deferred tax benefit/deferred tax asset.

10
11 **Q. HOW DOES THE COMPANY RECORD INCOME TAXES IN THE RATE CASE**
12 **FILING?**

13 **A.** The income taxes in the rate case are based on stand-alone results. They start
14 with the general ledger amounts booked, as described above, and are projected
15 forward based on the book projections of the Company. No allocation of taxes
16 from the consolidated group or parent company is performed. In reviewing the
17 calculations in the rate case again, I would like to note that the net operating loss
18 was not utilized to bring the current liability shown on the rate case filing to zero.
19 While this does not change to total income tax expense in the case, it does
20 change the pieces of income tax expense, current and deferred income tax
21 expense.

1 **Q. DOES MAWC HAVE ENOUGH NET OPERATING LOSS CARRYFORWARD**
2 **ON A STAND ALONE BASIS?**

3 **A.** Yes, it has enough net operating loss generated in prior years to negate the
4 current income tax liability shown in the rate case.

5
6 **Q. DOES MR. HYNEMAN REVEAL WHAT IS THE REAL SOURCE OF HIS**
7 **CLAIM THAT THE TREATMENT OF INCOME TAXES IS DIFFERENT THAN**
8 **OTHER AREAS OF THE RATE CASE?**

9 **A.** Yes, he concedes that his unhappiness stems from the fact that American Water
10 made a decision to opt out of bonus depreciation, a tax deduction, in 2011 and
11 2013 to preserve its consolidated net operating losses and charitable
12 contributions, for which MAWC is a part. He concedes, however, at pages 48-
13 49 that OPC did not propose to impute bonus depreciation because they
14 recognized that to do so would violate the normalization provisions of the Internal
15 Revenue Code.

16
17 **Q. DOES MR. HYNEMAN SUGGEST SOME ALTERNATIVE APPROACH TO THE**
18 **IMPUTATION OF BONUS DEPRECIATION?**

19 **A.** Based on his mistaken assertion that MAWC is somehow “subsidizing”
20 American Water by not claiming bonus depreciation, he asks the Commission to
21 direct MAWC be subjected to the Missouri Commission’s Affiliate Transaction
22 Rules. governing gas and electric utilities.

23

1 **Q. DOES THIS RECOMMENDATION MAKE SENSE?**

2 A. No, these rules only pertain to the electric and gas industry and not to the
3 water/sewer industry. 4 CSR 240-40, section .015 states:

4 This rule is intended to prevent regulatory utilities from subsidizing their
5 non-regulated operations...The rule and its effective enforcement will
6 provide the public the assurance that their rates are not adversely
7 impacted by the utilities' nonregulated activities.
8

9 Also, it defines an affiliate transaction:

10 Affiliate transaction means any transaction for the provision, purchase or
11 sale of any information, asset, product or service, or portion of any product
12 or service, between a regulated...corporation and an affiliated entity, and
13 shall include all transactions carried out between any unregulated
14 business operation of a regulated...corporation and the regulated
15 business operations of a...corporation.
16

17 **Q. WHAT DOES THE AFFILIATE TRANSACTION RULES SAY REGARDING**
18 **INCOME TAX DEDUCTIONS?**

19 A. I have reviewed the rule and it does not appear to pertain to tax deductions taken
20 on the income tax return of a consolidated group. The decision of taking or not
21 taking an income tax deduction on a tax return is not a transaction between
22 affiliated companies, per the definition. In addition, the Company is not
23 subsidizing its non-regulated business with its regulated business, through its
24 income tax deductions. The benefits of any income tax deductions do not get
25 held on the parent company books, nor do detriments get allocated amongst the
26 subsidiary companies. It is based on stand-alone results only.
27

1 **Q. IS MR. HYNEMAN CORRECT IN CORRELATING THESE AFFILIATE**
2 **TRANSACTION RULES TO THE TAX TREATMENT OF INCOME TAX**
3 **DEDUCTIONS BY THE COMPANY ON ITS TAX RETURN AND THEREFORE**
4 **IN THE RATE CASE?**

5 A. No, not based on his reasoning or the facts I have demonstrated above. The
6 decision to take bonus depreciation has nothing to do with subsidization.
7 Furthermore, the affiliate rules, as I read them, are totally inapposite to tax
8 calculations. Mr. Hyneman is simply trying to apply the affiliate rules to a
9 situation to which they have no reasonable application based on the fact that he
10 doesn't like the IRS rules on bonus depreciation.

11
12 **Q. PLEASE EXPLAIN WHAT PARTS OF MR. BOATENG'S TESTIMONY TO**
13 **WHICH YOU ARE RESPONDING.**

14 A. First, on pages 2 and 3 of his rebuttal testimony, Mr. Boateng indicates that Staff
15 supports OPC witness Smith's position with regard to the Domestic Production
16 Deduction ("DPAD"). I have previously stated in my rebuttal testimony why Mr.
17 Smith's proposed imputation of DPAD is inappropriate and will not repeat that
18 here. Second, on page 3 and 4 of Mr. Boateng's rebuttal testimony, he states

19 ...Staff is not making any adjustment at this time to recognize the impact
20 of the failure of MAWC and its parent company AWW to take bonus
21 depreciation deduction. In the next MAWC rate case, Staff may perform
22 adjustments to impute a generic rate base offset balance for loss of the
23 ADIT that would have resulted had MAWC appropriately taken advantage
24 of the bonus depreciation in prior years.
25

26 **Q. WHY DOES THE COMPANY HAVE AN ISSUE WITH THIS STATEMENT?**

1 A. As explained in my rebuttal testimony (and recognized by OPC witnesses Smith
2 and Hyneman), this would be a violation of the IRS normalization rules. It would
3 provide an additional reduction to rate base, and benefit to ratepayers, by using a
4 different calculation than what was filed on the Company's income tax returns.
5 The Company would not be getting the cost-free capital from the IRS, but would
6 be required to provide the benefit to the ratepayers as if it did take the deduction.

7

8 **Q. ARE THERE ANY OTHER POINTS TO WHICH YOU WOULD LIKE TO**
9 **RESPOND ?**

10 A. Yes, Mr. Boateng also states

11 Alternatively, Staff may propose to include a parent company tax
12 deduction in future rate cases to address the fact that the parent company
13 made these decisions without regard for how it might impact MAWC and
14 its ratepayers.
15

16 **Q. WHY DOES THE COMPANY HAVE AN ISSUE WITH THIS STATEMENT?**

17 A. First of all, we are not going to respond to speculative claims. If, and when, Mr.
18 Boateng decides to propose such an adjustment, we will address it. It is also
19 worth noting that Mr. Boateng is talking about the effects of past business
20 decisions.. These were not made lightly and certainly not with the intent to be
21 detrimental to ratepayer. Had the decisions been made to elect bonus
22 depreciation, there were negative effects to MAWC as well as to the American
23 Water system, as a whole. This is explained in my Rebuttal Testimony to OPC
24 witness Smith.

25

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 A. Yes, it does.