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Exhibit No.:  
Issues: ISRS Accumulated Deferred Income  
Taxes, Normalization  
Witness: John R. Wilde  
Exhibit Type: Direct  
Sponsoring Party: Missouri-American Water Company  
Case No.: WO-2020-0190  
Date: May 22, 2020

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO. WO-2020-0190**

**DIRECT TESTIMONY**

**OF**

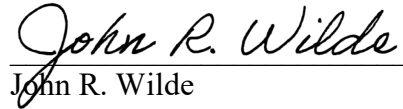
**JOHN R. WILDE**

**ON BEHALF OF**

**MISSOURI-AMERICAN WATER COMPANY**

## AFFIDAVIT

I, John R. Wilde, under penalty of perjury, and pursuant to Section 509.030, RSMo, state that I am Vice President, Tax Strategy and Compliance, for American Water Works Service Company, Inc., that the accompanying testimony and schedules have been prepared by me or under my direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, I would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of my knowledge and belief.

  
John R. Wilde

May 21, 2020  
Dated

**DIRECT TESTIMONY  
JOHN R. WILDE  
MISSOURI-AMERICAN WATER COMPANY  
CASE NO. WO-2020-0190**

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**DIRECT TESTIMONY****JOHN R. WILDE****I. INTRODUCTION**

1

2 **Q. Please state your name and business address.**3 A. My name is John R. Wilde, and my business address is One Water Street, Camden, NJ,  
4 08102.

5

6 **Q. By whom are you employed and in what capacity?**7 A. I am employed by American Water Works Service Company, Inc. (“Service  
8 Company”) as Vice President, Tax Strategy and Compliance. The Service Company  
9 is a subsidiary of American Water Works Company, Inc. (“American Water”) that  
10 provides services to American Water’s subsidiaries, including Missouri-American  
11 Water Company (“Missouri-American,” “MAWC” or the “Company”).

12

13 **Q. Please outline your educational background and professional experience.**14 A. I graduated from Saint Norbert College, De Pere, Wisconsin in 1984 with a Bachelor  
15 of Business Administration Degree in Accounting. I have a graduate certificate in state  
16 and local taxation, as well as a Master of Science Degree in Taxation from the  
17 University of Wisconsin-Milwaukee. I have over 35 years of experience as a tax and  
18 accounting professional serving utilities with regulated operations in multiple states.  
19 Before coming to American Water, I spent fifteen years as the head of tax for a  
20 corporate group (WEC Energy Group, Inc., formerly Integrys Energy Group, Inc.) that  
21 had six utilities with operations in four states.

1

2 **Q. Have you previously testified before a regulatory body?**

3 A. Yes. I provided testimony before the Missouri Public Service Commission  
4 (“Commission”) in MAWC’s last general rate case (WR-2017-0285), in MAWC’s  
5 Accounting Authority Order case related to property taxes (WU-2017-0351), and in  
6 two of MAWC’s Infrastructure System Replacement Surcharge (“ISRS”) cases (WO-  
7 2018-0373 and WO-2019-0184). Additionally, I have testified before the Federal  
8 Energy Regulatory Commission, the Public Service Commission of Wisconsin, the  
9 Michigan Public Service Commission, the Virginia State Corporation Commission, the  
10 Illinois Commerce Commission, the Indiana Utility Regulatory Commission, the  
11 Kentucky Public Service Commission, the Minnesota Public Utilities Commission, the  
12 Virginia State Corporation Commission, the California Public Utilities Commission,  
13 the Tennessee Public Utility Commission, the West Virginia Public Service  
14 Commission, and the Pennsylvania Public Utility Commission.

15

16 **Q. What is the purpose of your testimony in this proceeding?**

17 A. The purpose of my Direct Testimony is to provide an update on the Company’s request  
18 for a Private Letter Ruling (“PLR”) from the Internal Revenue Service (“IRS”) on the  
19 normalization issues raised in MAWC’s prior three ISRS cases (Files Nos. WO-2018-  
20 0373, WO-2019-0184, and WO-2019-0389).

21

## **II. ISRS**

22 **Q. What is the general issue in regards to normalization that was present in Files**  
23 **Nos. WO-2018-0373, WO-2019-0184, and WO-2019-0389?**

1 A. While Section 393.1000(1)(a), RSMo, describes that “Appropriate pretax revenues”  
2 includes “recognition of accumulated deferred income taxes and accumulated  
3 depreciation associated with eligible infrastructure system replacements which are  
4 included in a currently effective ISRS,” there was a dispute as to whether a net  
5 operating loss (“NOL”) existed within the context of the ISRS and, if so, to what extent  
6 a normalization violation would exist in the absence of including such amount in the  
7 calculation of Accumulated Deferred Income Taxes.

### 8 III. NORMALIZATION

#### 9 **Q. What are the normalization provisions of the Internal Revenue Service Code?**

10 A. Generally, for rate purposes, the tax benefits associated with timing differences  
11 associated with accelerated depreciation can either be assigned to ratepayers upfront  
12 by reducing the amount of income tax expense the utility would otherwise recover from  
13 its customers (i.e., the “flow-through” method of ratemaking for income taxes), or those  
14 benefits can be retained by the utility for a period of time before being passed on to  
15 ratepayers (the “normalization” method of ratemaking for income taxes). For utility  
16 ratemaking, the concept of tax normalization is applied by collecting income tax  
17 expense amounts in rates calculated as if the particular tax deduction or treatment was  
18 not available to the utility.

#### 19 20 **Q. Do the normalization rules impact the Commission?**

21 A. Yes. In most situations, while a state utility regulatory commission is aware of tax  
22 impacts, it would not be required to treat taxes in any particular manner from a

1 ratemaking standpoint. However, as Staff witness Oligschlaeger stated in his testimony  
2 in Case No. WO-2018-0373 (Exh. 3, Oligschlaeger Dir., p. 3-4):

3 . . . in regard to the specific timing differences associated with use of  
4 accelerated depreciation methods for tax purposes, the IRS Code  
5 effectively mandates that regulatory commissions normalize the  
6 benefits of the accelerated depreciation tax deductions in setting rates.  
7 If the regulatory commissions do not allow for such normalization  
8 treatment, that action could result in loss of the entire accelerated  
9 depreciation deduction by the utility.

10

11 Mr. Oligschlaeger went on to correctly comment that “[i]n essence, the tax  
12 normalization requirements of the IRS Code mandate that utility rates be set so that  
13 customers do not receive the tax benefit of accelerated depreciation deductions any  
14 faster than over the estimated straight-line book lives authorized for the utilities’  
15 assets.”

16

17 **Q. If the IRS determines the Company violated the normalization rules, what are the**  
18 **consequences?**

19 A. As suggested above, the consequences depend on the Company’s ability to timely work  
20 with the Commission to cure the violation. If the Company has the ability to timely  
21 collect the revenue from customers that should have been collected in those periods  
22 where the violation occurred, then there should be no adverse consequences. If the  
23 Company is unable to timely cure the violation, in other words, has no mechanism to  
24 appeal the decision and be made whole for these revenues, for example either through  
25 a Commission rehearing or as a result of an appellate proceeding, then the Company  
26 could lose the ability to use accelerated depreciation in the future.

27

1 **Q. Has the IRS provided guidance on what it considers to be a timely cure of a**  
2 **violation, once it becomes known a violation has occurred?**

3 A. Yes. The IRS has consistently held in prior rulings and guidance that upon recognizing  
4 its failure to comply with the normalization rules, the taxpayer needs to change the  
5 inconsistent practice or procedure to a consistent practice or procedure *at the next*  
6 *available opportunity* in a manner that totally reverses the effect of the inconsistent  
7 practice or procedure, provided the taxpayer's regulator adopts or approves the  
8 change<sup>1</sup>. IRS regulations also provide relevant guidance.<sup>2</sup>

9

10 **Q. If the Company loses accelerated depreciation due to an uncured normalization**  
11 **violation, is that change permanent?**

12 A. Yes. The only cure that I am aware of is for a Federal legislative exception to be made.  
13

14 **Q. Is there an example of a public utility that has ever lost the ability to use**  
15 **accelerated depreciation due to a normalization violation?**

16 A. I am aware of a situation where two utilities but for an act of Congress would have lost  
17 accelerated depreciation. In California in the late 1970s the California Public Utilities  
18 Commission ("CPUC") and two phone utilities had a dispute regarding normalization.  
19 These companies were Pacific Telephone and Telegraph ("PT&T") and General  
20 Telephone and Electronics Corporation ("GTE"). In short as I understand it, orders

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<sup>1</sup> See, e.g., Safe Harbor for Inadvertent Normalization Violations, I.R.S. Rev. Proc. 2017-47, Section 3.01(3), 2017 WL 4099476 (Sept. 18, 2017).

<sup>2</sup> Treasury regulation 1.46-6(f)(8)(iii) - The term "final determination" means a determination with respect to which all rights to appeal or to request a review, a rehearing, or a redetermination have been exhausted or have lapsed.



1 were entered by the CPUC requiring refunds and rate reductions. PT&T and GTE  
2 exhausted all legal remedies available and the orders became final. At that point the  
3 IRS issued deficiency notices because they had ruled in PLRs that if the orders became  
4 final the orders were inconsistent with normalization. It is important to note these facts  
5 illustrate that there is a time frame in which the violation must be cured, otherwise the  
6 IRS would be statutorily required to impose the relevant statutory consequences. The  
7 situation prompted Congress to enact within the Highway Revenue Act of 1982, what  
8 is now known as the consistency provisions related to normalization. In addition, the  
9 law provided special transitional guidance which effectively relieved these two  
10 companies from the consequences of the violation. Qualified CPUC Orders were  
11 exempted and not considered inconsistent with normalization subject to certain  
12 conditions. Specifically, the definition of Qualified CPUC Order limited the guidance  
13 to the two specific companies involved. Further requirements were imposed as follows:

- 14 • A closing agreement had to be entered into with the IRS within certain  
15 dates as prescribed.
- 16 • Payment of tax equal to the amount actually flowed through under the  
17 qualified order.

18  
19 **Q. What would the impact be to customers if the Company were no longer able to  
20 use accelerated depreciation or take the repairs deduction?**

21 A. It would result in higher rates for customers. Accelerated tax depreciation allows the  
22 Company to expense investments faster for tax purposes than for book purposes. This  
23 differential, sometimes described as a “zero interest loan” from the government, is a

1 reduction to rate base. All else being equal, both the Company's revenue requirement  
2 and the customer's rates are lower when the Company can utilize this tax treatment.

#### 3 **IV. PRIOR CASES**

4 **Q. Has the Commission previously addressed this issue?**

5 A. Yes. This was the primary issue presented to the Commission in Files Nos. WO-2018-  
6 0373 (decided on December 5, 2018); WO-2019-0184 (decided June 5, 2019); and,  
7 WO-2019-0389 (decided on November 21, 2019).  
8

9 **Q. How was the issue resolved in those cases?**

10 A. In Files Nos. WO-2018-0373 and WO-2019-0184, the Commission concluded that the  
11 Company had not presented evidence sufficient to support a finding that it would have  
12 a NOL. In File No. WO-2019-0389, the parties entered into a stipulation (approved  
13 by the Commission) that provided for an Accounting Authority Order associated with  
14 amounts in dispute in the event that the IRS provided a PLR indicating that the  
15 Commission's treatment represented a normalization violation.

#### 16 **V. PRIVATE LETTER RULING**

17 **Q. Did the Company request a PLR from the IRS to obtain guidance on the proper  
18 treatment of NOLs within ISRS?**

19 A. Yes. Soon after December 5, 2018, the date the Commission ruled in Case No. WO-  
20 2018-0373, MAWC began the process of pursuing a PLR from the IRS. On a parallel  
21 path, MAWC attempted to remedy the situation through its appeals of File Nos WO-  
22 2018-0373 and WO-2019-0184, and an agreement concerning an Accounting  
23 Authority Order that was approved by the Commission in File No. WO-2019-0389.

1 Through these processes, MAWC has tried to keep avenues open for the Commission  
2 to be able remediate any concerns validated by the IRS in the ruling process. Now that  
3 guidance has been received from the IRS, MAWC is attempting to establish a rate  
4 making mechanism that would cure any concerns validated by the IRS in the ruling  
5 process.

6

7 **Q. When was the Company's PLR request filed?**

8 A. MAWC's request for a PLR was filed with the IRS on June 5, 2019, and supplemented  
9 thereafter on June 6, 2019. A copy of the request is attached as **Schedule JRW-1**.  
10 Schedule JRW-1 has been identified as Confidential in accordance with Commission  
11 Rule 20 CSR 4240-2.135(2)(A)5.

12

13 **Q. Was there any interaction with the Staff of the Commission as a part of the PLR  
14 request process?**

15 A. Yes. On April 16, 2019, MAWC provided the Staff a draft of the PLR request for  
16 review and comment. This interaction with the Commission is a required step before  
17 MAWC could file the PLR request. Revenue Procedure 2019-1 contains requirements  
18 related to PLR's concerning normalization. Specifically, it states in relevant part, "A  
19 letter ruling request that involves a question of whether a rate order that is proposed or  
20 issued by a regulatory agency will meet the normalization requirements of §168(f)(2)  
21 (pre-Tax Reform Act of 1986, §168(e)(3)) and former §§46(f) and 167(l) ordinarily  
22 will not be considered unless the taxpayer states in the letter ruling request whether—

23

24

25

(1) the regulatory authority responsible for establishing or approving the  
taxpayer's rates has reviewed the request and believes that the request is  
adequate and complete; and,

1  
2  
3  
4

(2) the taxpayer will permit the regulatory authority to participate in any Associate office conference concerning the request.

5 **Q. Did the Staff of the Missouri Commission have a chance to review the request and**  
6 **participate as required by the cited Revenue Procedure?**

7 A. Yes. Members of the Staff, including Mr. Mark Oligschlaeger, in consultation with  
8 Mr. Mark Johnson (legal counsel), did much more than simply review and edit the  
9 document so the Company could make the above-mentioned representations. Mr.  
10 Oligschlaeger submitted a well written discussion, which included arguments and  
11 views of the Commission Staff as to the specific rulings being requested. On May 1,  
12 2019, Staff provided its initial content in the form of an attachment to the ruling request,  
13 as well as feedback to sections drafted by the Company. The Company/Staff  
14 consultation continued until Staff’s final response was received on June 4, 2019. The  
15 Staff’s final response was a document provided to the IRS as a part of the PLR request.

16

17 **Q. Was the Commission interested in this process?**

18 A. Yes. The Commission’s Report and Order in File No. WO-2019-0184, among other  
19 things, provided as follows:

20 Missouri-American Water Company shall file notice with the Missouri  
21 Public Service Commission within 10 days [of] the issuance of a  
22 conclusion or a statement of violation from the Internal Revenue Service  
23 regarding Missouri-American Water Company’s February 1, 2019,  
24 letter to the Internal Revenue Service self-reporting a possible violation  
25 of its consent order and/or normalization rules. (Order at 14.)  
26

27 **Q. \*\* \_\_\_\_\_**

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1 A. \*\* \_\_\_\_\_

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6 Q. \*\* \_\_\_\_\_ \*\*

7 A. \*\* \_\_\_\_\_

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14 Q. \*\* \_\_\_\_\_ \*\*

15 A. \*\* \_\_\_\_\_

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**Q.** \*\* \_\_\_\_\_  
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**A.** \*\* \_\_\_\_\_  
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**Q. Is it important that the Commission help cure the violation identified by the IRS?**

**A.** Yes. Because of the PLR’s finding that the Company violated the tax normalization rules, MAWC could lose significant tax benefits currently benefiting customers. Specifically, MAWC could lose its ability to claim accelerated tax depreciation deductions. The consequences depend on the Company’s ability to work with the Commission to cure the violation. If the Company has the ability to collect the revenue from customers that should have been collected in those periods where the violation occurred, then there should be no adverse consequences. If the Company is unable to cure the violation, in other words, has no mechanism to appeal the decision and be made whole for these revenues, for example either through a Commission rehearing or as a result of an appellate proceeding, then the Company could lose the ability to use accelerated depreciation in the future.

**Q. Has a cure been proposed in this case?**

**A.** Yes. The mechanism and cure amount identified in the Direct Testimony of MAWC witness Brian LaGrand would provide such a cure.

1 Q. Does this conclude your direct testimony?

2 A. Yes, it does.

Schedule JRW-1 has been marked CONFIDENTIAL in its entirety.



Schedule JRW-2 has been marked CONFIDENTIAL in its entirety.