Exhibit No.:	
Issues:	ISRS Accumulated Deferred Income Taxes, Normalization
Witness:	John R. Wilde
Exhibit Type:	Rebuttal
Sponsoring Party:	Missouri-American Water Company
Case No.:	WO-2019-0184
Date:	May 13, 2019

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WO-2019-0184

REBUTTAL TESTIMONY

OF

JOHN R. WILDE

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

REBUTTAL TESTIMONY
JOHN R. WILDE
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WO-2019-0184

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

IN THE MATTER OF MISSOURI-AMERICAN WATER COMPANY'S PETITION TO ESTABLISH AN INFRASTRUCTURE REPLACEMENT SURCHARGE	)))))	CASE NO. WO-2019-0184

AFFIDAVIT OF JOHN R. WILDE

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

John R. Wilde

State of New Jersey
County of Camden
SUBSCRIBED and sworn to
Before me this 10th day of May 2019.

Notary Public

My commission expires:

SHARIFAH HILTON
NOTARY PUBLIC OF NEW JERSEY
My Commission Expires 4/25/2022

REBUTTAL TESTIMONY

JOHN R. WILDE

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is John R. Wilde, and my business address is One Water Street, Camden, NJ, 08102.

Q. Are you the same John R. Wilde who previously submitted direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony in this case?

A. The purpose of my testimony is to rebut the direct testimony of Missouri Public Service Commission ("Commission") Staff ("Staff") witnesses Karen Lyons and Mark Oligschlaeger, and Office of the Public Counsel ("OPC") witness John Riley, supporting Staff's recommendation to exclude the Net Operating Loss ("NOL") from the Accumulated Deferred Income Tax ("ADIT") calculation in this case.

II. NOL

Q. Staff witness Oligschlaeger indicates that MAWC is "recommending that a 'hypothetical' NOL amount" be imputed in this case. (Dir., p. 7-8). Is the NOL identified by MAWC as being associated with ISRS investment "hypothetical"?

A. No.

Q. Why not?

A. On its tax return for 2018 and 2019 and in its financial accounting provision for income taxes, MAWC will have to record **<u>all</u>** changes in book to tax timing differences related to tax deductions impacting taxable income and tax expense. With respect to ISRS eligible property the parties agree MAWC will be able to claim approximately $34 million of incremental tax depreciation and tax repair deductions on its tax returns for 2018 and 2019, but in doing so there is an actual and not hypothetical change of ($34)M in the NOL deduction being claimed on the respective 2018 and 2019 tax return. This is also true with respect to accounting for income taxes during the period. The same incremental change on the tax returns will impact the respective book to tax timing difference and associated accumulated deferred income taxes Therefore, MAWC calculates the net accumulated deferred tax amount that results from investing in IRSR during the relevant period to be $544,857

Q: What does staff compute to be the net accumulated deferred income taxes associated with eligible ISRS investments to be?

A: Staff adjusts MAWC net accumulated deferred taxes by $8,764,652 (Staff Recommendation – Appendix B) during a period when MAWC does not have a tax liability to reduce. If net accumulated deferred taxes are supposed to be additional interest free capital, it would seem to me that it would be impossible to have incrementally saved the additional taxes of 8,764,652. This result seems a to be an improbable result.

Q. Staff witness Oligschlaeger further alleges that there is an absence "of any incurred NOL amount on MAWC's books in 2018 and 2019." Is that correct?

A. No. There are NOL's and associated deferred income taxes being carried forward at the beginning and ending of both years, and a NOL deduction and accumulated deferred tax activity being claimed in both years[1]. What is relevant is the net accumulated deferred tax activity during the period and the interest-free capital that result from recording the tax deductions associated with ISRS expenditures during the period. Claiming $34,441,075 of additional tax repair and accelerated depreciation deductions related to ISRS will result in a net operating loss associated with ISRS. There is no tax liability to reduce by applying the incremental loss to non-ISRS activity, a fact which requires a change in the NOL to be recorded associated with ISRS activity.

Q. OPC witness Riley uses a mathematical example on p. 4-5 of his Direct Testimony to allege that a NOL cannot be shown to exist in regard to ISRS plant. Is there a similar example that shows why the NOL identified by the Company in this case is "associated with eligible infrastructure system replacements" to be included in this ISRS?

A. Yes. Despite his assertions, OPC witness Riley's example actually demonstrates the fundament flaw in his and Staff's argument. He stops short of correctly identifying the actual change in the net accumulated deferred taxes that would result and that should be included in rate base. The $31.50 Deferred Tax Liability ("DTL") is correctly calculated and is a reduction to rate base. However, important components are left out of his calculation. The incremental $1,000 investment generates no revenue, yet has

[1] Lyons DT, page 6

$200 of tax depreciation, resulting in an incremental tax loss of $200. Since there is no taxable income to offset this tax loss, it will be carried forward as an NOL. The NOL becomes a Deferred Tax Asset ("DTA") of $42.00 (21% of the $200), which when netted with the $31.50 DTL, results in a net ADIT of $10.50, which increases rate base.

Q. Staff witness Oligschlaeger indicates that "MAWC is projecting that it will be able to reflect all of its net accelerated depreciation benefits on its books associated with ISRS plant additions from January 1, 2108, forward without the need to record any offsetting NOL amount." (Dir., p. 7) Is that correct?

A. Yes, there is a limitation on that amount of tax deductions you can claim for tax repairs or tax depreciation to the extent you are not cash taxpayer at the end of the day and carrying forward a loss, you will not benefit all of those deductions.

Q. Staff witness Lyons recites the monthly NOL Deferred Tax Asset Balance for MAWC from December 2017, through December 2019, at page 6 of her Direct Testimony. Are there updates to those amounts?

A. Yes. The following is a table that provides the NOL Deferred Tax Asset amounts through April 30, 2019:

Month	Ending Balance	Change in balance
Dec-17	$31,464,998	
Jan-18	$31,464,998	$0
Feb-18	$30,928,397	$536,601
Mar-18	$30,222,134	$706,263
Apr-18	$28,099,143	$2,122,991
May-18	$26,261,074	$1,838,069
Jun-18	$27,493,077	($1,232,003)
Jul-18	$25,207,589	$2,285,488
Aug-18	$23,689,065	$1,518,524
Sep-18	$21,183,942	$2,505,123
Oct-18	$21,795,951	($612,009)
Nov-18	$27,807,457	($6,011,506)
Dec-18	$22,108,537	$5,698,920
Jan-19	$21,845,006	$263,531
Feb-19	$21,915,687	($70,681)
Mar-19	$21,164,312	$751,375
Apr-19	$20,260,456	$903,856

.

Q. What should the Commission understand about the NOL Deferred Tax Asset amounts in that table?

A. First, these are tax effected book to tax timing differences or accumulated deferred tax balances, the actual NOL would be that amount divided by the tax rate. So the carryover balance of losses as of April, 2019 is expected to be $96,478,361[2], and the tax benefit that MAWC has yet to receive is $20,260,456 (Table proceeding question April 2019 / 21% = 96,478,361). Thus, at the beginning and end of the relevant period for both 2018 and 2019, MAWC is in a NOLC position. The presence of an NOLC at the end of the year means that MAWC is not currently paying tax, and as of the respective period means that, MAWC has no capacity to reduce its tax liability and achieve the tax cash flow that Staff and OPC suggest.

[2] The NOL DTA is $20,260,456 in April 2019, and the NOLC is $96,478,361, which is the NOL DTA divided by the 21% Federal income tax rate.

Q. Staff witness Lyons suggests that a NOL "will always result" from the methodology used by MAWC to calculate the NOL, "whether the utility is actually recording an NOL amount on its books or not." (Dir., p. 4) How do you respond?

A. MAWC has asked the IRS for guidance on this matter. However, that is not the issue either in this case or in the prior case. The fact pattern here is there is a NOLC deduction waiting to be claimed at the end of each period, eliminating any opportunity to raise additional interest-free capital on an incremental basis by claiming ISRS related deductions. Thus, Ms. Lyon's concern is not presented by the facts at hand.

III. Impact of Exclusion

Q. What impact does excluding the NOL from the ADIT calculation have in this case in regard to the Infrastructure System Replacement Surcharge ("ISRS") revenue requirement?

A. This adjustment by Staff has the effect of decreasing rate base by $8,764,652[3] and decreasing the ISRS revenue requirement by $827,383.[4]

Q. On page 3 of her Direct Testimony, Staff witness Lyons refers to a "book-tax timing difference" that creates a cost-free funding source for the Company. Do you agree with this assertion in this case?

A. No. Staff witness Lyons correctly describes the "book-tax timing difference" being created by the Company having larger tax deductions than it has book expenses related

[3] LaGrand RT, pages 3-4.
[4] Lyons DT, page 2

to capital investments. This creates a Deferred Tax Liability ("DTL"), which is a reduction to rate base. However, Staff witness Lyons further describes this DTL as "funds that are provided cost-free to the Company."[5] This is incorrect in this case, as MAWC did not actually receive the $8,764,652 of cost-free capital, but, because it was unable to use this deduction, instead funded that capital with debt and equity. This result is inconsistent with Missouri statute, cost of service ratemaking, and the tax normalization rules.

Q. How so?

A. A plain reading of Section 393.1006(1)(a), RSMo, indicates that MAWC should recover the weighted cost of capital associated with ISRS plant. The rate base in that calculation includes ADIT. Both Staff witness Lyons[6] and Oligschlaeger[7] agree the ADIT should be the net accumulated deferred tax balance associated with ISRS, and agree that amount should be representative of interest free capital available to fund these investments[8]. However, ultimately, Staff does just the opposite. Staff associates the activity with ADIT related to ISRS eligible property by implying additional interest free capital of $8,764,652 was made available to fund $66,167,640 of expenditures. To avoid the impact claiming $34,441,075 of additional tax deductions has on NOL deductions in the year, the NOLC accumulated deferred tax balance has to be adjusted to reconcile current taxes to zero. Thus, MAWC is not being allowed to recover its total weighted average cost, which seems inconsistent with Missouri ISRS statutes.

[5] Lyons DT, page 3
[6] Lyons DT, pages 3-4
[7] Oligschlaeger DT, pages 5-6
[8] Lyons DT, Page 3, Oligschlaeger DT, Page 5

Moreover, cost of service ratemaking should allow the recovery of such costs. Finally, the tax normalization rules are premised on the assumption that a reduction to rate base for accumulated deferred taxes related to accelerated depreciation should not be made until the related cash has been received.

Q. Does OPC witness Riley also suggest that MAWC has received a cost-free funding source?

A. Yes. On page 3 Lines 25-26 of his direct testimony OPC Witness Riley states that "Staff's conclusion is accurate for this report.

Q. Does the Company agree with OPC's position?

A. No. As discussed in greater detail below, the Company has not received any cost-free funds to finance the ISRS investments and will finance those capital costs with debt and equity. In addition, it is the Company that funded $66,167,640 of ISRS eligible expenditures during the period and those eligible expenditure drove the $34,441,075 of tax deductions and the $8,764,652 DTL, However, claiming those additional deduction at a time when MAWC taxable income and tax liability was $0 required and offsetting DTA related to previously claimed NOL deductions. Therefore, the net accumulated deferred income taxes associated with ISRS should be as MAWC reported.

Q. Does Staff witness Lyons or OPC witness Riley identify the actual source of the $8,764,652 in "cost-free funds," and whether MAWC actually received this additional cash flow?

A. No. Staff witness Lyons identifies MAWC's customers as the source of the additional capital, and the deferred tax expense collected from customers as the mechanism[9]. OPC witness Riley states that "the utility expended no monies . . ." but fails to identify the source of funding if not the utility. Neither Staff witness Lyons nor OPC witness Riley explain how the $8,764,652 of additional capital was provided while current taxes are assumed to be zero (based on the need for a NOLC as of the end of 2017, 2018, and 2019.

Q. Can you illustrate for the Commission why Staff's hypothesis is not supported by all facts relevant to determining if MAWC came into possession of $8,764,652 of additional cash taxes by incrementally claiming $34,441,075 in additional tax deductions?

A. Yes. For Federal income tax purposes, MAWC, as a member of a consolidated tax filing group, reconciles all items of income and expense (deductions) to taxable income and its current tax obligation on form 1120 (Attached as Schedule JRW-1 CONFIDENTIAL). All income items are subtotaled on line 11. All expense items, including tax repairs and accelerated tax depreciation, are subtotaled on line 27. The difference between total income and total expenses is shown as taxable income on line 28, prior to the application of an NOL. To the extent there exists taxable income on line 28, it may be offset with the Company's prior NOLs on line 29a. If the taxable income on line 28 is negative, then it will add to the existing NOL to be used in a future tax year. The ISRS investment in this case generates substantial tax deductions that will be included in line 27 of the Company's Federal tax return, and will decrease the Company's taxable income. Because the taxable income is lower with the ISRS

[9] Lyons DT, page 3

investments than it would be without the ISRS investments, the Company's NOL will be larger at the end of the period than it would otherwise be without the ISRS investments. The net change in taxable income line 30, and the net change tax expense is what creates tax savings. Therefore, the ISRS investments create an incremental increase in the NOL that is explicitly recognized on the Company's Federal tax return. Since the Company is not able to use the tax deductions to reduce the cash taxes it pays, it must use debt and equity to fund the ISRS investments and therefore does not have access to cost-free capital.

Q. What other assumptions and hypothesis do Staff and OPC use to reason that there should be no offset to MAWC net operating loss deduction and its related impact on accumulated deferred income taxes?

A. OPC and Staff seem to suggest any change the accumulated deferred income taxes related to NOL deductions claimed in future periods should only be reconciled in a future general rate case[10]. However, any change in an accumulated deferred income tax balance that is associated with the ISRS eligible plant amount should be included. MAWC is not double counting the impact of the NOLC in base rates. MAWC is measuring a very specific change in a current period tax deduction, that results in a book to tax timing difference during the period, and therefore an adjustment to ADIT during the period. Staff assumes that during the period MAWC had taxable income in excess of all deductions relevant to the period[11].

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[10] Lyons DT, Page 7 and Riley DT, Page 5
[11] Lyons DT, Page 5

Q. Does this conclude your rebuttal testimony?

A. Yes.