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BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Confluence)
Rivers Utility Operating)
Company, Inc.'s Request for)
Authority to Implement a)
General Rate Increase for) File No. WR-2023-0006
Water Service and Sewer)
Service Provided in)
Missouri Service Areas)

CHARLES HATCHER, Presiding
SENIOR REGULATORY LAW JUDGE

EVIDENTIARY HEARING
Friday, August 11, 2023
10:30 a.m. - 4:43 p.m.

Office of the Missouri Public Service Commission
200 Madison Street
Jefferson City, Missouri

Stenographically Reported by:
Jill Bleskey, CSR, CCR, RPR

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A P P E A R A N C E S

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1 * * * * *

2 (Hearing commenced at 10:30 a.m.)

3 * * * * *

4 JUDGE HATCHER: Let's go on the record.

5 Today is Friday, August 11th. This is the second day
6 of the time that the Commission has set aside for the
7 general rate increase case of Confluence Rivers
8 Operating Company filed under WR-2023-0006.

9 With me today are Commissioner Glen
10 Kolkmeyer, Commissioner Jason Holsman, Commissioner
11 Maida Coleman is on WebEx. And I expect to be joined
12 later by the other two Commissioners.

13 We do have a couple of announcements
14 before we get into today's events. Which, for the
15 benefit of those listening, I understand our first
16 issue will be coming up as income taxes. I do want
17 to, like I said, make two quick announcements. The
18 first is to ask the parties, Staff Counsel, would you
19 please tell me what further issues have settled.

20 THE REPORTER: And could you identify
21 yourself too, please.

22 MR. PRINGLE: Yes, yeah. For the record,
23 this is Travis Pringle from Staff Counsel. Actually
24 Judge, if it's a little easier, I was just going to
25 give you the issues that are still live.

1 JUDGE HATCHER: Perfect.

2 MR. PRINGLE: So we have income taxes.

3 And this is going off the amended list that was filed
4 on August 8th. So that's Issue 4, income taxes.

5 Issue 6, acquisition related costs. Issue 8, time
6 sheets. Issue 13, cost of capital. Issue 16,

7 advanced meter infrastructure. Then in Issue 17 only
8 Subissues C and D, and that is operation. Issue 21,

9 corporate allocations. And Issue 25, capital verse
10 expense. Those are the only live issues remaining.

11 JUDGE HATCHER: Twenty-five was capital
12 expense?

13 MR. PRINGLE: Capital v -- capital verse
14 expense, correct. One moment, Judge.

15 JUDGE HATCHER: Yes.

16 COMMISSIONER KOLKMEYER: Would you read
17 those numbers down again, please?

18 MR. PRINGLE: And sorry, Judge, I did miss
19 one other live issue. That is going back to Issue 5,
20 rate design, Subissue A, A1, what is the appropriate
21 amount of uses for purposes of establishing water
22 rates. But the parties have agreed to waive
23 cross-examination on that issue and just resolve it
24 via the briefs.

25 JUDGE HATCHER: Please inform -- first,

1 let's note for the record the arrival of our Chairman
2 Scott Rupp. S-C-O-T-T, R-U-P-P.

3 Counsel.

4 MR. PRINGLE: Yes.

5 JUDGE HATCHER: Go ahead.

6 MR. PRINGLE: Oh. And that's it pretty
7 much for now. Those are the issues that are still
8 live. Looking at the schedule, as it stands right
9 now, time sheets is scheduled to end today. But we
10 currently have no live issues scheduled for Monday,
11 only cost of capital and advanced meter
12 infrastructure scheduled for Tuesday. The Subissues
13 C and D for operations and corporate allocations for
14 Wednesday, and then just capital verse expense on
15 Thursday.

16 JUDGE HATCHER: Okay. Thank you. Don't
17 go anywhere. I have questions. You kind of stepped
18 on my toes with my second announcement which I have
19 not made yet but we're there. Please fill me in on
20 district consolidation without telling me the terms
21 of the settlement as I believe those would still be
22 confidential. A, have the parties agreed to some
23 form of --

24 MR. PRINGLE: I'll tell you, Judge. The
25 only remaining issue on there has to do with the

1 actual water uses amount, the 5,000 as Staff proposed
2 or the -- what is it, 3,500?

3 JUDGE HATCHER: Twenty-seven was in
4 testimony.

5 MR. PRINGLE: Twenty-seven fifty or
6 something like that.

7 JUDGE HATCHER: Yeah.

8 MR. PRINGLE: That's the only live issue
9 left on the rate consolidation.

10 MR. WOODSMALL: And if you're inquiring --
11 I'm sorry. Dave Woodsmall on behalf of the Company.
12 If you want to inquire about the nature of the
13 settlement, it's not in writing but I have no
14 problems either Counsel doing it or I'll put Mr. Cox
15 up just to give whatever -- so while the
16 Commissioners are here, if you want to know a little
17 more substance around how we plan to resolve that I
18 can put him up and you can ask him those questions.

19 JUDGE HATCHER: I would say yes,
20 absolutely. That was my second announcement.

21 The Commission would like more information
22 on additional district consolidation options.

23 MR. WOODSMALL: Okay. You want to do that
24 before income taxes?

25 JUDGE HATCHER: Yes.

1 MR. WOODSMALL: The other thing I'll offer
2 along those lines. This is obvious. This will all
3 be memorialized into a stipulation. Consistent with
4 past practice, I imagine there would be a stipulation
5 presentation which you can ask further questions.
6 But given the complexity of that issue I'll put him
7 up right now. I'm sorry.

8 JUDGE HATCHER: And just a general
9 announcement for those in the room. We do have
10 people listening on WebEx which only picks up audio
11 if you speak into a live microphone pretty directly.

12 MR. WOODSMALL: Understood.

13 MR. CLIZER: Your Honor, John Clizer on
14 behalf of OPC. I apologize but I'm slightly
15 confused. Is Mr. Cox standing up to discuss the
16 terms of the stipulation or to answer Commission
17 questions regarding possible other options? Because
18 the latter would be more of an evidentiary point and
19 we would at least like the opportunity to put on our
20 other witnesses if that's what's going to happen.

21 JUDGE HATCHER: Yeah. No, I'm not ready
22 for witnesses. I'm trying not to break
23 confidentiality.

24 MR. CLIZER: Can I put forward potentially
25 that I think the stipulation is going to be

1 forthcoming relatively quickly.

2 MR. WOODSMALL: I doubt if it's today.

3 MR. CLIZER: Not today necessarily. But
4 since we don't have anything Monday would it be
5 possible to postpone that until we have the
6 stipulation then we don't have to worry about
7 confidentiality?

8 JUDGE HATCHER: Yes. Yes, I like that
9 answer. Would --

10 MR. WOODSMALL: Your Honor.

11 JUDGE HATCHER: Go ahead, Mr. Woodsmall.

12 MR. WOODSMALL: The concern there, as Mr.
13 Pringle said given the settled issues Monday would be
14 empty. So there -- doing it on Monday would possibly
15 cause witness availability concerns. If you want to
16 do it Tuesday or whatever.

17 Honestly, I'll be real clear with you, the
18 term of the settlement would provide for two
19 districts water, two districts sewer not geographic.
20 It would go along technology lines. Therefore, --
21 and Mr. Cox can explain this further. Therefore,
22 waste water systems, several of them are lagoons. As
23 lagoons they don't have blowers, aerators, and those
24 types of things. Those are cost elements. So
25 lagoons would be a lower cost 'cause they don't have

1 those cost elements, and mechanical plants would be a
2 higher cost. And there's a similar type of breakdown
3 for water into two districts. And if you want to
4 delve into that, he's available. Whatever the
5 Commission wants.

6 MR. PRINGLE: And Judge, also Jim Bush,
7 he's also happy to testify for Staff's perspective.

8 JUDGE HATCHER: Thank you. I appreciate
9 that. I'm nodding my head not at approval of
10 settlement but at the idea of checking witness
11 availability. As I said, this has been one of the
12 larger issues in the case. But yes, that was the
13 answer I was looking for. I didn't want a witness, I
14 just wanted a high level here's the direction we're
15 going. That answers that question.

16 If Counsel, sometime through today,
17 without me -- well, I'm sorry. The witnesses that I
18 have are Lyons, Cox, Roth, Seiver, and Dr. Mark. I'm
19 sure those are -- witnesses are listening or are in
20 the room. If they would communicate with their
21 counsel between now and the end of today. Just tell
22 me what day all of them are available as a group and
23 that will be the day, regardless of Counsel's
24 schedule. Not -- I don't want to step on your
25 schedule but this is a large and important issue that

1 we want to make sure gets covered.

2 MR. WOODSMALL: Understood.

3 MR. PRINGLE: And I have one more update
4 for that list of live issues right now, Judge. I
5 have been informed that when it comes to the AMI
6 investments issue also that that cross will be waived
7 and that will also be argued in the briefs.

8 JUDGE HATCHER: Okay. I'm going to repeat
9 this list by number and Commissioners and advisers I
10 will e-mail this out subsequently later this morning.
11 The issues by number in order. Number 4, income tax.
12 Number 5, only the amount of water to be used in the
13 calculation. And the two positions of the parties
14 are 5,000 gallons and 2,750 gallons, and the parties
15 have waived cross-examination on those witnesses so
16 but for Commissioner questions that issue would be
17 submitted on the pre-filed testimony.

18 MR. WOODSMALL: The only other
19 complication on that is if the Commission has
20 questions our witness Tim Lyons is testifying
21 virtually so I need to, if you can, let me know if
22 you have questions for him and I'll make sure that
23 happens.

24 JUDGE HATCHER: Will do.

25 MR. WOODSMALL: Thank you.

1 JUDGE HATCHER: Number 6, acquisition
2 costs. Number 8, I can't read my writing.

3 MR. PRINGLE: Time sheets.

4 JUDGE HATCHER: Thank you. It seems very
5 clear now that you've said it out loud. Number 8,
6 time sheets. Number 13, cost of capital. Number 16,
7 advanced metering infrastructure, commonly called
8 AMI. And this is another waiver of cross-examination
9 by the parties. So absent Commissioner or Bench
10 questions the parties will submit this issue for
11 Commission decision on the pre-filed testimony.
12 Issue 17, only Subparts C and D, this is operations
13 and maintenance. Issue 21, corporate allocations.
14 And Issue 25, capital v. expense.

15 MR. PRINGLE: That is correct, Judge. And
16 parties, please let me know if I was wrong on any of
17 that.

18 JUDGE HATCHER: I see no disagreement by
19 the parties. And I thank you, Mr. Pringle. Go ahead
20 and have a seat.

21 MR. PRINGLE: Thank you, Judge.

22 JUDGE HATCHER: Let's get started with our
23 issue. If I can get a nod of heads. We are ready to
24 go to income taxes. I am confirmed in my assumption.
25 Many opening statements before we -- Mr. Clizer.

1 MR. CLIZER: Judge, do you want to do
2 entries of appearance? We all kind of said our name
3 at this point, so...

4 JUDGE HATCHER: Yes. Let's keep with our
5 current ad hoc system and we will just make sure and
6 introduce the first time when anybody is speaking.
7 Many opening statements. I just want to remind
8 Counsel that time is precious here. The
9 Commissioners have all -- oh, and I also would like
10 to make sure that all Commissioners have joined
11 including making sure for the record -- oh, good, I'm
12 on camera again. Commissioner Kayla Hahn has joined
13 us. We have all five Commissioners now in
14 attendance.

15 Just to remind Counsel once again, time is
16 precious. The Commissioners and myself, we've read
17 the pre-filed testimony, are familiar with the issue,
18 we are really just looking for a summary from Counsel
19 on these many openings. Let's get started. This is
20 Confluence's rate case. Mr. Woodsmall.

21 CHAIRMAN RUPP: No two hours.

22 MR. WOODSMALL: I promise you. Possibly
23 two minutes.

24 CHAIRMAN RUPP: Key word is many.

25 MR. THOMPSON: And time is precious. Good

1 morning, Commissioners. Nice to see you again. I
2 realize that when I did my opening statement
3 yesterday that I probably complicated income taxes
4 much more than it needed be. It's really a simple
5 issue. You just need to keep your mind focused on
6 how rate making's done. Rate making, just like your
7 other tax -- your personal taxes. If you have any
8 type of business rate making looks at expenses and
9 revenues and it looks at your capital structure so
10 that the amount of return that you have on equity is
11 factored up for income taxes. That's it. You don't
12 factor up the return on debt because that's not
13 income, that's covering debt expense.

14 So rate making, very simple. In any case
15 you've seen ever, I promise you, ever, every case
16 you've done, Ameren, Evergy, Empire, Spire, income
17 taxes were simply factoring up the return on equity.
18 And that's what we seek in this case, just give us
19 the income taxes that would derive from rates.

20 This has been complicated by Staff and
21 Public Counsel who want to bring in the concept of
22 net operating losses. Don't let that complicate
23 things. I'll tell you what the net operating losses
24 are, plain and simple. In the past the Company has
25 covered losses. As I mentioned, when we buy a system

1 rates are deflated. Some of these systems haven't
2 had a rate increase for 30 years. We buy systems
3 with depressed rates and we adopt those for the
4 convenience of the customer.

5 So what happens. We go in and we do all
6 the triage work that I talked about. I showed you
7 the work that's done within 50 days. Rates are now
8 here, costs are here. The Company covers all that
9 lost, the Company covers all that loss and the
10 ratepayers got the benefit of that loss. We covered
11 it.

12 Now, Public Counsel and Staff says, well,
13 thank you very much but please, sir, may I have
14 another. I not only want the fact that you covered
15 those losses, I want the tax benefit from you
16 covering those losses. And that's where this gets
17 complicated. We simply ask you to do it like you've
18 always done it in every other case, how FERC does it,
19 how everybody does it, you factor up the return on
20 the equity component or taxes.

21 Available for any questions. Two minutes.

22 JUDGE HATCHER: Are there any Commissioner
23 questions for Mr. Woodsmall? Thank you, Mr.
24 Woodsmall.

25 MR. WOODSMALL: Thank you.

1 THE COURT: Move on to Staff.

2 MR. THOMPSON: Thank you, Judge. Do I
3 have my visual? There we go.

4 THE REPORTER: Mr. Thompson, right?

5 MR. THOMPSON: What's that?

6 THE REPORTER: Mr. Thompson?

7 MR. THOMPSON: Yes. I'm Kevin Thompson
8 and I represent the Staff. Post Office Box 360,
9 Jefferson City, Missouri, 65101.

10 I was impressed yesterday that Mr.
11 Woodsmall recruited Benjamin Franklin to his team on
12 the income tax issues so I have recruited Plato and
13 Aristotle. And the reason I have recruited them, the
14 fathers of logic, is because Mr. Woodsmall's
15 position, the Company position is absolutely
16 illogical. Absolutely illogical. Let me explain it
17 to you. And I'm going to do this in two minutes too.

18 Take a minute at some point to read the
19 position statement of the Company on this issue
20 because you will notice it has absolutely nothing
21 whatsoever to do with what Mr. Woodsmall stood here
22 talking about. Because perhaps they have realized
23 that their original argument is a loser and so
24 they're trying to shift to something else.

25 So how does this work? They buy systems

1 with rates that are inadequate and they're stuck with
2 inadequate revenues until such time as they have a
3 rate case like this one and raise the rates to a
4 level that is adequate, right? So they have lost
5 that money. Remember that one of the primary
6 principles of rate making is you cannot have
7 retroactive rate making, you cannot go back and
8 recover what was lost, that's gone, that's gone,
9 okay. So they don't get to recover that through
10 income taxes or anything else. So they say we're
11 trying to steal, bad Staff; bad, bad Staff, we're
12 trying to steal the benefit of the income tax issue
13 from them.

14 Let me explain that to you. Cost of
15 service rate making means the rates will make the
16 Company whole for the cost of service, for what it
17 costs them to provide the service. That includes
18 whatever income taxes they actually pay. Not the
19 income taxes they don't pay but the income taxes they
20 do pay.

21 So how does that work with net operating
22 losses? You understand, I know, that a business is
23 taxed on its net income, right. To the extent that
24 revenue exceeds expenses that's what they pay taxes
25 on. To encourage business, the federal government,

1 the Internal Revenue Code, gives business a benefit.
2 The benefit is they can use that loss, if they have a
3 loss year, right, the net operating loss, they can
4 use that to shield income from taxes in a later year.
5 And after the Tax Cut and Jobs Act that benefit lasts
6 forever. Used to expire after 20 years, no, now it's
7 forever. Those losses can be used at anytime in the
8 future to shield positive income from taxes, okay.
9 That's the benefit. The federal government has given
10 that benefit. It applies when there is positive
11 income to shield.

12 They want a second benefit. They want the
13 ratepayers to pay as though there was no net
14 operating loss shielding the positive income from
15 taxes. In other words, put into rates what we would
16 have paid had we not had net operating losses.

17 That is a violation of two important
18 principles, as I've told you. Number 1, it's making
19 the ratepayers pay more than the actual cost of
20 providing the service, Number 2, it's a sneaky way to
21 try to recover money that was lost because prior
22 rates were inadequate. Both of those are principles
23 that would be violated.

24 I urge you to stand firm on those
25 principles. Thank you. Any questions, I'll be happy

1 to try to answer.

2 JUDGE HATCHER: Are there any Commissioner
3 questions? Yes, Chairman.

4 CHAIRMAN RUPP: Showing your
5 archaeological background with the --

6 MR. THOMPSON: Yeah.

7 CHAIRMAN RUPP: -- Aristotle and Plato.

8 MR. PRINGLE: Greeks.

9 CHAIRMAN RUPP: The Greeks, that's right.
10 So two questions. First one. When I read
11 everything, the analogy I was coming up in my head,
12 and I'm going to give you how my brain worked at it
13 and I want you to -- 'cause I think it's the same
14 thing what you were saying. Is if on my personal
15 income, you know, I earn an income and I am at this
16 income bracket and I would pay X amount of dollars on
17 that. But with the home mortgage deduction and the
18 standard deduction and everything of that nature it
19 lowers me down to my adjusted gross income and then
20 that's what I pay tax on. Is the way I'm
21 understanding it is they are asking for the amount of
22 tax that they would have been taxed on their gross
23 income and then in addition to what they actually
24 paid based off their net income, they're asking for
25 that difference even though they did not pay it?

1 MR. THOMPSON: That's absolutely right.

2 CHAIRMAN RUPP: Okay. Wanted to make sure
3 I understood that. Second thing is we heard the
4 Company's counsel talk about how this is a deviation
5 from how the Staff has done all of other water and
6 sewer cases, American Water, and this is how
7 different and how FERC does that. Can you speak to
8 that ascertainment?

9 MR. THOMPSON: I think my witness will be
10 much better able to speak to that than I can. But I
11 will tell you that because this is such a blatant
12 violation of rate making principles I would be very
13 surprised if the witness were to tell you that, why,
14 yes, he was correct, FERC and other states do it the
15 way that Mr. Woodsmall has described.

16 CHAIRMAN RUPP: I will ask the witness.
17 Thank you.

18 MR. THOMPSON: Thank you.

19 JUDGE HATCHER: Commissioner Holsman.

20 COMMISSIONER HOLSMAN: Thank you. From
21 the macro perspective, do you think that the signals
22 that the Commission would potentially set here would
23 disincentivize future purchases of distressed systems
24 knowing that the revenue is not there to essentially
25 cover your cost and then knowing that you can't

1 retroactively rate make to get that back should I
2 guess -- let me ask it this way. Should there be an
3 incentive for companies to rescue distressed systems
4 from a macro perspective?

5 MR. THOMPSON: That's a very good question
6 and it -- there's a way for the Commission to do
7 that. And the way to do that is not by making
8 ratepayers pay for an expense that doesn't exist.
9 Instead what you can do is give them a higher return
10 on equity than you otherwise have. If you want to
11 incentivize them for buying bad systems then give
12 them some basis points, that's how you can do it
13 because you have absolute discretion in where you set
14 the return on equity.

15 COMMISSIONER HOLSMAN: Would you oppose
16 then the amount of cost that's being argued over here
17 if it were shifted into return on equity as, you
18 know, the same amount versus it being from a
19 mechanism standpoint not captured by deferred taxes
20 but through return on equity, would you oppose that
21 shifting?

22 MR. THOMPSON: I don't have -- I have not
23 conferred with any of my, you know, fellow Staff
24 members on that and I haven't talked to our ROE
25 expert. I would have to say that I think Staff would

1 be reluctant to say yes on that but I think I'm
2 telling you the absolute truth that that is the best
3 mechanism with which to do that if you decide you
4 want to do that.

5 COMMISSIONER HOLSMAN: Okay. Thank you.
6 Thank you, Judge.

7 JUDGE HATCHER: Thank you, Commissioner.
8 And Commissioner Kolkmeier.

9 COMMISSIONER KOLKMEYER: Thank you, Judge.
10 Good morning, Mr. Thompson.

11 MR. THOMPSON: Good morning, sir.

12 COMMISSIONER KOLKMEYER: Has Staff ever
13 recommended offsetting income taxes on net operating
14 loss amounts in any other rate case?

15 MR. THOMPSON: I think we let the Internal
16 Revenue Code do what it does and I believe that in
17 rates we put whatever the actual tax burden is going
18 to be, the actual tax liability, that's what we stick
19 into rates. It's unusual to have a situation where
20 you have a lot of net operating loss with a utility
21 company. You know, utility companies have captive
22 customers, they have a monopoly, they're selling a
23 necessity of life. So they're not typically
24 operating at a loss, right.

25 We have a company here that has a very

1 unusual business plan. Let's buy decrepit loser
2 systems and we're going to make money off of it.
3 Okay. We're happy to have them do that because we'd
4 like to have someone responsible buy those systems
5 and fix them up and make them work. That's a great
6 thing. And that's why our engineering department
7 really likes this company. But our accountants on
8 the other hand, they make them crazy because of the
9 way they keep, or should I say don't keep their
10 records. So it's a difficult pickle for us. But
11 it's also an unusual situation because, you know,
12 Ameren and those companies they don't have net
13 operating losses.

14 COMMISSIONER KOLKMEYER: Thank you.

15 MR. THOMPSON: Thank you, sir.

16 COMMISSIONER KOLKMEYER: Thank you, Judge.

17 JUDGE HATCHER: Thank you, Commissioner.

18 And thank you, Mr. Thompson. The spelling of Holsman
19 is H-O-L-S-M-A-N, spelling of Kolkmeier is
20 K-O-L-K-M-E-Y-E-R.

21 And we go to Mr. Clizer, C-L-I-Z-E-R, for
22 the Office of the Public Counsel, commonly
23 abbreviated to OPC. Mr. Clizer, the floor's yours.

24 MR. CLIZER: Give me one second, Judge.

25 Can you tell me whether or not that's in frame? All

1 right. Now, I know that you're probably scared up
2 here because you're thinking I'm going to take
3 forever. I'm not, I'm going to keep this as short as
4 possible but you guys asked some really good
5 questions so I want to hit some of those things.

6 First of all, to answer sort of and
7 address what you said, this is very similar to how
8 you would actually file your own tax returns, right.
9 You have your income, that's your wages, you take off
10 your available deductions, that gives you your
11 taxable income. Same thing has happened with the
12 Company. You have your revenues, you take your
13 expense deductions, what's left over is the taxable
14 income.

15 Now, for individuals it's really pretty
16 hard for you to actually have deductions in excess of
17 your income, not so much for companies, they can do
18 that and when that happens you have a net operating
19 loss. What that means is that your expenses, your
20 deductions have exceeded your income. Now, there are
21 two things that happen when you have NOL, and you
22 keep them separate.

23 First, in the year that you have the NOL
24 your taxable income is zero because your expenses
25 have exceeded your income. So you have no taxes in

1 that year. That's benefit one to the Company. The
2 Company does not pay tax in the year that they
3 generate the net operating loss. But they get a
4 second benefit. The net operating loss gets carried
5 forward into the future and it gets used to offset
6 your income in future years.

7 What has happened in this case is Staff
8 has simply recognized the fact that the Company has
9 net operating loss carryforwards and that those
10 carryforwards is going to reduce what the Company is
11 actually going to remit to the IRS. And if you don't
12 take those into account the Company will collect more
13 money from customers than it's going to remit.

14 What's going to happen to the excess?
15 That's an important question, I'm going to come back
16 to that. But after anything else that's just going
17 to be pure profit for the Company, they're going to
18 stick it in their pocket and they're going to walk
19 away.

20 Now, I echo what Mr. Thomas (sic) said
21 regarding what Mr. Woodsmall's opening about is not
22 at all consistent with what their actual witnesses
23 have argued and I'm a bit confused by that. I'm
24 going to address something -- what their actual
25 witnesses have argued. Because what their witnesses

1 are trying to convince you is that an NOL generates a
2 tax liability. There is several points where their
3 witness Mr. Seltzer states it generates a tax
4 liability. And what they're trying to do is they're
5 trying to get you to think that this is like
6 accelerated depreciation. I don't want to go too
7 much into detail there. But at a minimum, what
8 accelerated depreciation does is it creates a tax
9 liability on a company's books which means they're
10 going to have increased taxes later on.

11 So the IRS has created what's called the
12 normalization rules and what the normalization rules
13 say is we're going to force the company -- I'm going
14 to have to actually explain a little bit about
15 accelerated depreciation, I apologize. I just want
16 to make sure this is really clear. Let's keep it
17 simple.

18 A company has something called
19 depreciation expense. For depreciation expense you
20 have a book version and a tax version. For the book
21 version in Missouri we use straight line depreciation
22 so we depreciate by the exact same amount every
23 single year. You have an asset that lasts ten years
24 you depreciate it ten percent each year, at the end
25 of the ten years it's done. For tax purposes you can

1 take accelerated depreciation. What that means is
2 you get to take more depreciation in the front end.
3 Let's say you take 20 percent depreciation. You do
4 20 percent for year one, two, three, four, five but
5 then you're fully depreciated. So for years six,
6 seven, eight, nine, ten you lack the depreciation
7 expense for tax purposes and your taxes are actually
8 higher than they would normally be. Does that make
9 sense?

10 So if you are a regulator and you were
11 saying how do I set income taxes if a company's doing
12 accelerated depreciation? You might say I'm going to
13 set the income taxes at exactly what the company is
14 actually going to pay. But the company says, hold
15 up, there's a problem with that. If you don't -- if
16 you set us -- give us exactly what we're going to pay
17 we're going to be able to pay our taxes for the first
18 five years but then as soon as our depreciations run
19 out we're not going to have taxes to pay what we
20 actually owe.

21 So instead what the IRS has said is for
22 accelerated depreciation you have to give the company
23 the amount of tax that they would have with straight
24 line depreciation. Now that results in the company
25 collecting more taxes than what it remits in the

1 first five years of my hypothetical but it takes that
2 money and it uses it to pay the extra taxes it ends
3 up paying on the back five years. In other words, it
4 defers those taxes through time. And we call that
5 deferred income tax liability. And the company books
6 those into its accounts where they accumulate and we
7 call it accumulated deferred income tax liability.

8 Now, the logic here, which is what I want
9 you to focus on. The logic is you are giving the
10 company money up front to pay for its future tax
11 liability, the taxes that are going to become due
12 once the company has exhausted taxable depreciation.
13 That is the logic of why we do that. And the IRS has
14 told us we have to do that.

15 Why am I talking about this? This case
16 has no accelerated depreciation, this case doesn't
17 concern the normalization rules, none of that's at
18 issue. But the Company is trying to trick you into
19 thinking that an NOL is a tax liability and therefore
20 you have to give them money up front to pay for some
21 future tax. But that's not the case. An NOL is
22 actually a tax asset. It generates a future
23 deduction. So you don't have to give the Company a
24 big pile of money up front to pay for that future
25 deduction. Anybody understand? If you can figure

1 out, if you can see how it's a tax asset and not a
2 tax liability it no longer makes sense to give them
3 this big pile of money up front because they're not
4 going to have the future tax burden they need to pay
5 for that.

6 On that note, ADIT, accelerated
7 depreciation -- accumulated deferred income tax, this
8 Commission includes that in rate base as an offset to
9 rate base because what it functionally represents is
10 a loan from the customers to the Company, a temporary
11 loan that they are going to use to pay their taxes in
12 the future.

13 In this case what the Company wants is
14 they want to have you force the customers to pay all
15 that money up front but then never do anything with
16 it, they want to make it a permanent tax benefit to
17 the Company. If you are going to do a normalization,
18 if you are going to force the Company -- sorry, force
19 customers to pay more than they're actually going to
20 remit what you need to do is you need to order the
21 Company to book those deferred taxes that you've
22 created into an account that will offset rate base.

23 And the reason I bring all this up is
24 because you asked has this happened before. In all
25 the other cases that have come before this Commission

1 what's happened is they've created -- the issue has
2 always been the company is in a net operating loss
3 position because of accelerated depreciation. This
4 is the first time that we are aware of where a
5 company who doesn't use accelerated depreciation has
6 created a net operating loss, that's where things are
7 slightly different. But the underlying logic has
8 been consistent with past cases and I believe Ms.
9 Bolin can speak on that. I also believe that you
10 also should ask Mr. Riley.

11 So to summarize, this is a tax asset. The
12 Company will have a future deduction, the Company
13 received a benefit in the year that it was created
14 because they didn't have to pay income taxes. The
15 Company will receive a future benefit because they
16 are not going to have to pay income taxes in the
17 future, or at least they will pay a lesser amount.
18 The Company is asking for a third benefit which is
19 for you to give them the income tax expense that they
20 otherwise wouldn't have had to pay. And then they're
21 going to get a fourth benefit in the form of they're
22 not going to have pay income taxes on that because
23 they're going to use the NOL to reduce the tax that
24 will be owed on the income tax expense you're going
25 to give them that they're not going to remit which is

1 going to give them profit.

2 There's no reason to do this. The IRS
3 doesn't require this, the Commission has never
4 required this, and as far as compensating the
5 utility, this utility is being fully compensated for
6 -- and I just want to throw this out there -- for the
7 systems that have come in in the past Mr. Murray's
8 evaluation has shown that if you use e-stas EMS run
9 those systems have been getting an ROE of up to 30
10 percent. This company has been heavily compensated.
11 They've hit a not (sic) operating loss for the
12 systems they've acquired but for the systems they've
13 had come in they've been making 30 percent returns.
14 You don't need to give them more money.

15 Are there any questions?

16 JUDGE HATCHER: Chairman Rupp.

17 CHAIRMAN RUPP: Thank you. That was
18 helpful. They are choosing straight line
19 depreciation so all of their tax liability -- all of
20 the deferred tax -- they are going to be able to
21 reduce their operating income with this deferred tax
22 through the straight line ten percent every year?

23 MR. CLIZER: You reduce your income tax by
24 your available deductions.

25 CHAIRMAN RUPP: Right.

1 MR. CLIZER: Depreciation expense is an
2 available deduction whether you use straight line or
3 accelerated. The Company is choosing to use straight
4 line depreciation for tax purposes as well as book
5 purposes which is fairly unique. I'm not sure that
6 there's any other utility -- actually I can't say,
7 I'm not sure about all small water utilities. But
8 it's fairly unique in my experience. The Company is
9 already -- so the Company is not generating an
10 accelerated depreciation tax liability.

11 CHAIRMAN RUPP: Right. They're straight
12 line?

13 MR. CLIZER: Yeah. They're straight line
14 depreciation.

15 CHAIRMAN RUPP: So they will receive the
16 benefit of the net operating loss spread out over the
17 ten years of the depreciation -- of the straight line
18 depreciation?

19 MR. CLIZER: They will receive the benefit
20 of the net operating loss carryforward.

21 CHAIRMAN RUPP: Carryforward.

22 MR. CLIZER: Again, we've got to be
23 careful here.

24 CHAIRMAN RUPP: I can't say -- yeah,
25 that's what I mean.

1 MR. CLIZER: The second they come in to
2 pay income taxes and they have any taxable income
3 they will be able to reduce that taxable income in an
4 amount up to 80 percent. There's a limit that was
5 put on it by the Tax Cuts and Job Acts. But the
6 second they have taxable income they can use their
7 net operating losses to reduce it. If not over the
8 ten year period that they take the depreciation,
9 those are separate concepts. The net operating loss
10 carryforward is going to sit on their books until it
11 is used to reduce their taxable income.

12 CHAIRMAN RUPP: So the net operating loss
13 is reducing the income of the Company in future years
14 which is lowering whatever that years's tax liability
15 for that year?

16 MR. CLIZER: Correct. And when we say
17 reduce the income of course we mean the taxable
18 income, they're not actually losing -- they're not
19 having less money, it's for tax purposes it's
20 reducing income.

21 CHAIRMAN RUPP: Yes. So the less tax that
22 they would have to pay. So the net operating loss is
23 reducing the tax liability of the Company in the
24 future up until the point of which they have
25 exhausted that amount?

1 MR. CLIZER: Correct.

2 CHAIRMAN RUPP: And they are -- can they
3 -- assuming that they're not expending the amount of
4 money on the higher tax level amount in this year
5 because they're deferring it to a future year but
6 they are receiving money from ratepayers to pay that,
7 are they allowed to earn their rate of return on that
8 amount of money from the ratepayers until they
9 exhaust the life?

10 MR. CLIZER: So let's break it down. If
11 the Commission were to say normalize the taxes,
12 meaning effectively put into rates the amount of
13 taxes that we expect to be paid without considering
14 the NOL they're going to have more income tax expense
15 built into their rates than they're actually going to
16 remit. Now, absent anything else, no, what's going
17 to happen is that's just going to be straight profit.

18 Now, if you choose to order them to defer
19 that excess, which is the recommendation of both
20 Staff and OPC, you can have them defer that into a
21 tax deferred account where you can then have that
22 reduce rate base, which is effectively getting to the
23 same point that you're saying. I mean, because rate
24 bases then get -- you multiply that by the weighted
25 average cost of capital. I mean, do you --

1 CHAIRMAN RUPP: Yeah. I'm following, I'm
2 just...

3 MR. CLIZER: And that -- that is exactly
4 consistent with how we've always treated ADIT, or
5 accumulated deferred income tax. See, the problem
6 here is two fold. First, they want to defer an
7 asset, which makes very little sense because why not
8 flow that through immediately; and then second, they
9 don't want the taxes to actually be booked anywhere.
10 At least one of those should be wrong. Both of them
11 -- well, in my opinion you shouldn't allow deferral
12 of an asset because they can -- customers -- sorry,
13 customers can receive the benefit of that
14 immediately. But if, if you're going to book the
15 deferral of an asset you should require them to book
16 that in their accounts as a deferred taxable offset
17 rate base.

18 And again, both Ms. Bolin and Mr. Riley
19 have independently recommended that in surrebuttal.

20 CHAIRMAN RUPP: Thank you. Thank you,
21 Judge.

22 JUDGE HATCHER: Commissioner Holsman.

23 COMMISSIONER HOLSMAN: Thank you. We
24 talked a little earlier about how this is done in
25 other rate cases with other companies. Is net

1 operating loss not a factor because most of those
2 companies do not have net operating loss and so it
3 doesn't come in or is it a policy issue that you
4 don't do it?

5 MR. CLIZER: The companies that come in
6 with net operating losses outside of Confluence come
7 in because the accelerated depreciation is driving
8 them below their taxable income. But remember,
9 accelerated depreciation allows you to forefront your
10 expense. So the company isn't actually -- I'm just
11 going to use as an example Missouri American Water,
12 they were in this situation.

13 The company isn't -- it's not like the
14 company is having less income than they have expenses
15 it's just that for tax purposes the accelerated
16 depreciation is driving you below your -- below your
17 taxable income. And because it's the accelerated
18 depreciation you start putting things in ADIT. And
19 ADIT is what we call a protected tax timing
20 difference. That's where the IRS literally says to
21 you you have to normalize it. This is explained in
22 Ms. Bolin's testimony.

23 This is not accelerated depreciation,
24 there is no ADIT, there is no normalization rule. So
25 what you do in other situations is regulate it by the

1 IRS normalization rules that say you have to
2 normalize accelerated depreciation, create a tax
3 deferred liability.

4 I feel like -- I'm not sure that
5 completely answered your question so please feel free
6 to re-answer -- re-ask it.

7 COMMISSIONER HOLSMAN: I'm just talking
8 about historically with other rate cases. Mr.
9 Smallwood (sic) said that we don't -- that net
10 operating losses are not a part of the tax discussion
11 in previous rate cases. And my question to you is is
12 that true and is that because most companies who come
13 in for a large rate case don't have any net operating
14 losses or is it a matter of policy that it wasn't
15 included in that as a choice?

16 MR. CLIZER: You know, I would absolutely
17 love to answer that question. I think I probably
18 could but I'm a little bit treading on thin ice here.
19 So I'm going to say that the -- probably the best
20 answer to either Ms. Bolin or Mr. Riley. I believe
21 that it has always been Staff's policy to attempt to
22 flow-through non-protected, which would include NOL
23 in most cases, deductions. But from what I
24 understand of what Ms. Bolin has testified it's been
25 a Commission on a case-by-case basis whether or not

1 non-protected tax deferrals, which would include NOLs
2 in this case, are normalized or not.

3 COMMISSIONER HOLSMAN: In this case is the
4 NOL a confidential number? Would we have to go on
5 camera to talk about --

6 MR. CLIZER: I believe that it is listed
7 as confidential in Ms. Bolin's testimony and so I am
8 going to say yes unless somebody tells me that the
9 amount of existing NOLs is not.

10 MR. WOODSMALL: You can make it public.
11 It's nine million dollars.

12 COMMISSIONER HOLSMAN: Okay.

13 JUDGE HATCHER: For the record, and those
14 listening on WebEx, Counsel Woodsmall indicated it
15 was nine million dollars. Thank you.

16 COMMISSIONER HOLSMAN: And so that nine
17 million dollars of net operating loss, in laymen's
18 understanding, would be the amount of expenses that
19 exceeded revenue over the period of time that they
20 operated before they have closed that period to come
21 in for this rate case?

22 MR. CLIZER: That net operating loss
23 represents the accumulation of the expenses over
24 income for each taxable year that they had a net
25 operating loss. So the general answer to your

1 question I think is probably somewhere in a yes but I
2 would be hesitant to absolutely say that with
3 conviction because I would need to kind of figure out
4 whether or not they have net operating loss in each
5 year for example or if they had net operating losses
6 carried forward from other years, I'm not entirely
7 sure what the situation is there.

8 COMMISSIONER HOLSMAN: And you said
9 they're going to use the book line, right, they're
10 not going to use accelerated depreciation they're
11 going to take in ten percent or --

12 MR. CLIZER: They are currently using
13 straight line depreciation.

14 COMMISSIONER HOLSMAN: Straight line
15 depreciation. And do we know how long that nine
16 million will stretch out over time at their current
17 revenues?

18 MR. CLIZER: So -- this comes back to you.
19 I want to make sure this is very clear. The straight
20 line depreciation versus accelerated depreciation
21 does not in anyway affect the timetable for when NOLs
22 are spent down. The reason I was bringing that up
23 was to explain to you what accelerated depreciation
24 is, why an accelerated depreciation tax deferred
25 liability is created, and how that's different from

1 NOL.

2 How long that nine million lasts, right,
3 is purely dependent on the future tax income they can
4 deduct, currently under the existing law, up to
5 80 percent of positive tax income using any NOL
6 carryforward. Which under the Tax Cuts and Jobs Act
7 now extends indefinitely. So what's going to happen
8 is that nine million dollars is going to sit there
9 and for every single future year if they have taxable
10 income they're going to deduct up to 80 percent using
11 some portion of that. And whatever portion is
12 obviously going to then reduce the nine million.

13 COMMISSIONER HOLSMAN: So if they had 12
14 million in the following year they could blow all
15 nine million of it on a reduction?

16 MR. CLIZER: If they had 12 million
17 dollars --

18 COMMISSIONER HOLSMAN: Eighty percent.

19 MR. CLIZER: If they had 12 million
20 dollars in taxable income.

21 COMMISSIONER HOLSMAN: Right.

22 MR. CLIZER: They could use up to 80 --
23 they could deduct up to 80 percent. Again, unless I
24 am corrected by a witness.

25 COMMISSIONER HOLSMAN: Okay. And so the

1 difference here is their position is we should be
2 able to put the amount of money that we would have
3 paid on that nine million into rates. And you're
4 saying that because you're going to spread this out
5 over the course of however long you need it for then
6 it should not be recouped in the rate side, right, is
7 that -- I'm trying to find the crux of the difference
8 between your two positions on why you can't get
9 together?

10 MR. CLIZER: The crux of the position is
11 that Staff and OPC says that that deduction should be
12 recognized when setting the Company's rates and the
13 Company says it should not be recognized, we should
14 pretend like it doesn't exist and have tax --
15 ratepayers pay the amount of taxes if it didn't
16 exist. And we are saying we should have ratepayers
17 pay taxes as -- we should set rates to collect taxes
18 based on what is actually going to be paid in taxes.

19 COMMISSIONER HOLSMAN: And we have the
20 ability, through our order, to let them collect that
21 as if they were going to pay it but then put it into
22 a deferred account so that as it comes in it could
23 then be used to reduce rates once it's been
24 exhausted? Help me further understand that mechanism
25 'cause it sounds like the Commission may have some

1 tools to maybe get to a compromise here.

2 MR. CLIZER: I want to start off by saying
3 that this is the recommendation of both Ms. Bolin and
4 Mr. Riley. So to the extent that I screw anything up
5 here direct that question to them to make sure it
6 gets right. I'm going to tell you what I understand
7 it to be and I'm hoping I'm correct.

8 If the Commission orders these rates --
9 sorry, these taxes to be normalized then the
10 Commission should order the difference between what
11 is included in income tax expense and what is
12 actually remitted or paid to the IRS. That
13 difference should be booked into a deferred tax
14 account which can then offset rate base in future
15 cases until it is used at some long point in the
16 future to pay down actual taxes.

17 COMMISSIONER HOLSMAN: But then it would
18 show up in the existing rate increase as ordered when
19 this is completed? They would start collecting that
20 from the ratepayers? Because that deferred account
21 would have to be filled, right?

22 MR. CLIZER: No. I don't -- I don't think
23 so. What we're saying is that what would be booked
24 to that account would be the difference between
25 income tax expense and what's remitted to the IRS

1 moving forward. The existence of the net operating
2 losses would just be there, they would only generate
3 into that account as they actually pay taxes and
4 didn't remit all of their money to the IRS.

5 So it would start off at zero and then
6 each year, if they paid income taxes -- sorry, when
7 they paid income taxes if there was anything
8 different between what they had in rates and what
9 they actually paid they would put it into that
10 account and it would have no effect on ratepayers
11 until the company came in for the next rate case and
12 there was actually money in there. So it would have
13 zero impact right now.

14 COMMISSIONER HOLSMAN: I guess.

15 MR. CLIZER: I'm genuinely trying to do my
16 best.

17 COMMISSIONER HOLSMAN: I'm trying -- I'm
18 doing my best to try to understand. Truly I am. All
19 right. Thank you. I mean, I...

20 MR. CLIZER: Again, this is the
21 recommendation in surrebuttal of both Ms. Bolin and
22 Mr. Riley. Have them explain it to you if I'm not
23 making sense.

24 COMMISSIONER HOLSMAN: So back to the last
25 question I asked. If, from a macro perspective --

1 and I heard from Staff's position. You know, do you
2 think there should be incentives for rescuing of
3 these distressed systems?

4 MR. CLIZER: The Company earns a profit
5 off of the investments it makes to save these
6 systems. I understand that it is not --

7 COMMISSIONER HOLSMAN: Well, apparently
8 not with a net operating loss of nine million.

9 MR. CLIZER: Because it hasn't come in for
10 a rate case. Once they come in for a rate case they
11 have been earning massive profits on their systems.
12 And they're going to earn a profit on these systems
13 now that they've come in for a rate case. The fact
14 that regulatory lag has occurred, as always happens.
15 You can't base your entire decision on the fact that
16 we have regulatory lag, you need to acknowledge the
17 Company makes money by making the investments
18 necessary to rehabilitate these systems. And if you
19 look at their entire business model do you really
20 think they're about to stop? They've been expanding
21 like crazy, they are making money.

22 They were bought out by a large firm
23 because it was recognized how profitable this entire
24 enterprise could be. You are going to increase their
25 rates by some amount presumably in order to make sure

1 that they are being incentivized to continue doing
2 this just on what's in rate base. You don't need to
3 give them additional money. You don't need to
4 incentivize a company to do its job.

5 COMMISSIONER HOLSMAN: Thank you, Judge.

6 JUDGE HATCHER: Before -- excuse me.

7 Before I forget, I do have a quick announcement. I'd
8 like the record to reflect the attendance of
9 Commissioner Maida Coleman, she has joined via WebEx.
10 All five Commissioners are in attendance.
11 Commissioner Hahn.

12 MR. CLIZER: Oh, I have more questions. I
13 apologize. I was about to step away.

14 COMMISSIONER HAHN: Thank you, Mr. Clizer.
15 Given that this is a very unique company that buys
16 distressed systems and repairs them, do you
17 anticipate that the future -- in the future they
18 would continue to experience significant net
19 operating losses?

20 MR. CLIZER: That's honestly hard to say
21 because it would be dependent on the rate of
22 expansion and the rate of rate cases. If they come
23 in regularly for rate cases and they get -- no, I
24 mean, it's not guaranteed that they're going to
25 experience net operating losses. Now, if they

1 continue to expand extremely rapidly and they're not
2 coming in for rate cases regularly then yes. I mean,
3 that's simple, right. If you don't take the time to
4 come in and deal with the regulatory lag you're going
5 to suffer for it. But it's not a guarantee.

6 COMMISSIONER HAHN: Thank you.

7 CHAIRMAN RUPP: Judge, I have one more.

8 JUDGE HATCHER: Chairman.

9 CHAIRMAN RUPP: Thank you. I was going to
10 save this for Kim just so she would have some
11 questions but I figured since Commissioner Hahn just
12 kind of jumped on I'm going to follow up.

13 What is the incentive to not just this
14 company, any utility company? Is there a better
15 incentive for them to take all of their net operating
16 loss and take it off all of their tax liability if
17 they can outside of a test year or is there a better
18 incentive for them to have a bigger net operating
19 loss and collect -- during a test year?

20 MR. CLIZER: That's probably something you
21 should probably ask Ms. Bolin.

22 CHAIRMAN RUPP: I will ask.

23 MR. CLIZER: I would ask Mr. Riley too.

24 CHAIRMAN RUPP: Okay.

25 MR. CLIZER: That's a -- I would need to

1 think through that one exactly.

2 CHAIRMAN RUPP: Thank you.

3 MR. CLIZER: Sorry about that.

4 CHAIRMAN RUPP: No. No. Appreciate it.

5 JUDGE HATCHER: Seeing no more

6 Commissioner questions. Thank you, Mr. Clizer.

7 Let's start with our first witness.

8 Confluence, go ahead and call your first witness.

9 MR. WOODSMALL: Thank you. And some
10 preliminary matters. First thing, there were a lot
11 of questions that went naturally far afield from
12 taxes. There were questions about incentives and
13 whether someone --

14 JUDGE HATCHER: Mr. Woodsmall, you've had
15 your opening statement. Can you call your witness?

16 MR. WOODSMALL: Yes. But I'd like to call
17 Mr. Cox so you guys could ask your questions about
18 incentives and whether companies will continue to
19 invest.

20 JUDGE HATCHER: No, sir. I would like Mr.
21 Seltzer or Mr. Thies, please.

22 MR. WOODSMALL: Okay. If the Commissioner
23 doesn't want to hear from the guy that knows then we
24 will --

25 JUDGE HATCHER: No. The Commissioner

1 doesn't want it hear it out of order. Can we please
2 proceed with the issue at hand.

3 MR. WOODSMALL: I am proceeding. So given
4 that, we would call Mr. Thies.

5 JUDGE HATCHER: Mr. Thies, go ahead and
6 have a seat. You've already been sworn in. I just
7 remind you that you are still under oath.

8 Go ahead. Your witness.

9 * * * * *

10 BRENT THIES,

11 The witness, having been recalled upon his
12 oath, testified as follows:

13 * * * * *

14 EXAMINATION CONDUCTED

15 BY: MR. WOODSMALL

16 Q. Would you state your name for the
17 record?

18 A. Brent Thies.

19 Q. And you're the previous Brent Thies
20 that testified yesterday; is that correct?

21 A. Yes, sir.

22 MR. WOODSMALL: And at that time, your
23 Honor, you admitted the direct, rebuttal, and
24 surrebuttal testimony, Exhibit 17, 18, and 19. I'd
25 ask for indulgence here. In -- as Staff and Public

1 Counsel acknowledged in their surrebuttal testimony,
2 they raise a new position. It wasn't in their
3 direct. They raised the idea that you could put this
4 into a deferred account. Because it was surrebuttal
5 we never got to respond so I'd like to ask him one
6 question.

7 MR. CLIZER: Yeah, I object absolutely.
8 It was in surrebuttal because it was response -- I'm
9 sorry, I didn't wait for you to ask if there were
10 objections.

11 JUDGE HATCHER: You're fine. Go ahead.

12 MR. CLIZER: I was hot on the gun. It was
13 proper surrebuttal. It was responding directly to
14 the recommendations made by Brad Seltzer. We don't
15 have an opportunity to respond to what he's going to
16 say at this point. You can't get into this back and
17 forth situation here. We have written testimony for
18 a reason.

19 MR. WOODSMALL: Your Honor.

20 JUDGE HATCHER: Mr. Clizer, what's the
21 reason then for this live testimony?

22 MR. CLIZER: To cross-examine. Which is
23 why we always just do direct of, introduce it, and
24 tender.

25 MR. WOODSMALL: Your Honor, just to

1 complete the thought very quickly. This was an issue
2 introduced in surrebuttal, it clearly got
3 Commissioner Holsman's attention. I'd like one
4 question just to acknowledge the fact that it was
5 done in surrebuttal.

6 MR. CLIZER: Your Honor, if you have that
7 issue in front of you, Bench can ask questions. Mr.
8 Woodsmall doesn't need to open this up. If the Bench
9 wants to know I'm sure the Bench will ask.

10 MR. WOODSMALL: And if -- that's what I'm
11 asking. Will the Bench allow me to do that for them?

12 MR. CLIZER: Does the Bench really need
13 Mr. Woodsmall to be their lawyer on this?

14 MR. WOODSMALL: It's a matter of getting
15 to the truth.

16 THE COURT: You guys have a lot of loaded
17 questions today. Okay. The Commission is interested
18 in these answers. Mr. Thies's testimony has already
19 been introduced. While traditionally the Commission
20 does have the counsel for the witness simply tender
21 them, in this situation, anticipating the interest in
22 this matter and wanting to make sure that, A, it gets
23 covered, and B, that the other parties have an
24 opportunity to respond, because they will be
25 following Mr. Thies and also available to

1 cross-examine Mr. Thies on Mr. Woodsmall's question.
2 Mr. Clizer.

3 MR. CLIZER: On that note then -- and I'm
4 just going to ask it now and I'll bring it up later.
5 Are the witnesses by OPC and Staff going to be
6 permitted to be asking the same question to their
7 witness as part of their direct?

8 MR. WOODSMALL: If you want to ask the
9 same exact question.

10 MR. CLIZER: Response to.

11 JUDGE HATCHER: Mr. Woodsmall, what's your
12 question?

13 MR. WOODSMALL: First off I'm going to
14 ask --

15 JUDGE HATCHER: No, to me. What's your
16 question? No, no. What is your question going to
17 be?

18 MR. WOODSMALL: Okay. I was going to
19 first ask him their surrebuttal, establish that
20 foundation. What is your response to their proposal
21 as contained in that surrebuttal.

22 MR. CLIZER: We'd like the opportunity to
23 respond to his response.

24 JUDGE HATCHER: I think that's all fair
25 game. Go ahead.

1 BY: MR. WOODSMALL

2 Q. Okay. Mr. Thies, did you review the
3 surrebuttal testimony of Ms. Bolin and Mr. Riley on
4 the issue of income taxes?

5 A. Yes.

6 Q. And did you see there a proposal that
7 any taxes collected in rates here be deferred into a
8 liability?

9 A. Yes.

10 Q. And what is your response to that?

11 A. I think that makes some sense in
12 terms of what we're doing here, that effectively
13 gives the concept we're talking about here of net
14 operating losses a similar treatment to accumulated
15 deferred income tax as Mr. Clizer described in his
16 opening.

17 I think the issue that wasn't dealt with
18 that maybe is in the Company's view is we have this
19 nine million dollar number and there's no asset
20 treatment for that in rate base so we would reduce
21 rate base on one side and not get any credit in rate
22 base for the history of losses there. So it feels a
23 little unbalanced but as stated there with a deferred
24 tax liability that part makes some sense to the
25 Company.

1 Q. Thank you.

2 MR. WOODSMALL: I tender the witness for
3 cross.

4 JUDGE HATCHER: Thank you, sir. I believe
5 we go to Staff.

6 MR. THOMPSON: No questions at this time,
7 Judge. Thank you.

8 JUDGE HATCHER: Thank you. Mr. Clizer.

9 MR. CLIZER: No questions.

10 JUDGE HATCHER: Thank you. Are there any
11 Commissioner questions? Commissioner Holsman.

12 COMMISSIONER HOLSMAN: Do you got one, Mr.
13 Chairman?

14 CHAIRMAN RUPP: I do, but...

15 COMMISSIONER HOLSMAN: Well, you're the
16 Chairman.

17 CHAIRMAN RUPP: You're very kind.

18 COMMISSIONER HOLSMAN: Defer to the
19 Chairman.

20 JUDGE HATCHER: Chairman Rupp, you have a
21 question.

22 EXAMINATION CONDUCTED

23 BY: CHAIRMAN RUPP

24 Q. Based off of your answer to your
25 attorney, --

1 A. Uh-huh.

2 Q. -- are you in agreement with Staff
3 and OPC's position for this tax liability treatment?

4 A. I think it's half of the solution. I
5 think their solution to allow the taxes in rate
6 making, which we believe is consistent with the rate
7 making that we've done in the State of Missouri in
8 our other five rate cases and that we're doing in
9 other parts of the country, other states, it's
10 consistent with all of that to allow taxes based on
11 the return that's granted in this rate case. And so
12 to book that into a deferred tax liability because
13 there is this another issue of NOLs makes some sense.

14 I think the part that isn't clear to the
15 Company is what -- is there fairness. We haven't
16 asked for some kind of treatment in rate base for
17 this nine million dollar number. And so conceptually
18 we would be reducing our rate base later for this
19 liability and get no credit in it now or in the
20 future for whatever is there in terms of the net
21 operating losses. So it feels like a one-sided
22 solution but that one side makes sense, if I can say
23 it that way.

24 CHAIRMAN RUPP: Okay. Thank you.
25 Appreciate it.

1 JUDGE HATCHER: Mr. Holsman.

2 COMMISSIONER HOLSMAN: Thank you.

3 EXAMINATION CONDUCTED

4 BY: COMMISSIONER HOLSMAN

5 Q. So what would be -- first off, part
6 of the solution that you agree with is -- would that
7 then moot the Staff and OPC's point that the taxes
8 would then be pure profit for the Company if they're
9 being booked for later deployment?

10 A. Yes. I mean, from a cash
11 perspective, the cash would be here now but a
12 liability would be booked that would reduce rate base
13 in the future. So yes.

14 Q. So what would your recommendation be
15 then for the other part of the equation? You say
16 this is one-sided, how would you then reflect the
17 nine million dollar net operating loss in some sort
18 of asset or some way to recognize that in the
19 process?

20 A. Sure. So we have -- excuse me -- a
21 mechanism in some other states to book the net
22 operating losses on acquired systems as an asset for
23 consideration in future rate cases. And so that's
24 all part of the state's determined incentivization
25 for us to continue to buy these distressed systems.

1 So something like that that could recognize a net
2 operating loss as an asset. Then it effectively
3 removes it from the consideration -- removes that
4 loss from the consideration of taxes in the current
5 year and so that would be the balancing piece. So
6 think we buy a system and maybe it loses \$10,000 per
7 year. If we could book that \$10,000 as an asset to
8 be considered in the future in rate base then the
9 liability makes some sense as the balance. And as I
10 said, we have that in a couple of other states
11 currently.

12 Q. And so your testimony is that in
13 other states they have taken that net operating loss
14 and booked it as an asset in the overall case?

15 A. Correct.

16 Q. Is that something that you're aware
17 that the State of Missouri has a practice of doing
18 or --

19 A. Not to my knowledge.

20 Q. So this would be a departure from the
21 way that normal rate cases are proceeded?

22 A. It would be. And I would also offer
23 that, you know, this whole, you know, net operating
24 loss issue seems to be a departure as to what to do
25 with it. But that part would be new and novel in

1 Missouri, yes.

2 COMMISSIONER HOLSMAN: All right. Thank
3 you, Judge.

4 JUDGE HATCHER: Thank you, Commissioner.
5 Are there any other Commissioner questions? The
6 Bench has no questions. That takes us to re-cross
7 examination. Mr. Thompson.

8 MR. THOMPSON: No questions, Judge. Thank
9 you.

10 JUDGE HATCHER: Mr. Clizer.

11 MR. CLIZER: Yes.

12 EXAMINATION CONDUCTED

13 BY: MR. CLIZER

14 Q. In response to one of the questions
15 from Mr. Holsman, you said that the deferred tax
16 liability would reduce rate base in the future?

17 A. Uh-huh.

18 Q. How would that happen?

19 A. If we -- excuse me. If we were -- so
20 the way I understand it is -- and let's say we were
21 collecting ten dollars of income tax in the rates
22 currently. The amount that we don't actually pay in
23 cash would be booked into a liability that in the
24 future could reduce rate base.

25 Q. When would it start reducing rate

1 base?

2 A. Next rate case.

3 Q. So you agree that it should reduce
4 rate base in the next rate case?

5 A. I'm suggesting that as a part of a
6 balanced solution it makes some sense to have a
7 mechanism like that.

8 Q. Okay. But, to make sure I understand
9 this correctly, you are proposing to create a
10 deferred tax liability that would offset rate base in
11 the future?

12 A. I'm responding to a proposal someone
13 else made. But what you're saying I think is my
14 suggesting that it would be for a future rate case,
15 yes.

16 Q. Okay. So you would agree that it
17 makes sense if you were going to book the excess
18 income tax expense that's not remitted to the IRS
19 into a deferred tax liability that that offset rate
20 base in the future case?

21 A. That makes sense from the Company's
22 perspective only when a company buys some sort of
23 asset treatment. But that part, yes.

24 Q. All right. So with regard to
25 recognizing the NOL. Let me make sure I understand

1 this correctly. The net operating losses that we're
2 talking about here. And for the record, NOL, net
3 operating loss, I'm going to use them
4 interchangeably. Those were generated, per the
5 Company's statement, because the Company purchased
6 systems with existing rates, correct?

7 A. Correct.

8 Q. And those rates -- sorry. The
9 Company then invested in those systems, correct?

10 A. Correct.

11 Q. And your argument is that the rates
12 that were currently in effect didn't cover the
13 investments, right?

14 A. It didn't cover the full cost of
15 operations which includes more than investments, it's
16 operational costs as well.

17 Q. So what your goal is is to allow the
18 Company some kind of asset to recognize the fact that
19 those rates weren't covering what you needed to; is
20 that right?

21 A. Yes.

22 Q. Right. So it's to go back and say we
23 need to get the money that we should have been
24 charging in order to cover these investments,
25 correct?

1 A. Going back would obviously be in the
2 Company's interest. I think a proposal like this
3 that starts today and it is booked concurrently with
4 the deferred tax liability makes sense as well.

5 Q. But to make sure I understand it
6 correctly, I just want to understand the argument
7 correctly. What you're proposing would be to have an
8 asset to allow you to go back and recover what you
9 should have recovered in order to make these
10 improvements?

11 A. What do you mean go back?

12 Q. Well, it would allow you to recover
13 what you needed to have recovered, what the rates
14 should have been in order to make the money necessary
15 to cover the improvements?

16 A. I still don't know what you mean by
17 go back in terms of an actual timeline. Are you
18 talking about going back to 2015, are we talking
19 about going back between rate cases, what's the
20 phrase?

21 Q. Okay. Let's simplify and make sure
22 we're trying to be clear here. The NOL was created
23 because the rates that were in effect weren't
24 sufficient to cover the improvements made, correct?

25 A. To cover the cost of service.

1 Q. Cost of service. I'm sorry, let me
2 try to make sure that's clear. You're saying that
3 this asset would allow the Company to effectively
4 have the income that would have been the case if
5 those rates had been set at what they needed to to
6 cover the cost of service?

7 A. It's a little bit nuanced. I'm not
8 suggesting -- so the mechanism could work and does
9 work in other states such that you establish a
10 formula, you know, revenues minus operating expenses
11 and whatever the negative number is there goes into a
12 regulatory asset. So it's not a recovery of
13 depreciation and it's not a recovery of any lost
14 return on equity or interest kind of expense, it's
15 simply the operational cost.

16 Q. I understand that. But as far as the
17 operational costs go it would effectively allow the
18 Company to recover what they would have recovered if
19 the rates had been changed to allow them to meet
20 those operational costs; is that accurate?

21 A. Yes. If you -- the same thing could
22 be accomplished by changing rates during an
23 acquisition case, yes.

24 Q. Okay. So the goal of your
25 recommendation is to allow the Company to operate as

1 if they had changed the rates during an acquisition
2 case, is that what you just said? It would put you
3 in the same position?

4 A. Mathematically that's the equivalent,
5 yes.

6 Q. Thank you.

7 MR. CLIZER: I have no further questions.

8 JUDGE HATCHER: Thank you. And re-direct.

9 MR. WOODSMALL: Thank you, your Honor.

10 EXAMINATION CONDUCTED

11 BY: MR. WOODSMALL

12 Q. Let's talk about some of these other
13 states. CSWR has affiliates in 13 states; is that
14 correct? Twelve?

15 A. Twelve, yes.

16 Q. Okay. Twelve. And in all those
17 states you use the same business model; is that
18 correct?

19 A. That's correct.

20 Q. In that you go in, you acquire
21 distressed systems and you adopt the rates; --

22 A. That's correct.

23 Q. -- is that correct?

24 A. Uh-huh.

25 Q. And similar to here, the rates do not

1 cover operating costs; is that correct?

2 A. That's correct.

3 Q. And that's because the rates are
4 dated, sometimes decades, as well as the fact as
5 operating costs are going up?

6 A. Correct.

7 Q. Okay. So in all these states, you
8 incur a net operating loss?

9 A. Yes.

10 Q. Okay. Let's start first off. In all
11 these states that you've incurred a net operating
12 loss and you had a rate case, have any of those
13 states sought to recognize that net operating loss
14 that was incurred by the investors for the benefit of
15 the customers?

16 MR. CLIZER: I'm going to object as to
17 relevance. This case concerns Missouri. We do not
18 concern ourselves with the laws of other states.
19 There may be statutory requirements, rule
20 requirements, et cetera, at play in other states and
21 is misleading the Commission to suggest what other
22 states do is what Missouri must do.

23 MR. WOODSMALL: Your Honor, Mr. -- I'm
24 sorry. Commissioner Holsman was asking about other
25 states and incentives and how things are done. So I

1 think -- I think clarifying that as to how other
2 states operate is directly responsive to his
3 question.

4 JUDGE HATCHER: I agree. The objection's
5 overruled.

6 BY: MR. WOODSMALL

7 Q. In all these other states, first off,
8 has any Commission attempted to use those net
9 operating losses that the investors incurred for the
10 benefit of customers?

11 MR. CLIZER: I object to the form of the
12 question. That is not consistent with what the OPC
13 or Staff is recommending.

14 THE WITNESS: Can you re -- can you ask
15 again?

16 BY: MR. WOODSMALL

17 Q. Okay. The investors incur net
18 operating losses; is that correct?

19 A. Yes.

20 Q. And those net operating losses, the
21 customers benefit from the investors incurring those
22 net operating losses?

23 A. That's correct.

24 Q. Okay. And so while they benefit from
25 the net operating losses up front, are you aware of

1 any state commissions that then try to give those
2 customers the benefit of the net operating losses
3 again through a reduction in rate making?

4 A. No.

5 Q. Okay. Let's move to the second part,
6 what the other states do. Let's talk Mississippi.
7 You're familiar with the recent Mississippi rate
8 case?

9 A. Yes.

10 Q. Okay. And there, can you tell me --
11 well, explain first what the mechanism is? You said
12 a regulatory asset. But can you tell us more about
13 what that is?

14 A. Sure. It's a System Acquisition
15 Regulatory Asset is the -- SARA is the acronym. And
16 it effectively does what I was explaining to Mr.
17 Clizer. For newly acquired systems it tracks revenue
18 less expenses and whatever that negative number is is
19 moved to the balance sheet for consideration in
20 future rate proceedings.

21 Q. And because that's put on the balance
22 sheet it's included in rate base in those other
23 states?

24 A. Correct.

25 Q. And the company is allowed to earn a

1 return?

2 A. Correct.

3 Q. Okay. Despite that, those regulatory
4 assets in both -- first off, that mechanism is done
5 in Mississippi and Louisiana; is that correct?

6 A. Correct.

7 Q. Okay. And that mechanism, taking
8 those losses and hanging them on the balance sheet as
9 a regulatory asset, is from X date going forward; is
10 that correct?

11 A. Correct.

12 Q. Okay. The past net operating losses
13 are not included in that regulatory asset, are they?

14 A. Correct. Only from the date of
15 Commission approval of booking that asset and moving
16 forward. Nothing historically.

17 Q. Okay. So while you've gone through
18 rate cases and that regulatory asset would effect
19 losses going forward, how have those Commissions
20 handled the past net operating losses?

21 A. No consideration given to them either
22 to reduce anything in current rate making or any kind
23 of asset from the historical standpoint.

24 Q. Okay. Would you believe -- we were
25 talking incentives again. Would you believe that

1 relative --

2 MR. CLIZER: Your Honor, I don't believe
3 that incentives were brought up as part of the
4 cross-examination. I thought it was brought up
5 during the openings.

6 MR. WOODSMALL: There were questions about
7 other states and relative to other states.

8 MR. CLIZER: Nobody mentioned incentives.

9 COMMISSIONER HOLSMAN: Do we have a chance
10 to ask questions once this is concluded?

11 JUDGE HATCHER: I can make it happen.

12 COMMISSIONER HOLSMAN: Okay.

13 JUDGE HATCHER: I'm of the belief that
14 we're going to have --

15 MR. CLIZER: Additional questions from the
16 Bench.

17 JUDGE HATCHER: We'll go back through
18 re-cross and re-direct. When you say incentives, are
19 you using that as a term of art reference to a
20 statutory or regulatory scheme or are you using that
21 as language?

22 MR. WOODSMALL: Let me clarify that with a
23 question and then you can take that up, if that works
24 for you. It's not a question to you but let me
25 rephrase the question.

1 BY: MR. WOODSMALL

2 Q. Given that Mississippi and Louisiana
3 have this regulatory asset treatment would
4 acquisitions in those states be viewed more favorably
5 than acquisitions in Missouri if Missouri doesn't
6 have it?

7 A. Absolutely.

8 MR. WOODSMALL: I have no further
9 questions. Thank you.

10 JUDGE HATCHER: Thank you. That was the
11 end of re-direct. However, as announced, we do have
12 further Commissioner questions. Commissioner
13 Holsman.

14 COMMISSIONER HOLSMAN: Thank you.

15 EXAMINATION CONDUCTED

16 BY: COMMISSIONER HOLSMAN

17 Q. So my first question is the SARA that
18 you mentioned. Was that a -- was that a product of a
19 statute that had to be passed in Mississippi and
20 Louisiana to allow those Commissions to book that as
21 a regulatory asset?

22 A. I don't think it had anything to do
23 with existing statutes. It was part of a
24 conversation with those Staffs about how to continue
25 to do what we had been doing in those states.

1 Q. So it's your testimony that that was
2 -- that scheme, as it were, --

3 A. Yeah.

4 Q. -- was a product of the Commissions
5 and not a product of requiring statute to allow that
6 to occur?

7 A. That's correct.

8 Q. Okay. And you view that as -- we use
9 the term incentive -- but as a signal for investors
10 to rescue distressed systems?

11 A. Absolutely. And certainly in our
12 investor context it is viewed favorably.

13 Q. Do you think that it would create a
14 prolonging of return for a rate case if the Company
15 knows that they're able to take this net operating
16 loss and book it as an asset, that it would keep them
17 out of a rate proceeding longer than normal without
18 an absence of being able to book that as an asset?

19 A. That's a good question. I don't
20 think so. Because it is a -- you know, effectively
21 an accounting trick, it has nothing to do with real
22 cash. So, you know, you're able to, you know,
23 protect your income statement and have some future
24 consideration for those losses. But it still does
25 nothing to sort of eliminate the cash reality that's

1 happening when we buy those systems.

2 Q. Is it your experience in these other
3 circumstances that the taxes then are deferred and
4 that this is a two part approach to the net operating
5 loss and the tax collection issue? Like are they
6 normally paired together?

7 A. They are not. We have not
8 experienced a deferred liability alongside this.
9 We've only experienced the regulatory asset.

10 Q. So in the other states that you're
11 citing, they provide the regulatory asset and they
12 provide the taxes to flow-through as if there wasn't
13 a net operating loss?

14 A. They do. And it's important to note
15 that this regulatory asset eliminates expense and so
16 would therefore increase your taxable income. And
17 that's just the accounting mechanics. I don't want
18 to get incredibly technical because it is -- or it
19 could be. But this is effectively saying, you know,
20 I didn't have enough revenue and whatever that number
21 is I'm going to reduce my expenses for so that my
22 taxable income is zero there so I'm not incurring
23 that net operating loss that can be used in the
24 future.

25 COMMISSIONER HOLSMAN: Okay. That's all

1 the questions I have, Judge.

2 JUDGE HATCHER: Thank you. Are there any
3 other Commissioner questions? The Bench has at least
4 one.

5 EXAMINATION CONDUCTED

6 BY: JUDGE HATCHER

7 Q. Would you offer your response to the
8 following statement. Confluence knew the rules of
9 Missouri when it purchased its systems, why is it now
10 asking for a change? I guess that was the question,
11 sorry.

12 A. Sure. I don't think Confluence is
13 asking for a change. You know, we came into the
14 state with the understanding that there was going to
15 be a period of net operating losses. Then in rate
16 making, in our first Staff assisted rate cases income
17 taxes were recognized there. And so this removal of
18 income tax expense from the rate making equation
19 would be the departure not what the Company has
20 requested. Now, that's prior to today.

21 Q. I want to clarify that. And I'm
22 sorry to interrupt. Was that system earning revenue
23 or was that system earning a loss?

24 A. Which system?

25 Q. The one that you were referencing

1 early on. Because that seems to be the difference
2 here.

3 A. Well, so everything that we have
4 purchased initially loses money, right. And so as we
5 have, you know, taken some of the -- gone through
6 some of the Staff assisted rate cases there is one of
7 those companies, Hillcrest, that prior to
8 consolidation, which the Commission approved, it
9 actually was earning some income. But other than
10 that one, we -- none of our six companies that became
11 one had ever earned income -- taxable income.

12 Q. Okay. I do have a follow-up
13 question. If I understand what the situation is,
14 similar to deferred acceleration, which is not this
15 case, but similar to that case where with an
16 accounting mechanism the Company is allowed a -- I
17 believe the phrase is a no interest loan to operate.
18 And I believe Confluence has acknowledged that's not
19 our situation, however that is the treatment we're
20 asking for because of these distressed systems we're
21 purchasing.

22 How should the Commission distinguish
23 Confluence's position essentially asking for, I think
24 what Mr. Clizer had referenced Ms. Bolin as stating
25 as a per situation solution. How are you going to

1 distinguish that from every other water company that,
2 as your counsel pointed out, might come in and
3 purchase any of the 3,000 small sewer districts in
4 Missouri, or whatever the appropriate number is, and
5 those companies then saying, hey, we also would like
6 our net operating loss for that system recognized in
7 our income taxes in order to take advantage of the
8 accounting mechanism in a similar manner of
9 accelerated depreciation and get our interest free
10 loan?

11 A. There's a significant policy question
12 there that is clearly, you know, a bigger concern for
13 the Commissioners, I think. For -- in our experience
14 we have, you know, sought to have conversations with
15 state commissioners -- state commissions in other
16 places to try to understand how we can acquire the
17 systems that are most distressed and do that well and
18 where Commissions have desired us to do that there
19 are certainly times when we've been incentivized.
20 And so the statutory policy making piece of that
21 makes me very nervous to sort of comment on because I
22 can't possibly know all of the component pieces of
23 that.

24 But I think as we're talking about it
25 today, without a statute in place, it should be

1 viewed in the light of what the Company has done and
2 would like to continue to do in the future and how
3 that benefits the people of Missouri and the people
4 served by these distressed systems.

5 Q. I didn't hear an answer to my
6 question though.

7 A. I'm trying not to answer like telling
8 you what policy to make. And I apologize for, you
9 know, being a little dodgy.

10 Q. I'm asking you to distinguish
11 Confluence Rivers from the competitor that may be
12 listening to this hearing and saying, a-ha, --

13 A. Sure.

14 Q. -- I am going to start my own utility
15 operating company, I'm going to go out and purchase
16 distressed systems for low investment money and then
17 as long as I can float the expense for X number of
18 years to a rate case --

19 A. Uh-huh.

20 Q. -- I will then get the rate increase
21 to cover my expenses plus they are going to ask, hey,
22 I bought this distressed system, I'd like my income
23 tax treated like Confluence. Can you distinguish
24 Confluence Rivers from that situation?

25 A. So I think pragmatically, especially

1 on the lowest quality systems, we're the only ones in
2 the state who are doing this type of work. So can --
3 you know, I don't know of an analog to us, especially
4 on the extremely small sized systems. And so I don't
5 know that that exists.

6 I think the other piece of that is
7 wouldn't it be a good thing, from a Commission
8 perspective, if there were incentives to fix
9 problems. And so, you know, I don't know that I can
10 offer anything that would say we are this and we
11 should get special treatment. I think I'm suggesting
12 this is a potential incentive for the problem in the
13 State of Missouri. And currently I don't know that
14 anyone else is doing it, especially at the extremely
15 small level -- small system size that we are.

16 JUDGE HATCHER: I'm just going to note
17 it's 11:58. I have gone in a unique direction. Are
18 there any Commissioner questions? Okay. Let's go
19 back to re-cross. We'll start with Staff.

20 MR. THOMPSON: Thank you, Judge.

21 EXAMINATION CONDUCTED

22 BY: MR. THOMPSON

23 Q. To follow up on the line of
24 questioning from Commissioner Holsman and also from
25 the Judge. You would agree with me that a net

1 operating loss is a concept that comes from the tax
2 code?

3 A. Yes.

4 Q. And the way it's treated is a tax
5 issue; isn't that correct?

6 A. Certainly there are ways -- and as we
7 described, accumulated deferred tax that makes its
8 way into rate making. But it does come from the tax
9 code initially, yes.

10 Q. But A-D-I-T is something different
11 than what we're talking about here today, isn't it?

12 A. It is.

13 Q. In fact, care has been taken to make
14 it clear that this case has nothing do with A-D-I-T;
15 isn't that correct?

16 A. That's correct.

17 Q. Okay. So a net operating loss you
18 have agreed is a tax concept. And isn't it true that
19 the prohibition on retroactive rate making means
20 there cannot be anything like a net operating loss
21 carryforward with respect to rate making?

22 MR. WOODSMALL: Your Honor, I would object
23 to the extent it's asking for a legal conclusion, for
24 him to make any type of legal conclusion that this is
25 retroactive rate making certainly if they want to

1 talk accounting. But whether there's a prohibition
2 against retroactive rate making, we should probably
3 handle that in the briefs.

4 JUDGE HATCHER: No. I'd like to hear the
5 witness's answer on this. He is an expert in the
6 utility industry, I'm sure he has some familiarity
7 with that. He's expressed familiarity with other
8 states on other administrative issues.

9 THE WITNESS: I am unfortunately not an
10 expert on the history of retroactive rate making and
11 the rules around that. I would suggest though that
12 retroactive rate making in this case could be
13 happening with past net operating losses being
14 applied to current rates. So -- and again, I'm not
15 an expert but the term retroactive feels as if it's
16 cutting both ways here.

17 BY: MR. THOMPSON

18 Q. You acknowledge that when you
19 purchase these systems that have inadequate rates
20 that the rates can be reset as part of the
21 acquisition case?

22 A. They have not been historically. I
23 guess that's possible though from a Commission
24 perspective.

25 Q. And do you have any explanation for

1 why the Company has not pursued seeking a reset of
2 those rates upon acquisition?

3 A. I know that -- excuse me. I know
4 that we preferred to keep the rates as they are for
5 public relations and customer service purposes and,
6 you know, if there were Commission policy around
7 setting those rates in acquisitioning cases we
8 certainly would pay attention to this. But our
9 preference would be to allow the customers a period
10 of time to get to know us before we raise their rates
11 which, as we know in this case, is not popular.

12 Q. And in your testimony you have raised
13 the operating losses as the justification for the
14 income tax treatment you seek, haven't you?

15 A. I'm not sure I follow.

16 Q. Well, let me take a look at your
17 position statement which was written by your
18 attorney; is that correct?

19 A. Yes.

20 Q. Based upon your testimony; is that
21 correct?

22 A. I don't know exactly what you're
23 referring to.

24 Q. You don't know where it came from,
25 okay. "In the process of acquiring distressed

1 systems, Confluence Rivers adopts the current rates
2 charged by those systems. In many cases these rates
3 are years or even decades old. As such, those rates
4 do not reflect the cost of service at the time of
5 acquisition and certainly do not reflect the
6 increased costs associated with the capital
7 investment and professional operations provided by
8 Confluence Rivers. Until Confluence Rivers files a
9 rate case and rates are increased to reflect
10 operational costs Confluence Rivers incurs a net
11 operating loss. Effectively, this net operating loss
12 is a quantification of the benefit that ratepayers
13 receive from Confluence Rivers providing service at a
14 below cost rate."

15 Skipping down to the next paragraph.
16 "Contrary to other states, Staff and Public Counsel
17 seek to use this net operating loss to reduce the
18 rates resulting from this case epitomizing the notion
19 of looking a gift horse in the mouth. Staff and
20 Public Counsel believe that ratepayers should not
21 only receive the benefit of both low cost initial
22 rates but also receive the tax benefit resulting from
23 those below cost rates."

24 Do you have any reason to disagree that
25 that's what the position statement filed by this

1 Company says?

2 A. No.

3 Q. Okay. And do you hear any echoes of
4 your testimony in that language?

5 A. Some. Certainly not all. Some.

6 Q. Okay. So you would agree with me
7 then that your attorney at least has linked operating
8 losses to the tax treatment the Company is seeking as
9 the justification for that favorable rate making
10 treatment of the tax issue; isn't that correct?

11 A. Can you say that again? Linked? I'm
12 not sure what you mean there.

13 Q. Well, when I read the position
14 statement it wasn't saying anything about tax law,
15 was it?

16 A. No.

17 Q. It was instead talking about
18 Confluence Rivers' losses because the rates are
19 inadequate in the systems it purchases?

20 A. Uh-huh.

21 Q. That those rates do not, in fact,
22 cover operating costs?

23 A. Correct.

24 Q. So you would agree then that the
25 favorable tax treatment that the Company is seeking

1 is in fact a way of recovering money lost because
2 rates were inadequate for past services?

3 A. I would not frame it that way, I
4 don't think that's a -- I don't think that's a way we
5 have framed it. I think the Company is seeking
6 consistent rate making math, if you will, you know,
7 the operating costs plus depreciation, amortization,
8 taxes and return are what make up the rate making
9 equation. That's what the Company's seeking. I
10 understand the connection that can be made there but
11 I don't think that's the way the Company views that
12 initially.

13 Q. And a net operating loss reflects
14 losses that occurred in a prior taxable year; isn't
15 that correct?

16 A. That's correct.

17 MR. THOMPSON: No further questions,
18 Judge. Thank you.

19 JUDGE HATCHER: Thank you. Mr. Clizer.

20 MR. CLIZER: Yes.

21 EXAMINATION CONDUCTED

22 BY: MR. CLIZER

23 Q. I'd like to start with a line of
24 questioning focused on the incentive conversation you
25 were having with Commissioner Holsman.

1 A. Okay.

2 Q. Before I wanted to kind of level set.
3 You would agree with me that the purpose of this rate
4 case in general is to bring Confluence's rates in
5 line with its cost of service?

6 A. Correct.

7 Q. And by cost of service, just to make
8 sure everybody's on the same page, we're talking
9 about the cost required to meet its operation costs
10 to continue serving customers, correct?

11 A. Correct.

12 Q. And in addition -- well, the issue at
13 hand here is income tax expense, correct?

14 A. Correct.

15 Q. And the improper amount of income tax
16 that needs to be put into rates, correct?

17 A. Correct.

18 Q. And the issue at hand is is the
19 Company going to collect more income taxes than it
20 actually remits to the IRS?

21 A. Correct.

22 Q. Would you agree with me that any
23 amount of income taxes that are collected but not
24 paid to the IRS aren't being used to pay to the IRS?

25 A. Sure.

1 Q. And -- okay. Would you agree with me
2 that that money is therefore no longer being used to
3 serve customers?

4 A. No.

5 Q. Fine. Moving on, 'cause I am just
6 trying to level set. The Company is also seeking a
7 return on equity in this case, correct?

8 A. Correct.

9 Q. Would you agree with me that return
10 on equity is roughly analogous to profit, we can call
11 that profit?

12 A. Sure.

13 Q. And that's what we're going to pay to
14 our shareholders and justifies their investment?

15 A. Sure.

16 Q. Now, the incentive conversation that
17 was had focused on the idea that other states are
18 giving preferentially more beneficial treatment,
19 right?

20 A. Correct.

21 Q. So am I correct to understand that
22 the Company's concern is unless Missouri gives the
23 same treatment we get from other states we're going
24 to go build in other states; is that right?

25 A. When you say same, you know, there's

1 not a lot of binary switches for us. I mean, like
2 we're -- let me say that differently. We did not
3 come in with an ultimatum, right. But what we are
4 saying is changing the rate making formula for us is
5 a disincentive in the State of Missouri as compared
6 to states that have used the standard rate making
7 formula.

8 Q. But it's not an ultimatum?

9 A. No.

10 Q. So you're not saying you won't come
11 into Missouri?

12 A. I mean, that is not a question for
13 me, I'm the accountant, that be would a question for
14 Mr. Cox.

15 Q. Fair enough. Well, let's think.
16 Does this mean that Missouri is effectively bidding
17 against other states for your services?

18 A. I mean, that's a strange way of
19 saying that. I think, you know, you'd be better off
20 to talk to Mr. Cox about incentivization across the
21 industry and in other states.

22 Q. Well, you're the one who had the
23 conversation with Mr. Holsman and I want --

24 A. Sure, sure.

25 Q. -- to make sure we get down to this

1 right now. As I understand it what the Company is
2 saying is if we don't get this tax treatment we are
3 disincentivized from doing stuff in Missouri?

4 A. That's absolutely true.

5 Q. Okay. So what you're trying to say,
6 hey, you have to give us as good as we're getting in
7 other states or we're just going -- we have less of a
8 reason to do things here, right?

9 A. I mean, that's not the way the
10 Company's framing it. We are not bringing an
11 ultimatum. We are suggesting this is a disincentive,
12 full stop.

13 Q. I'm really not sure I'm seeing the
14 difference. Let me make sure I'm getting this down.
15 You're saying that, again, unless you get the same
16 treatment that other states are giving you you have a
17 disincentive to continue operation or to expand
18 operations probably, expand, in Missouri?

19 A. That's correct.

20 Q. So again, basically if another state
21 does something beneficial Missouri has to match them
22 in order to get you to stay in Missouri? Or continue
23 to expand in Missouri -- I'm going to keep -- you're
24 using expand. Let me restate that question because
25 it's getting confused. You're telling me that if

1 another state gives you something more beneficial you
2 say Missouri has to match that if you want us to
3 expand operations in Missouri?

4 A. So I'm not the one making decisions
5 about state expansion so that would be Mr. Cox for
6 sure.

7 Q. You did testify though it's a
8 disincentive?

9 A. Absolutely. It's simple math.

10 Q. Again, --

11 A. It's a disincentive.

12 Q. So I don't understand how you can say
13 it's a disincentive but then also turn around and say
14 you're not the one making decisions. I mean, you
15 clearly at some level are aware of the decision
16 making process?

17 A. It's a conceptual disincentive when
18 you have a different rate making treatment in one
19 state versus another.

20 Q. Right. And you're saying to avoid
21 that disincentive Missouri has to be as good as all
22 the other states, we have to give you the same
23 treatment?

24 A. I think by definition to avoid a
25 disincentive you can't disincentivize, right.

1 Q. Right. So again, if another state is
2 not giving as good as Missouri is you're saying we
3 have a disincentive to expand operations?

4 A. Correct.

5 Q. And you want Missouri's existing
6 ratepayers, your existing ratepayers to continue to
7 fund that expansion, that's that incentive to expand?

8 A. I'm not sure how you -- how you get
9 there. You know, from net operating loss position
10 customers aren't funding any expansion that would
11 still have to be investors.

12 Q. Well, you're saying that the
13 customers have to pay you income tax above what
14 you're going to remit?

15 A. I'm saying that's consistent with
16 regulatory rate making.

17 Q. Okay. So we're in agreement, you are
18 asking customers to pay more than you are going to
19 remit to the IRS?

20 A. I'm asking the Commission to give me
21 consistent rate making. That's the ask.

22 Q. Can we agree that the consistent rate
23 making that you're asking for is for customers to pay
24 more than you're going to be remitting to the IRS? I
25 feel like that's a very simple standard, I don't know

1 why we're arguing about this.

2 A. Because it's two separate issues and
3 it goes back to a similar concept to accumulated
4 deferred income tax. Because I'm not paying it,
5 there are regulatory rate making treatments for
6 whether I'm paying it or not. And so I'm asking for
7 the Commission to provide consistent rate making
8 treatment as to what they've done in this state for
9 our group of companies before.

10 Q. And that consistent rate making
11 treatment, according to you, is to allow the Company
12 to collect more than it's going to ultimately remit
13 to the IRS?

14 A. The consistent rate making treatment
15 would be to allow the Company to base income taxes on
16 the return granted in this case.

17 Q. And the effect of that would be to
18 collect more than they're going to remit, correct?

19 A. Yes.

20 Q. Thank you. I don't know why we had
21 to go to such lengths to get --

22 MR. WOODSMALL: Objection, your Honor.

23 MR. CLIZER: -- to the point.

24 JUDGE HATCHER: Mr. Clizer.

25 MR. CLIZER: Sorry.

1 BY: MR. CLIZER

2 Q. And you are saying that Missouri
3 needs to do that or else you'll have a disincentive?

4 A. Yes.

5 Q. Okay. Are you aware that there's a
6 statute that allows the Commission to order a company
7 to acquire a distressed system?

8 A. I am not aware of a statute at all,
9 no.

10 Q. So you wouldn't happen to know why
11 the Commission's never utilized that statute?

12 A. No.

13 MR. CLIZER: I have no further questions.
14 Thank you.

15 JUDGE HATCHER: Thank you. We will be
16 adjourning for lunch after this witness. We do have
17 re-direct to finish off Mr. Thies's testimony
18 regarding income taxes. Mr. Woodsmall.

19 MR. WOODSMALL: Thank you, your Honor.

20 EXAMINATION CONDUCTED

21 BY: MR. WOODSMALL

22 Q. Let's work backwards. First off, you
23 were asked questions about whether -- if you're not
24 provided the same treatment in other states whether
25 you would quit investing in Missouri, something along

1 those lines. You recall that?

2 A. Yes.

3 Q. Does the Company have unlimited
4 capital?

5 A. No.

6 Q. Okay. And would you agree with the
7 statement that capital will necessarily follow, will
8 go to the states where it provides the best overall
9 return including consideration of income taxes?

10 A. Yes.

11 Q. Okay. Lot of questions that talked
12 about standard rate making formula, end quote, and,
13 quote, regulatory rate making, do you recall those?

14 A. Yes.

15 Q. Okay. Would you explain to me, in
16 rate making, the difference between normalization of
17 taxes and flow-through of taxes?

18 A. That's a good question. It's a
19 technical issue and I am not a tax expert. But the
20 best of my understanding, normalization would be
21 setting the amount of taxes based on all the
22 components in the rate making equation. Flow-through
23 would be setting taxes based on what is actually
24 going to be paid in that period.

25 Q. Okay. And to put this in

1 perspective. The Company's position is a
2 normalization of taxes; is that correct?

3 A. Correct.

4 Q. And Staff and Public Counsel want to
5 look at the actual taxes that may or may not be paid
6 and flow that through to the rate making formula; is
7 that correct?

8 A. That's correct.

9 Q. Would you agree that in virtually
10 every other aspect of cost of service we don't
11 include the actual amount, rather we go in and we
12 look and we normalize and we annualize and we make
13 adjustments to try to look at what the normal amount
14 of that cost is, would you agree with that?

15 A. I agree that we seek to adjust,
16 annualize, normalize, as much as necessary.

17 Q. So while we normalize every other
18 component of cost of service, here Staff and OPC want
19 to turn its back on norm -- on normalization and use
20 flow-through; is that correct?

21 A. That's my understanding, yes.

22 Q. I was going to get into ADIT but
23 let's let that go. Going back to the very
24 beginning -- this is my last question. There were
25 comments -- or questions to you from the Bench based

1 upon Ms. Bolin's surrebuttal using the quote interest
2 free loan?

3 A. Uh-huh.

4 Q. Is this an interest free loan? And
5 you can --

6 A. Is what an interest free loan?

7 Q. Is it a gift or an interest free loan
8 for the Commission to normalize income taxes?

9 A. Gosh, I've never thought about it
10 that way. I think the context of that conversation
11 was it is reduced from rate base because it's a
12 source of capital that doesn't have -- that was not
13 supplied by investors or supplied through debt. So
14 in that sense this would be similar, yes.

15 Q. But it is not a gift because it's
16 more recognition of the losses the Company has
17 previously incurred?

18 MR. CLIZER: I'm going to object. I feel
19 like he's attempting to get his witness to change his
20 answer.

21 MR. WOODSMALL: I'm asking for a
22 clarification.

23 JUDGE HATCHER: I'll allow it. I'll allow
24 it. Go ahead. Overruled.

25 THE WITNESS: Could you ask the question

1 again, I'm sorry?

2 BY: MR. WOODSMALL

3 Q. Is this a gift or is this more
4 recognition of the past losses the Company has
5 incurred?

6 A. Which part? The -- income tax and
7 the rate or the reduction based on --

8 Q. Income taxes.

9 A. I mean, I wouldn't think about it as
10 a gift as much as I'm thinking about it as standard
11 rate making that offers certainty and reliability as
12 we plan the next rate case and the rate case after
13 that. So I never considered the option that -- or
14 the thought that it's a gift.

15 Q. Okay. And again, to try and put a
16 bow on all this. Under normalization of taxes and
17 any other cost of service, basically it normalizes,
18 it flattens out that cost component, it tries to
19 eliminate fluctuations, would you agree with that?

20 A. I would.

21 Q. And under flow-through however, if
22 you pass through the amount that is actually paid,
23 that can fluctuate rapidly over time, would you agree
24 with that?

25 A. I would agree with that, yes.

1 Q. Okay. I have no further questions.

2 MR. WOODSMALL: Thank you, your Honor.

3 JUDGE HATCHER: Thank you. Mr. Thies, you
4 are excused from the stand. I understand you will be
5 back later on --

6 THE WITNESS: Uh-huh.

7 JUDGE HATCHER: -- for other issues. I
8 intend to adjourn in the next few minutes. Are there
9 any issues before we adjourn for lunch? We are on
10 income taxes and we have three witnesses, Seltzer,
11 Bolin, and Riley to go. Any corrections, any
12 announcements?

13 MR. WOODSMALL: No corrections. Simply
14 just a reminder, and we'll try and take care of this
15 before we come back from break, that Mr. Seltzer will
16 be appearing virtually.

17 JUDGE HATCHER: Let's come back at 1:30.
18 1:30. That's an hour and 10 minutes.

19 MR. THOMPSON: Thank you, Judge.

20 JUDGE HATCHER: We are off the record and
21 adjourned.

22 (At this point in the proceedings, a short
23 recess was taken.)

24 JUDGE HATCHER: Okay. Let's go back on
25 the record, the time of recess having expired. The

1 Commission will now resume the evidentiary hearing of
2 the water and sewer general rate case of Confluence
3 Rivers. That file number is WR-2023-0006.

4 We are on the issue of income taxes and we
5 are ready to begin with the Company's second witness.
6 Confluence Rivers.

7 MR. WOODSMALL: Before I lay the
8 foundation, let me just inquire. Mr. Seltzer, are
9 you on the phone?

10 MR. SELTZER: I am.

11 MR. WOODSMALL: Okay. Thank you. Your
12 Honor, call Mr. Seltzer to the phone -- or to the
13 stand.

14 JUDGE HATCHER: Mr. Seltzer, you are on
15 our virtual witness stand, so to speak. Please raise
16 your right hand, I'll swear you in.

17 * * * * *

18 BRADLEY M. SELTZER,

19 The witness, having been first duly sworn
20 upon his oath, testified as follows:

21 * * * * *

22 JUDGE HATCHER: Thank you. And Counsel,
23 your witness.

24 MR. WOODSMALL: Thank you, your Honor.

25 EXAMINATION CONDUCTED

1 BY: MR. WOODSMALL

2 Q. Mr. Seltzer, would you state and
3 spell your name, please?

4 A. My name's Bradley M. Seltzer,
5 S-E-L-T-Z-E-R.

6 Q. And by whom are you employed and in
7 what capacity?

8 A. I'm an equity partner at Holland and
9 Knight.

10 Q. And have you been retained to provide
11 testimony on the issue of income taxes in this case
12 on behalf of Confluence Rivers Utility Operating
13 Company?

14 A. Yes, I have.

15 Q. And do you have a copy of what's been
16 marked as Exhibit 16, your rebuttal testimony, in
17 front of you?

18 A. I do.

19 Q. And do you have any changes to that
20 testimony?

21 A. No.

22 Q. And if I were to ask you those same
23 questions today as contained therein would your
24 answers be the same?

25 A. Yes.

1 MR. WOODSMALL: Your Honor, I'd move for
2 the admission of Exhibit 16 and tender the witness
3 for cross-examination.

4 JUDGE HATCHER: You've heard the motion of
5 the Counsel. Are there any objections to the
6 admission of Exhibit 16?

7 MR. THOMPSON: No objection from Staff,
8 Judge.

9 JUDGE HATCHER: Hearing none, Exhibit 16
10 is so admitted onto the record.

11 Did you tender the witness?

12 MR. WOODSMALL: I did, your Honor.

13 JUDGE HATCHER: The witness is tendered
14 and we go to cross-examination. Looking for a little
15 assistance. We'll go to Staff.

16 MR. THOMPSON: Thank you, Judge.

17 EXAMINATION CONDUCTED

18 BY: MR. THOMPSON

19 Q. Mr. Seltzer, you are an attorney, are
20 you not?

21 A. Yes.

22 Q. And you have been practicing law for
23 a good many years; isn't that correct?

24 A. Yes.

25 Q. And you specialize in tax law of

1 public utilities; is that correct?

2 A. Amongst other things, yes.

3 Q. And you have previously testified
4 here in Missouri?

5 A. Yes.

6 Q. And are you familiar with rate making
7 in Missouri?

8 A. Yes. As it relates to the treatment
9 of taxes in rate making, yes.

10 Q. Are you aware that there is a
11 prohibition on retroactive rate making in Missouri?

12 A. Yes.

13 Q. Now, looking at your testimony, I'm
14 on Page 5 at Line 4, the proposed disallowance of any
15 tax expense in cost of service fails to appreciate
16 that the NOLs in this case reflect actual increased
17 operating expenses attributable to the distressed
18 assets acquired by Confluence Rivers that have been
19 borne by Confluence Rivers but have adhered to the
20 benefit of its customers. Do you see that?

21 A. I do.

22 Q. Now, those NOLs reflect operating
23 expense losses incurred in previous tax years; isn't
24 that correct?

25 A. At least in part, yes.

1 Q. And their recovery in this rate case
2 would in fact violate the prohibition on retroactive
3 rate making; isn't that true?

4 A. I don't believe so. I don't believe
5 that the Company is seeking to recover the costs.
6 What I believe the Company is seeking to recover is
7 the carrying costs attributable to spending the money
8 for expenses which were deductible for rate making
9 purposes -- for book purposes but which they could
10 not claim a tax deduction until a future year. It's
11 the carrying cost of the deferred tax deduction.

12 Q. And those tax deductions in a future
13 year, that is a benefit, is it not, that is conferred
14 on businesses by the Interstate -- excuse me, the
15 Internal Revenue Code?

16 A. It is a benefit that will be received
17 in the future, yes.

18 Q. If my living expenses exceed my
19 income am I able to deduct that on my individual tax
20 return?

21 A. Define living expenses. Some of them
22 you can, some of them you can't.

23 Q. Okay. But a business can deduct all
24 of its business operating expenses to the extent that
25 they exceed its income; isn't that correct?

1 A. Eventually I guess that's true.

2 Q. Depending on when they happen to have
3 positive income, correct?

4 A. And again, as you mentioned earlier,
5 subject to the 80 percent limitation, yes.

6 Q. Thank you. I have no further
7 questions.

8 JUDGE HATCHER: Mr. Clizer.

9 MR. CLIZER: I have no questions. Thank
10 you.

11 JUDGE HATCHER: Thank you. Are there any
12 Commissioner questions for Mr. Seltzer? The Bench
13 does have a few questions.

14 EXAMINATION CONDUCTED

15 BY: JUDGE HATCHER

16 Q. Do you know if Confluence Rivers or
17 any of the holding companies affiliated with
18 Confluence Rivers that are filing federal tax
19 returns, do any of those companies issue financial
20 statements in compliance with FAS 109?

21 A. Honestly I've never seen their
22 financial statements.

23 Q. Okay. Do you know if FERC has any
24 jurisdiction over Confluence or any water or sewer
25 utility in Missouri?

1 A. They clearly do not.

2 Q. Does the NARUC USOA, that's the
3 Uniform System of Accounts, for Class A3 water
4 utilities, does that USOA have an Account 190?

5 A. Could you repeat that question?

6 Q. Does the NARUC, that's the National
7 Association of Regulatory Utility Commissioners, does
8 the NARUC USOA for Class A3 water utilities have an
9 Account 190?

10 A. I believe so.

11 Q. And I'd like to turn to your rebuttal
12 testimony. And I'm going to be looking at Pages 5,
13 6, and 8.

14 A. Okay.

15 Q. Can you provide a copy and the
16 authoritative source of the actual tax doctrine
17 and/or principle that you refer to on Pages 5, 6, and
18 8?

19 A. Are we talking about the actual tax
20 document?

21 Q. Yes.

22 A. It's discussed at length in Water 144
23 by FERC, it's discussed to some extent in one of the
24 two leading treatises on accounting for public
25 utilities which was written by Richard Matheny, it's

1 referred to from time-to-time in cases. But those
2 are the two leading authorities on the actual tax
3 doctrine.

4 It might be a helpful time to clarify one
5 thing 'cause it's -- there's been a lot of references
6 to, you know, how you go about calculating tax
7 expense. When you calculate tax expense, the way the
8 Internal Revenue Service looks at it, and we all
9 agree that the Internal Revenue Service only has
10 jurisdiction over accelerated depreciation as it
11 pertains to this net operating loss. But when you
12 compute tax expense and you basically take your rate
13 base and multiply it by your rate of return and you
14 apply a tax rate you only apply the statutory rate.
15 It doesn't care what your effective tax rate is even
16 if it's less than the statutory rate. You compute
17 tax expense under normalization for federal tax
18 purposes at the statutory rate. I just want to be
19 clear. And that is regardless of what you currently
20 pay to the Internal Revenue Service.

21 Q. Thank you.

22 JUDGE HATCHER: I'll ask once again if
23 there's any Commissioner questions? No. And we will
24 go to re-cross. Mr. Thompson.

25 MR. THOMPSON: Thank you, Judge.

1 EXAMINATION CONDUCTED

2 BY: MR. THOMPSON

3 Q. Is the Commission required to
4 normalize in this case?

5 A. As my testimony stated, no.

6 Q. Thank you. No further questions.

7 JUDGE HATCHER: Mr. Clizer.

8 MR. CLIZER: I guess just very briefly.

9 EXAMINATION CONDUCTED

10 BY: MR. CLIZER

11 Q. In response to the clarification you
12 stated, that would be the definition of
13 normalization, correct?

14 A. The definition of normalization is
15 longer than that but it does embrace that principle,
16 yes.

17 MR. CLIZER: All right. Thank you. That
18 was all I had.

19 JUDGE HATCHER: And re-direct from
20 Confluence?

21 MR. WOODSMALL: Just one question, your
22 Honor.

23 EXAMINATION CONDUCTED

24 BY: MR. WOODSMALL

25 Q. Mr. Seltzer, do you recall the

1 question from Mr. Thompson about retroactive rate
2 making?

3 A. Yes.

4 Q. And when you were asked that, you
5 said that the Company's trying to seek recovery of
6 the net operating losses, simply the carrying cost of
7 those net operating losses, do you recall that
8 response?

9 A. Yes.

10 Q. And would you agree that the carrying
11 costs on those net operating losses is a current
12 expense to the Company?

13 A. Yes. Until we can use the losses,
14 yes.

15 MR. WOODSMALL: No further questions.
16 Thank you.

17 JUDGE HATCHER: Thank you. And Mr.
18 Seltzer, you are excused from the stand on this
19 issue, subject to any callback. Where are we at?

20 MR. CLIZER: The Staff's first witness.

21 JUDGE HATCHER: I think we're moving to
22 Staff's first witness. Thank you. Ms. Bolin, please
23 raise your right hand. Last name is spelled
24 B-O-L-I-N.

25 * * * * *

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KIM BOLIN,

The witness, having been first duly sworn upon her oath, testified as follows:

* * * * *

JUDGE HATCHER: Thank you. Please, have a seat. Mr. Thompson, your witness.

MR. THOMPSON: Thank you, Judge.

EXAMINATION CONDUCTED

BY: MR. THOMPSON

Q. Please state your name.

A. My name is Kim Bolin, and Bolin is spelled B-O-L-I-N.

Q. And how are you employed?

A. I'm a division director for the financial and business analysis division.

Q. And by profession, are you an accountant?

A. Yes.

Q. And how long have you practiced accountancy?

A. I have worked in the regulatory arena for over 25 years.

Q. Okay. Did you prepare or cause to be prepared direct and surrebuttal testimony, both public and confidential, which has been designated

1 Exhibits 101 and 123?

2 A. Yes.

3 Q. Do you have any corrections to that
4 testimony?

5 A. Yes. I have a correction on my
6 direct testimony, Page 4, Line 11. The number
7 1,153,219 should read 1,198,879.

8 JUDGE HATCHER: Before you get to what I
9 expect is your next correction, that includes a
10 confidential number that is included in Exhibit 133
11 and it is available to be seen by all of the parties
12 and the Commissioners and the Bench but will not be
13 repeated by Ms. Bolin as she testified today. Go
14 ahead, Ms. Bolin.

15 THE WITNESS: Okay. So --

16 JUDGE HATCHER: So I'll paraphrase what I
17 believe is your next correction on Page 4, Line 13.

18 MR. CLIZER: Correct.

19 JUDGE HATCHER: Delete that confidential
20 number and replace it with -- that's a public number?

21 THE WITNESS: That's a public number.
22 9.77 million. And then the Footnote Number 2 on that
23 page should read, Response to Staff Data Request
24 Number 0120.1.

25 BY: MR. THOMPSON

1 Q. Do you have any other corrections,
2 Ms. Bolin?

3 A. No, I do not.

4 Q. With those corrections in mind, is
5 your testimony true and correct to the best of your
6 knowledge and belief?

7 A. It is.

8 Q. If I were to ask you those same
9 questions today would your responses be the same?

10 A. They would.

11 MR. THOMPSON: At this time, Judge, I move
12 for the admission of Exhibits 101 and 123, both
13 public and confidential as corrected.

14 JUDGE HATCHER: You've heard the motion of
15 Counsel. I'll take both together at once. Are there
16 any objections to the admission of Exhibit 101 or
17 123? Seeing none they are so admitted. Counsel,
18 your witness.

19 MR. THOMPSON: Thank you, Judge. I tender
20 the witness for cross-examination.

21 JUDGE HATCHER: Mr. Clizer. Thank you.

22 EXAMINATION CONDUCTED

23 BY: MR. CLIZER

24 Q. Good afternoon, Ms. Bolin.

25 A. Good afternoon.

1 Q. Do you happen to have a copy of Mr.
2 Seltzer's rebuttal testimony with you?

3 A. Yes, I do.

4 Q. Do you have a copy of your own
5 testimony with you?

6 A. Yes, I do.

7 Q. I'll probably be bouncing back
8 between the two. Starting with Mr. Seltzer's
9 testimony, could you turn to Page 5 for me. And I
10 will clarify, he only filed rebuttal testimony,
11 that's why I'm not specifying it.

12 A. Okay. I'm there.

13 Q. You would agree with me that starting
14 on Pages 2 through 4 -- well, actually starting on
15 Line 1, Page 5, my apologies, and I'm going to try
16 and paraphrase this, he accuses Staff of
17 misrepresenting or misapplying the actual taxes
18 doctrine by failing to acknowledge the deferred tax
19 liability?

20 A. Yes, that's what it says.

21 Q. That's what NOL represents. And
22 again, I've omitted some there, trying to keep it
23 simpler. And at the same time, on Line 17 through 19
24 -- again, I'm not going to read the entire line,
25 trying to keep things a little bit quicker. He

1 references the deferred tax liability inherent in the
2 NOL; is that correct?

3 A. He refers to that, yes.

4 Q. And if you'll turn to Page 8 for me.
5 He accuses you of attempting to exclude a future tax
6 liability; is that correct?

7 A. Yes, he does.

8 Q. And would your understanding be that
9 he is referring to the NOL in that case as well?

10 A. I believe that's what he's referring
11 to, yes.

12 Q. So we can assume then that Mr.
13 Seltzer's testimony is referring to an NOL as
14 creating a tax liability; is that correct?

15 A. That's what one could assume from his
16 testimony, yes.

17 Q. You would agree with me that an NOL
18 carryforward results in a deduction in future tax
19 years?

20 A. Yes, it does.

21 Q. You would agree with me that an NOL
22 is a -- sorry. You would agree with me that an NOL
23 results in carryforward for future tax years?

24 A. Yes.

25 Q. And you would agree with me NOL does

1 not result in new taxes in a future year?

2 A. It reduces the taxes for future
3 years.

4 Q. It does not increase taxes in future
5 years?

6 A. Correct.

7 MR. CLIZER: Your Honor, I'd like to mark
8 an exhibit. This should be 215.

9 JUDGE HATCHER: So marked. And can you
10 give me the five word description?

11 MR. CLIZER: Yeah. Okay. I would go with
12 the title Statement of Financial Accounting Standards
13 109.

14 MR. THOMPSON: Thank you, sir.

15 MR. CLIZER: I am going to run out of
16 numbers if I -- I'm going to give yours after the
17 fact. My apologies. Oh, wait.

18 JUDGE HATCHER: Okay. And for those
19 listening this is marked, not yet admitted. It is
20 marked as Exhibit 215, Statement of Financial
21 Accounting Standards Number 109.

22 BY: MR. CLIZER

23 Q. Are you familiar with this document?

24 A. Somewhat.

25 Q. Would you agree with me that this is

1 a document referenced in Mr. Seltzer's testimony?

2 A. I believe it is, yes.

3 Q. Could you turn to Page 5 for me.

4 Would you agree with me that the line under deferred
5 tax liability reads, "A deferred tax liability is
6 recognized for temporary differences that will result
7 in taxable amounts in future years?"

8 A. That is what it says.

9 Q. You would agree with me that the
10 deferred tax asset is recognized in the next
11 paragraph as, "A deferred tax asset is recognized for
12 temporary differences that will result in deductible
13 amounts in future years and for carryforwards?"

14 A. That's what it says.

15 Q. Based on these definitions you would
16 agree with me that an NOL would be at most creating a
17 deferred tax asset, correct?

18 A. I would agree.

19 Q. You would agree with me that
20 therefore the statements made in Mr. Seltzer's
21 testimony claiming the deferred tax liability is
22 contrary to the sources upon which he relies,
23 correct?

24 A. It is contrary to this document.

25 Q. I'm going to press forward.

1 MR. WOODSMALL: John, did you offer that
2 document?

3 MR. CLIZER: Not yet.

4 MR. WOODSMALL: Okay.

5 BY: MR. CLIZER

6 Q. You have a copy of Mr. Thies's
7 testimony?

8 A. Rebuttal and surrebuttal both.

9 Q. Could you turn to the surrebuttal for
10 me. Specifically Page 10. I'm sorry, I forgot to
11 tell you what page.

12 A. Okay.

13 Q. Again, I don't want to have to read a
14 whole bunch into the record so I'm simply going to
15 ask you to read that first Paragraph 1 through 11 for
16 a second. Not out loud, just read it to yourself and
17 let me know when you're finished.

18 A. I'm finished.

19 Q. Sorry. Thank you. You would agree
20 with me that this testimony is at most, or in essence
21 attempting to claim that you needed to calculate NOLs
22 on an individual system basis?

23 A. For the Confluence River systems,
24 yes.

25 Q. And your understanding that

1 Confluence filed a consolidated tax return?

2 A. They -- my understanding is they will
3 file a consolidated tax return for 2022, they have
4 not yet filed it.

5 Q. Would you expect an NOL to be
6 reported in a consolidated tax return on individual
7 system basis?

8 A. No, it will not be.

9 Q. I believe you were in the room
10 earlier when there was a discussion with Mr. Seltzer
11 regarding what a normalization is?

12 A. Yes.

13 Q. Would you agree with him that that's
14 a fair characterization of normalization for tax
15 purposes?

16 A. Yes.

17 Q. Would you agree with me that
18 normalization for tax purposes and normalization for
19 bookkeeping purposes are very different things?

20 A. They are different, I would agree
21 with you.

22 Q. Were you in the room earlier when Mr.
23 Thies was testifying?

24 A. Yes, I was.

25 Q. Do you remember questions coming from

1 Mr. Thies's attorney suggesting that Staff was
2 turning its back on normalization rules in this case?

3 A. I remember some questions concerning
4 normalization from his --

5 Q. You would agree with me that your
6 recommendation is not a departure from the Staff's
7 existing normalization rules with regard to
8 normalizing book accounts?

9 A. As you mean normalizing other
10 expenses?

11 Q. Correct.

12 A. That is correct.

13 Q. Much has been said that this is a
14 novel approach. In your opinion, is what you are
15 proposing inconsistent with the Staff position taken
16 in past cases?

17 A. In past cases we have not had NOLs
18 that have not have occurred due to accelerated
19 depreciation.

20 Q. If in past cases you had had
21 situations similar to this one where you had NOLs
22 generated that were not caused by accelerated
23 depreciation would you have taken the same position?

24 A. We probably would have. I'd have to
25 review all circumstances, see how large the NOL was,

1 and see if it would be continuing in the future.

2 Q. I believe earlier you indicated that
3 you were in the room during the testimony of Mr.
4 Thies; is that correct?

5 A. That is correct.

6 Q. Do you recall his recommendation to
7 the Commission regarding the creation of an asset to
8 account for funds -- sorry, account for the
9 difference between rates and what the actual
10 operating costs and required systems are? I'm trying
11 my best to keep that consistent with what you
12 recommended.

13 A. I remember the discussion on creation
14 of an asset.

15 Q. Would you agree with me that that
16 asset would constitute retroactive rate making?

17 A. I believe it would.

18 Q. Are net operating losses, again
19 potentially referred to as NOLs, capable of being
20 booked into a water company's accounts? Actually,
21 let me try and clear that up.

22 A. Not sure I understand your question.

23 MR. CLIZER: Your Honor, the Bench asked
24 previously a question regarding Account 190? Was it
25 190 or 109, I have dyslexia sometimes?

1 JUDGE HATCHER: 109.

2 MR. CLIZER: It was 109.

3 BY: MR. CLIZER

4 Q. Are you familiar with Account 109?

5 A. I thought it was 190, but...

6 JUDGE HATCHER: Oh, gosh dang it. It was
7 FS 109 and Account 190. Yes, thank you.

8 THE WITNESS: I did not bring up my NARUC
9 chart of accounts with me and I cannot tell you right
10 now what Account 190 is.

11 BY: MR. CLIZER

12 Q. Are you requesting that Confluence
13 book NOLs to its accounts?

14 A. I don't think I am.

15 Q. Is it correct to say that your
16 request is solely for net operating losses that are
17 being experienced for tax purposes to be reflected in
18 income tax calculations?

19 A. That is correct.

20 Q. So there is no request to change how
21 things are being booked in Staff's -- sorry,
22 Confluence's accounts?

23 A. Now, under our alternative we are
24 asking that if -- our alternative of setting -- of
25 including the income taxes and then tracking the

1 difference between what is paid and what is billed
2 into rates, we would be setting up an account for
3 that, having them book that amount in an account.

4 Q. But only under that circumstance?

5 A. Under that circumstance.

6 Q. I believe in your surrebuttal
7 testimony you described the situation analogous to
8 ADIT -- not analogous to. You described the
9 situation with ADIT which is analogous to what you're
10 proposing here, do you recall that conversation?

11 A. In my surrebuttal?

12 Q. Yes. Specifically on Page 6, Lines 7
13 through 13.

14 A. Yes. That's analogous, yes.

15 Q. And you state, "Because the amounts
16 paid in by customers for deferred income tax expense
17 represents capital paid by the ratepayers that the
18 utilities can use for a period of time it is
19 appropriate to provide customers a return on this
20 capital contributed by reducing utility's rate base
21 by the balance of its net collection of accumulated
22 deferred income taxes at a point in time customers
23 can see a return on capital contribution;" is that
24 correct?

25 A. That is what I wrote, yes.

1 Q. And you would agree with me that if
2 the Commission were to order rates in this case where
3 income tax expense was set such that it was greater
4 than the amount that the Company expected to remit,
5 that Company would be receiving, in the same manner
6 that you described here, what amounts to an interest
7 free loan?

8 A. Yes.

9 Q. It would be an amount of capital that
10 the Company would be allowed to use?

11 A. That is correct.

12 Q. And under the same logic that the
13 Commission has employed in the past with ADIT it is
14 reasonable that that amount should offset rate base?

15 A. That is my opinion, yes.

16 Q. And if the Commission were to allow
17 the Company to collect income tax expense greater
18 than what it was going to remit and not book that
19 into ADIT, you would agree that that would create a
20 permanent tax bonus for the Company, correct?

21 A. Yes.

22 Q. It would effectively be free money
23 for the Company?

24 A. That is correct. Then they'll have
25 to pay that back.

1 Q. Would the systems that are being
2 acquired by Confluence that are currently regulated
3 by the Commission -- well, actually let me back up.
4 It is the practice of Staff to include the amount
5 necessary to pay income taxes when setting ratings
6 for all utilities, correct?

7 A. That is correct.

8 Q. So for the systems being acquired by
9 Confluence that are currently under the jurisdiction
10 of the Commission that have had their rates set by
11 the Commission an amount for income tax would be
12 included for those rates, correct?

13 A. Yes, it should be.

14 Q. And if the Company is in a net
15 operating loss position after acquiring that system
16 the amount that is currently in rates to pay taxes
17 for that system will ultimately be profit for the
18 Company?

19 A. The Company will be able to use it,
20 yes.

21 Q. And that would constitute a benefit
22 to the Company, correct?

23 A. Correct.

24 Q. And you would agree with me that a
25 taxpayer not having to pay taxes is a benefit to the

1 taxpayer, correct?

2 A. Could you repeat that question?

3 Q. Would you agree with me that a
4 taxpayer not have to pay taxes is a benefit to the
5 taxpayer?

6 A. Yes.

7 Q. And you would agree with me that a
8 taxpayer in a net operating loss position does not
9 have to pay taxes?

10 A. I would agree with you.

11 Q. So you would agree with me that a
12 taxpayer in a net operating loss position receives an
13 immediate tax benefit in the form of not having to
14 pay taxes?

15 A. That is true.

16 Q. Are you familiar with the actual tax
17 doctrine?

18 A. I have seen a data request where that
19 was requested by Office of the Public Counsel and
20 what was provided. I don't know that it's an actual
21 tax doctrine. It outlines normalization.

22 Q. Because of the name, let's make sure
23 we got that clear. When you say you're not sure it's
24 an actual tax doctrine, what did you mean by that,
25 'cause the name is Actual Tax Doctrine?

1 A. I don't know that the document I
2 provided said anywhere that it was an actual tax
3 doctrine.

4 Q. Do you understand my point of
5 confusion 'cause I want to try and clarify -- okay.
6 You think -- okay. I'm just going to move on. So
7 you're not sure if it's a real doctrine, let me put
8 it that way?

9 A. That's correct.

10 Q. Okay. That's what I was trying to
11 get to. The Commission is setting rates
12 prospectively, correct?

13 A. That is correct.

14 Q. So the income tax expense included in
15 this case is to pay future taxes, correct?

16 A. Correct.

17 Q. And the taxes coming due in the
18 future will be able to make use of any existing net
19 operating loss carryforward?

20 A. Yes.

21 Q. So the taxes -- sorry, the rates --
22 the taxes paid on rates set in this case will
23 immediately be able to make use of the benefit of net
24 operating loss carryforwards, correct?

25 A. For a certain period of time, yes.

1 As long as the NOLs are still available.

2 Q. So when you say for a certain period
3 of time, you mean --

4 A. Until they --

5 Q. -- for as long as the net operating
6 loss carryforwards exist?

7 A. Correct.

8 Q. Until they are fully used up?

9 A. Correct.

10 Q. And the Company will be able to
11 receive that benefit immediately?

12 Let's talk very briefly regarding census.
13 Are you familiar with the fact -- well, did you work
14 on any recent acquisition case by Missouri American
15 Water?

16 A. If you could give me an exact case
17 number.

18 Q. How about -- and I'm just going to
19 list these off and you can tell me. WA-2021-0376,
20 Eureka; WA-2022-0049, City of Orrick; WA-2022-0293,
21 City of Purcell; WA-2022-022, I think that's a 9,
22 Monsees Lake Estates; and WA-2022-0311,
23 Stewartsville?

24 A. I did not work any of those cases. I
25 am somewhat familiar with them but I did not work

1 them.

2 Q. You caught -- you described
3 Confluence's request in this case as creating a
4 phantom tax; is that correct?

5 A. That is correct.

6 Q. Is it your -- you would agree with me
7 that such a phantom tax is not necessary to
8 incentivize acquisitions of systems, correct?

9 A. I would agree.

10 Q. You would agree with me that other
11 utilities in the state are acquiring small systems
12 without the need of such a phantom tax, correct?

13 A. That is correct.

14 Q. And to your knowledge, does any of
15 the other systems that are acquired by other
16 utilities, do those utilities request this phantom
17 tax treatment?

18 A. Missouri American pays taxes, so no.

19 Q. Are there carrying costs on a net
20 operating loss?

21 A. Not on the net operating loss.

22 Q. So a net operating loss generated for
23 tax purposes does not have any carrying costs
24 associated with it?

25 A. Correct.

1 Q. And that's because it is effectively
2 just a thing that the IRS has created for the benefit
3 of a taxpayer when filling out their tax forms?

4 A. That is correct.

5 Q. All right.

6 MR. CLIZER: I believe that is all the
7 questions I have. I did not move for the admission
8 and honestly I'm just going to ask, does the
9 Commission request it be admitted?

10 MR. THOMPSON: No objection. If he's not
11 going to move for it to be admitted, I will.

12 JUDGE HATCHER: Okay.

13 MR. CLIZER: In that case then I will move
14 and I'll use my number.

15 JUDGE HATCHER: Okay. Any objection?

16 MR. THOMPSON: No objection.

17 JUDGE HATCHER: No objection. It is so
18 admitted as Exhibit 215, Statement of Financial
19 Accounting Standards Number 109. Mr. Woodsmall, your
20 witness.

21 MR. WOODSMALL: Thank you.

22 EXAMINATION CONDUCTED

23 BY: MR. WOODSMALL

24 Q. Let's start at a higher level.
25 You're -- what's your current position?

1 A. Division director.

2 Q. Of which division?

3 A. The financial and business analysis
4 division.

5 Q. Okay. And relative to the witness
6 that -- witnesses that have appeared in this case,
7 you would supervise all those auditors; is that
8 correct?

9 A. The auditors, yes.

10 Q. Okay. So Mr. Majors, Ms. Lyons,
11 Amenthor, Dougherty, Sarver, all of those; is that
12 correct?

13 A. That is correct.

14 Q. And would you review their testimony?

15 A. I do review their testimony.

16 Q. Okay. And so you're -- you are
17 familiar with the positions in that testimony?

18 A. Yes, I am.

19 Q. Do you consider how those positions
20 may reflect on a bigger policy of trying to encourage
21 acquisition of distressed systems?

22 A. I do not.

23 Q. Okay. So in this case, for Staff,
24 who would consider how auditing positions may impact
25 acquisition or non-acquisition of distressed systems?

1 A. I don't know that anybody on Staff
2 would be concerned with what auditing's positions are
3 and how they would impact future acquisitions.

4 Q. In your role reviewing all this
5 testimony, did you go back to look at how Staff
6 handled certain issues in Staff assisted rate cases
7 for Confluence River?

8 A. I talked with witnesses from those
9 previous cases, yes.

10 Q. Okay. And so you're familiar with
11 the positions in that case?

12 A. Somewhat familiar, yes.

13 Q. Okay. Do you believe that Staff's
14 position on preliminary legal costs are in this case
15 consistent with that done in previous cases?

16 A. Not for the Confluence River case.
17 We have a little different position and further
18 review of this case made it so.

19 Q. But it is different?

20 A. It is different.

21 Q. Okay. Preliminary engineering costs
22 are different than how it was handled in a previous
23 case?

24 A. I'm not exactly sure on the
25 preliminary engineering costs because I do believe

1 some engineering costs, if they're tied to
2 construction, are capitalized.

3 Q. Okay.

4 MR. CLIZER: Your Honor, I'm only making
5 this objection to the extent that these are issues
6 which are being brought up later in the case so I'm
7 not sure why the cross of those issues are being done
8 right now.

9 MR. WOODSMALL: Because Ms. Bolin, as the
10 supervisor for all those, is only scheduled to appear
11 once. So this is my only time to ask her about how
12 Staff's position has changed or how it fits the
13 bigger picture.

14 MR. CLIZER: Okay.

15 JUDGE HATCHER: I've -- go ahead.

16 MR. WOODSMALL: Sorry. I saw you nod your
17 head but I think you want to make a ruling, so...

18 JUDGE HATCHER: I understand that the
19 objection was withdrawn.

20 MR. CLIZER: I guess my concern is that I
21 wasn't aware that we were supposed to be crossing Ms.
22 Bolin on those issues. If that was the case, I
23 probably would have had additional cross. It seems
24 -- and again, I apologize to Ms. Bolin. But wouldn't
25 it make more sense to bring her back for that issue?

1 MR. WOODSMALL: Your Honor, Rules of
2 Evidence say that I can cross-examine on anything
3 relevant. I knew the Rules of Evidence, I knew that
4 she -- this was her only time and I'm crossing on
5 things that are relevant.

6 JUDGE HATCHER: Okay. I can certainly see
7 both sides. The Commission operates by breaking down
8 large rate cases into issues. Those issues that
9 you're cross-examining on are going to be raised next
10 week if -- well, today is Friday. So yes. Ms.
11 Bolin, are you going to be in the office next week?

12 THE WITNESS: I guess I will. I will.

13 JUDGE HATCHER: Okay.

14 MR. WOODSMALL: Okay. So she will appear
15 on those issues?

16 JUDGE HATCHER: I'm going to ask Staff
17 right now. Staff counsel.

18 MR. THOMPSON: Yes, sir.

19 JUDGE HATCHER: Would you please make Ms.
20 Bolin available at whichever day happens to be -- Mr.
21 Woodsmall will contact you with when --

22 MR. THOMPSON: As part of what issue
23 exactly?

24 MR. WOODSMALL: Preliminary legal costs,
25 preliminary engineering costs. We're handling NOLs

1 here today. Classifying --

2 MR. THOMPSON: Are you talking about the
3 acquisition costs issue?

4 MR. WOODSMALL: It is --

5 MR. THOMPSON: It's scheduled --

6 MR. WOODSMALL: It's wrapped up in there.

7 MR. PRINGLE: Well, that's scheduled for
8 today.

9 MR. WOODSMALL: So he'll be -- Dean will
10 be able to handle that. And then the issue for next
11 week regarding the reclassification of capitalized --

12 MR. THOMPSON: Got it.

13 MR. WOODSMALL: -- cost as repairs.

14 MR. THOMPSON: That is currently set for
15 Friday -- or Thursday, I believe, of next week.

16 MR. WOODSMALL: Okay. So we will then
17 limit your cross here solely to net operating losses.
18 I'm sorry, did you have something? Okay.

19 BY: MR. WOODSMALL

20 Q. Did you go back to look at how Staff
21 previously handled net operating losses in Staff
22 assisted Confluence River cases?

23 A. Yes, I did.

24 Q. And did you include income taxes in
25 those cases?

1 A. We did.

2 Q. Okay. So your treatment here today
3 is a departure from your typical -- your treatment in
4 those previous cases?

5 A. It is. We look at things on a
6 case-by-case basis.

7 Q. Okay. And would you agree that your
8 treatment in previous Confluence River cases is more
9 consistent with the treatment that you have done for
10 Ameren, Spire, Evergy, Missouri American?

11 A. Those entities use accelerated
12 depreciation so that's why this situation is
13 different than that.

14 Q. Okay. Putting aside the ADIT issues
15 resulting from accelerated depreciation, your tax
16 calculation in those previous Confluence Rivers cases
17 is consistent with Ameren, Evergy, and those type of
18 cases?

19 A. We did not apply an NOL to those --

20 Q. Okay. And you cal --

21 A. -- Confluence cases.

22 Q. I'm sorry for interrupting for you.

23 A. That's all right.

24 Q. You calculated taxes in those
25 previous cases simply by looking at the equity

1 component and the cost of that equity in applying
2 just an income tax factor?

3 A. That is correct.

4 Q. And that's different than what you're
5 doing today?

6 A. That is correct.

7 Q. Okay. Do you know if any of the CS
8 -- have you looked at how any other states handle
9 these net operating losses for CSWR affiliates?

10 A. I have not reviewed that.

11 Q. Okay. So you haven't reviewed how
12 other states handled it, you didn't look at how the
13 Staff's positions affect the bigger picture, and you
14 made a departure from how Staff did it in previous
15 cases?

16 A. Yes.

17 MR. THOMPSON: Objection, asked and
18 answered.

19 BY: MR. WOODSMALL

20 Q. Okay. You said yes?

21 A. Yes. Based upon the large amount
22 of --

23 MR. THOMPSON: Can I get a ruling here?

24 MR. WOODSMALL: Or the answer.

25 JUDGE HATCHER: Mr. Woodsmall, do you have

1 a response to the objection?

2 MR. WOODSMALL: No. I think I got the
3 answer I wanted so I'm ready to move on.

4 JUDGE HATCHER: Okay. Objection seems
5 moot.

6 MR. THOMPSON: I move to strike the
7 answer, Judge.

8 JUDGE HATCHER: Mr. Woodsmall?

9 MR. WOODSMALL: I was simply summarizing
10 what her testimony was and making sure the record was
11 clear. I'm ready to move on.

12 JUDGE HATCHER: You may be. But we have a
13 motion to strike the witness's answer.

14 MR. THOMPSON: He already got answers to
15 each of those three questions.

16 MR. WOODSMALL: Your Honor, I'll withdraw
17 it. If he wants to strike it, strike it.

18 JUDGE HATCHER: Okay. The question and
19 answer for the summary is withdrawn. Now the motion
20 is moot. Mr. Woodsmall.

21 MR. WOODSMALL: Thank you.

22 BY: MR. WOODSMALL

23 Q. You were asked some questions by Mr.
24 Clizer about some other acquisition cases, do you
25 recall that?

1 A. Yes, I do.

2 Q. And I believe his point was to show
3 that there are other entities besides Confluence
4 Rivers making acquisitions in Missouri?

5 A. I don't know if that was the point of
6 his question or not.

7 Q. Okay. Do you agree that there are at
8 least Missouri American making other acquisitions?

9 A. I am aware of Missouri American
10 filing for acquisition cases in the State of Missouri
11 recently, yes.

12 Q. Okay. Do you know if any of those
13 are distressed water systems as in they are not
14 compliant with environmental regulations?

15 A. The City of Orrick may have been a
16 distressed system, if I remember right.

17 Q. So maybe one of the cases?

18 A. I'm not familiar with all of them but
19 I do remember hearing something about the City of
20 Orrick.

21 Q. Okay. Let's talk size. Are you
22 familiar with the City of Eureka?

23 A. Somewhat, yes.

24 Q. Okay.

25 A. I know where it's at, yes.

1 Q. Significant size city, would you
2 agree?

3 A. Depends on how you define
4 significant.

5 Q. Okay. Let's say more than 20,000
6 people?

7 A. I'm assuming.

8 Q. Okay. And that was a Missouri
9 American acquisition; is that correct?

10 A. That is correct.

11 Q. Have any reason to believe that they
12 weren't in compliance at the time?

13 A. I am not aware of any compliance
14 issues.

15 Q. Okay.

16 A. But I'm not not aware either.

17 Q. Okay. So to put it in perspective,
18 do you know of anybody else out there acquiring small
19 distressed systems?

20 A. In the State of Missouri?

21 Q. Correct.

22 A. Maybe other public water supply
23 districts which we don't regulate and we don't
24 approve.

25 Q. Point taken. Okay. But other than

1 that, you're not aware of anybody else --

2 A. Any other regulated.

3 Q. Okay. Thank you. Let's talk about
4 the A-D-I-T analogy that Mr. Clizer was making.

5 A-D-I-T, can you tell me first what it stands for?

6 A. Accumulated deferred income taxes.

7 Q. And would you agree that in large
8 part A-D-I-T balances stem out of the practice of
9 allowing accelerated depreciation?

10 A. For the most part, yes.

11 Q. Okay. And can you tell me in an
12 A-D-I-T, accelerated depreciation environment, who
13 provided the ability for the utility to take
14 accelerated depreciation? Would you agree that it
15 was a governmental code or governmental statute
16 regulatory provision?

17 A. The IRS code.

18 Q. Okay.

19 A. Yeah.

20 Q. Let's analogize that to now. The net
21 operating losses. What are the genesis of those net
22 operating losses, are they some type of governmental
23 rule or policy change or anything the government did?

24 A. I don't know if I understand your
25 question.

1 Q. Let's get at it this way. Would you
2 agree that the net operating losses here are not the
3 result of governmental action but the fact that this
4 company was buying systems where rates were below
5 cost?

6 A. I don't know that I would attribute
7 it to them buying systems. I would probably
8 attribute it to they have more expenses than
9 revenues.

10 Q. Okay. It was an operational not the
11 acquisition is the point you're taking?

12 A. Yes.

13 Q. Okay. That's fair. What happens to
14 rates if -- let's say the Company has an NOL balance
15 of nine million dollars. They have a net operating
16 balance of nine million dollars, right?

17 A. Correct. Well, they will after they
18 file their '22 -- 2022 tax return, that is correct.

19 Q. Okay.

20 A. Projected.

21 Q. And let's say next year they
22 magically made ten million dollars. They would then
23 apply that net operating loss against those earnings;
24 is that correct?

25 A. That is correct. But in this

1 situation we're nowhere near --

2 Q. True.

3 A. -- ten million dollars --

4 Q. Hypothetical.

5 A. -- taxable income. We're closer to
6 one million.

7 Q. Okay. But just hypothetically, they
8 would use those to the extent of the 80 percent
9 limiter; is that correct?

10 A. Yes. Anything after 2018 -- any NOLs
11 after 2018 only 80 percent can be applied in one
12 year.

13 Q. Okay. So in -- for tax purposes,
14 taxes can change -- fluctuate over time?

15 A. Yes.

16 Q. Okay. What would happen -- absent a
17 rate case what would happen to rates because of those
18 tax changes?

19 A. Rates do not change in between rate
20 cases.

21 Q. Okay. So if -- let's say rates --
22 okay. So regardless of what happens with taxes rates
23 will not change?

24 A. Correct. Unless the Company comes in
25 for a rate case.

1 Q. Okay. And finally, there were some
2 questions -- well, let's go to this. Your experience
3 is solely limited to rate making in Missouri; is that
4 correct?

5 A. That is correct.

6 Q. Have you ever done a FERC rate case?

7 A. No, I have not.

8 Q. You're not familiar with how FERC
9 handles this issue?

10 A. Not at all.

11 Q. Or you haven't done cases in any
12 other jurisdiction?

13 A. Correct. No, I have not.

14 Q. So you're not familiar with how it's
15 handled there?

16 A. No.

17 Q. Okay. Staff set rates on an
18 individual system -- or they did a cost of servicing
19 calculation on an individual system basis; is that
20 correct?

21 A. That is correct.

22 Q. Okay. And how did you then handle,
23 if you -- if you calc -- if you calculated a cost of
24 service on an individual system basis, how did you
25 handle the application of net operating losses to

1 each system then?

2 A. This is kind of a lengthy discussion
3 on this. But I looked at the NOLs based on each
4 utility holding company that filed tax returns. 2002
5 they'll file one -- 2021 they'll file one tax return
6 for the whole company. But some of these systems
7 were the only systems in the utility operating
8 company so I applied that NOL to that system. Some
9 of the systems, like Confluence Rivers, has several
10 systems within the utility holding company. I
11 allocated the NOL based on what their taxable income
12 would be using a composite tax rate of 24.13 percent.

13 Q. Okay. So you didn't try in any way
14 to attribute the NOL balance to the losses that were
15 incurred at each individual system?

16 A. If the system was the only system in
17 the utility holding company I did do that.

18 Q. Okay.

19 A. But for the ones that were within
20 Confluence Rivers, I did break it out by systems.

21 Q. Okay. So let's take as an example,
22 are you familiar -- have you heard of the Glen
23 Meadows system?

24 A. Yes, I have.

25 Q. And it was acquired in December

1 of 2022?

2 A. I'm not sure the exact date but yes.

3 Q. Okay. And so the test year in this
4 case ended January 31st of 2023; is that correct?

5 A. I don't know if it was the test year
6 or the update year was January 2023.

7 Q. Update period, would you accept that?

8 A. Yes.

9 Q. So if Glen Meadows was acquired in
10 December and if the update period ended in January,
11 there was only one month of opportunity to incur net
12 operating losses there; is that correct?

13 A. The tax return will be filed as one
14 entity, Confluence Rivers Utility Holding Company.
15 So they will get the full use of the NOL going
16 forward.

17 Q. Okay. But even though they didn't --
18 they didn't help to create the net operating losses
19 you assign to them some of the benefit of the net
20 operating losses?

21 A. Yes. Because taxes going forward,
22 they will be able to benefit from the NOL.

23 Q. Okay. So there was no attempt to
24 actually have rates for those systems strictly follow
25 costs of service, you assigned, to some regard, these

1 net operating loss balances?

2 A. I would disagree on the following
3 cost of service. We set rates prospectively and they
4 will not be paying any taxes.

5 Q. Okay.

6 A. So I set it to that level.

7 Q. Even though the net operating losses
8 were the result of other systems those other systems
9 didn't get the full -- the full effect of the net
10 operating losses, it's being attributed to other
11 systems as well?

12 A. It's being attributed to every system
13 that's in the utility holding company of Confluence
14 Rivers.

15 Q. Okay. I have no further questions.
16 Thank you.

17 JUDGE HATCHER: Thank you. Are there any
18 Commissioner questions for Ms. Bolin? Chairman Rupp.

19 CHAIRMAN RUPP: Thank you, Judge.

20 EXAMINATION CONDUCTED

21 BY: CHAIRMAN RUPP

22 Q. Do you remember the question that I
23 asked --

24 A. Unfortunately, yes.

25 Q. Okay. Can you walk me through --

1 what is the incentive there for a company to not take
2 -- or to carryforward the net operating loss and then
3 have it appear in a test year versus not?

4 A. I wouldn't think they would want to
5 do that because they would want to take advantage of
6 not paying income taxes. We would see -- even if
7 they did pay taxes in test year we would still look
8 at the NOL balance and what they would pay in taxes
9 in the future.

10 Q. So if a company exhausts all of their
11 net operating loss, they choose to do it in 2024,
12 then in 2025 they would not have -- be able to count
13 that on their -- deduct that off of their taxes and
14 they were to come in for a rate case in that year.
15 How would that -- how would the rates be different if
16 it -- if they had have come in the year that they had
17 taken the deduction versus the year that they had
18 not, is there any difference on rates?

19 A. We would set -- if they exhausted all
20 their NOLs we would then set -- create tax -- income
21 tax, we would generate an amount in there, the full
22 amount.

23 Q. So is there -- is there an incentive
24 for a company to -- like to utilize all of their tax
25 deduction in a year so that it would show a tax

1 liability in a future year which they plan to come in
2 for rates?

3 A. I don't know that there is an
4 incentive that way.

5 Q. Is the amount in rates going to be
6 relatively insignificant or do you think the amount
7 of rates -- so how would a nine million dollar net
8 operating loss affect the revenue requirement in the
9 rate -- in the rate base?

10 A. I don't know if I understand your
11 question.

12 Q. I'm trying to understand -- I'm
13 trying to theorize. How would a utility plan in the
14 future if they know they're coming in for a -- you
15 know, 'cause utilities talk. I think I'm coming in
16 in 18 months, I think I'm coming in in 16 months.
17 What is the incentive for them, when they are looking
18 at should I exhaust all -- use all of my net
19 operating loss from the previous year to yes, I'm
20 going to get the tax benefit now but how -- will that
21 hurt me if it's a test year and are they having those
22 conversations internally to anticipate what will show
23 up in a test year?

24 A. We ask for several previous year's
25 tax returns and review those balances. If we would

1 see that that may flag something that we would have
2 to take into consideration if they did not happen to
3 use their NOLs for a tax year and still had them
4 sitting out there. Or if they exhausted all of them.

5 Q. Does that not violate the test year
6 of this is the information the test year, if you're
7 going back and looking at previous years?

8 A. Well, all these NOLs were generated
9 from year 2000 -- let's see here.

10 Q. They're generated from previous
11 years?

12 A. Previous years. So, you know. I
13 looked at all those tax returns, watched the balance.
14 One of the operating companies did start to eat into
15 their NOL so I reduced their NOL on the balance just
16 like they did on their tax return. What I saw was
17 going forward and setting rates you want to set rates
18 for what's going to occur in the future and it does
19 not appear they're going to be paying taxes for a
20 couple years. I don't know, I think maybe we've got
21 a disconnect here.

22 Q. I'm just -- I'm thinking more big
23 pause why and stuff not as much on the numbers on --
24 I guess I'm just trying to understand the incentive.
25 Is there an incentive, is there not an incentive, how

1 do utilities approach this issue?

2 A. I mean, I would think they would want
3 to pay income taxes. So I would think they would
4 utilize their NOL regardless of if it was a test year
5 or not.

6 Q. All right. Thank you.

7 JUDGE HATCHER: Commissioner Kolkmeyer
8 then Commissioner Holsman.

9 COMMISSIONER KOLKMEYER: Thank you, Judge.

10 EXAMINATION CONDUCTED

11 BY: COMMISSIONER KOLKMEYER

12 Q. Good afternoon.

13 A. Good afternoon.

14 Q. I think you said in past Confluence
15 Rivers' rate cases that you said that Staff did not
16 recommend offsetting income tax with NOL amounts; is
17 that right?

18 A. That is correct. We did not pass
19 small Staff assisted cases.

20 Q. So then what was the change in
21 position for this case?

22 A. We got to reviewing it a little more
23 and we noticed the large amount of NOLs and did a
24 little more digging. You find things in different
25 cases that you missed in previous cases. It's just

1 part of the audit. Sometimes you see things you
2 don't see in one audit, you see it in the other.

3 Q. When was the last time, are you
4 aware, that Confluence Rivers came in for a rate
5 case?

6 A. The Confluence River Utility Holding
7 Company came in in 2020.

8 Q. Okay.

9 A. I think Elm Hills was in 2020 also.
10 They've had different rate cases over the years.

11 Q. Okay. I was appointed in 2020 -- no,
12 2021 and I didn't remember --

13 A. Right.

14 Q. -- Confluence Rivers having a rate
15 case since I've been here. This is the first one
16 that I remember.

17 A. Yeah. And that was -- those were all
18 small Staff assisted cases in the past.

19 Q. All right. They've grown
20 dramatically since then, --

21 A. Yes.

22 Q. -- since their last rate case?

23 A. Yes.

24 Q. Is probably where a lot of this is
25 coming from?

1 A. I don't know about the growth on the
2 -- impacting the NOLs. It would be they have more
3 expenses than they do revenues.

4 Q. Okay. Thank you.

5 COMMISSIONER KOLKMEYER: Thank you, Judge.

6 JUDGE HATCHER: Mr. Holsman.

7 COMMISSIONER HOLSMAN: Thank you.

8 EXAMINATION CONDUCTED

9 BY: COMMISSIONER HOLSMAN

10 Q. Hello.

11 A. Hello.

12 Q. So I want to drill in just a little
13 bit deeper on what Commissioner Kolkmeier was talking
14 about. So when you're dealing with the small rate
15 cases, Staff assisted in the past, you basically
16 treated them the same way that the precedent had been
17 in the other rate cases on how to deal with taxes.
18 Now you've got a departure. And what I heard you
19 just testify was is it was the amount of the net
20 operating loss that got your attention which put it
21 into a different classification, or category in your
22 estimation which then created a different approach
23 than what you have done previously; is that accurate?

24 A. And the fact that they do not use
25 accelerated depreciation.

1 Q. And the fact they do not use --

2 A. Yeah. To separate them from the
3 other utilities that do use accelerated depreciation
4 for tax purposes.

5 Q. Okay. Okay. So then the answer to
6 the question of why are Ameren and Evergy and Spire
7 and American Water and everybody else treated
8 differently, because they use accelerated
9 depreciation?

10 A. Yes.

11 Q. That's what --

12 A. Yes.

13 Q. -- your position is?

14 A. Yes. And so we have to normalize on
15 that per IRS code.

16 Q. Okay. What, in your estimation,
17 would be the reason why the Company would choose to
18 not use accelerated depreciation? What's the benefit
19 to them if we're now in this conflict over how to
20 approach the taxes if they would get the same
21 treatment -- well, let me back up. Would you treat
22 them the same as the rest if they did use accelerated
23 depreciation?

24 A. We would have to.

25 Q. You would have to. So then there

1 must be some benefit to the Company for them not
2 using accelerated depreciation causing this departure
3 from normal practice. What do you think that that
4 benefit would be?

5 A. If they used accelerated depreciation
6 their NOL would be even larger.

7 Q. Okay. And so then by that token, the
8 effort, or the hope would be is that they could
9 spread that NOL out longer and offset future revenues
10 that might be greater as opposed to taking it up
11 front when the revenues may not be as great to
12 offset. Would they then lose that -- if they had to
13 accelerate the depreciation would they lose that if
14 they didn't have the revenue to offset it? Does that
15 make sense? Let me give you an example.

16 A. Yeah.

17 Q. So if you had a hundred dollars and
18 you were going to do ten years and you did ten
19 dollars a year and you thought that in years seven,
20 eight, and nine you're going to have revenue that
21 that ten dollars is going to be able to be applied to
22 but in year one and two you don't have that much
23 revenue. But if you accelerated that hundred dollars
24 into 80/20 in the first two years but you didn't have
25 that revenue would you then lose the ability to apply

1 that 80 dollars and that 20 dollars in year one and
2 two in years six, seven, and eight when you might
3 have the revenue to offset, is that a loss?

4 A. I think they would have the NOL they
5 could apply still.

6 Q. Even if it was accelerated?

7 A. Even if it was accelerated, yes.

8 Q. Okay.

9 A. In rate making though they would have
10 to offset rate base with that deferred income tax
11 that is related to the accelerated depreciation.

12 Q. Okay.

13 A. So that would be an offset to rate
14 base.

15 Q. Earlier we talked a little about
16 other states and I know that we deal in our sandbox
17 and the state laws that we have. But we also deal
18 with precedents and the traditions of process that we
19 also have. And you've indicated that this is a
20 departure from that traditional process treatment
21 that other companies have had because of accelerated
22 depreciation, or whatever the cause is, we are now
23 approaching -- or you have taken a position that is
24 different than what would have been in their Staff
25 assisted cases and how it's treated with the other

1 companies as well. Is this the first time that
2 you're aware of that we are approaching this tax in
3 this way?

4 A. I don't know how we handled it before
5 I started this -- in the '90s. I think there may be
6 sometimes where we did flow-through possibly in the
7 '70s and '80s, but...

8 Q. But since you've been here --

9 A. But since I've been here --

10 Q. -- this is the first time that this
11 approach --

12 A. Yes.

13 Q. -- has been employed?

14 A. Yes.

15 Q. Deployed. Okay. So when we look at
16 other states, when we had earlier testimony that said
17 other states will book that net operating loss as an
18 asset, have you had -- do you have any experience or
19 have you seen that in practice or are you familiar
20 with any studies that have to do with taking that
21 approach and what the results are on rates?

22 A. No, I do not.

23 Q. No?

24 A. No.

25 Q. Do you -- given that concept, do you

1 believe that this Commission would have the ability
2 to execute a concept like that or do you think that
3 we would be confined by statute of not being able to
4 book that as an asset?

5 A. I think you could do it if you wish
6 to.

7 Q. You think we could do it?

8 A. Uh-huh.

9 Q. Do you agree that if you take the
10 approach of deferring --

11 A. Now, on the asset, are you talking
12 about when they buy a small distressed system?

13 Q. Yes. The time -- the time period
14 that they're operating at a loss on distressed
15 systems to the time that they come into a rate case,
16 we were testified earlier that in other states they
17 will be allowed to book that as an asset. So as a
18 balance to the fact that now the taxes are going to
19 be deferred into another account to be deployed later
20 on, that would not pass through as what is being
21 considered just profit right now. So it's sort of
22 like -- is the way I understood it being explained in
23 testimony it would be a balance between those two
24 factors. And so I'm curious to get your opinion on
25 whether you think that that is equal weight?

1 A. I don't think it is because to me the
2 looking at the expenses in the past kind of gets into
3 retroactive rate making.

4 Q. Uh-huh.

5 A. And that's prohibited.

6 Q. When we talk about incentives and we
7 look at it in a macro sense like why would a company
8 take over a small distressed system when they know
9 that the revenues are not going to be there to
10 justify the capital expense on improvements, why
11 would they do that? Now, OPC has testified that
12 they're going -- as soon as they get it rate based
13 and they get caught up then they're going to have
14 their rate of return and they're going to make money
15 on that once it's folded in --

16 A. Uh-huh.

17 Q. -- and that's why they would do it.
18 But in the period of time between -- we heard
19 yesterday in opening statements, we looked at how
20 long -- I asked the question how long does it take to
21 make these investments and one answer was, well, in
22 the first 50 days we could potentially make an
23 investment to improve water quality but most of the
24 time it takes a year before the investment has, you
25 know, fully been made to get that system back to, you

1 know, at least DNA certifiable or, you know, healthy.

2 A. Uh-huh.

3 Q. So we know that there's going to be
4 lag. And OPC said, well, you can't factor in
5 regulatory lag in this. But as a company that's
6 relying on return on investment those investors are
7 figuring in the lag portion of it and the taxes are
8 clearly a part of that forecast into why would I take
9 over this system. Now, we have DNR, who's on record
10 in an exhibit saying we're thankful that a company
11 like Confluence is out there buying these small
12 systems and refurbishing them and bringing them back
13 up to code. So earlier Staff suggested that if taxes
14 aren't the place to do that, you know, perhaps a
15 larger ROE or in that portion of it you could make it
16 -- this Commission has the ability to make it more
17 incentivized to do that.

18 In your opinion, do you agree with the
19 statement the Staff has made that taxes here --
20 because again, this is a departure from your
21 statement of how it's normally treated. So you're
22 treating them separately because of the NOL. Do you
23 think that ROE would be the place to create an
24 incentive to rescue distressed systems?

25 A. Many times when they buy these

1 systems they pay underneath the book value and then
2 they get book value later on so they're paying less.
3 So there is incentive there.

4 Q. Uh-huh.

5 A. I'm not a fan of this one but we do
6 have a rule making that allows you to increase the
7 ROR or do a debt acquisition adjustment to
8 incentivize companies to buy small systems.

9 Q. Okay. Earlier testimony said that if
10 the taxing -- that the way that we're approaching the
11 taxing would be a disincentive for that. Do you
12 agree that for the State of Missouri to treat the
13 acquisitions of distressed systems in a manner that
14 factors in NOL and that does not allow for that tax
15 passthrough as we've been talking about, do you see
16 that as a disincentive for investment in our state?

17 A. I'm not sure I do.

18 Q. No?

19 A. Uh-uh.

20 Q. Okay. My last question. From a
21 macro perspective, you have said that other companies
22 have potentially acquired distressed systems. You
23 cited Orrick as an example?

24 A. Missouri American, yes. I think it
25 was.

1 Q. We're not 100 percent sure?

2 A. Yeah.

3 Q. But that's the only one that came to
4 your mind that has done. What percentage of systems
5 are left out there right now that you're aware of
6 that would fall into this category of being
7 distressed, how many systems -- do we know how many
8 systems there are in the entire state?

9 A. I don't know that number.

10 Q. Don't know that number?

11 A. That would be better addressed to Mr.
12 Gaitley.

13 Q. Okay. So would it also be the
14 question of what percentage of them are distressed
15 left out there that need rescuing?

16 A. Yes.

17 Q. Okay. All right. Thank you very
18 much.

19 COMMISSIONER HOLSMAN: Thank you, Judge.

20 JUDGE HATCHER: Any other Commissioner
21 questions? Okay. Ms. Bolin, the Bench does have a
22 few more questions.

23 EXAMINATION CONDUCTED

24 BY: JUDGE HATCHER

25 Q. First, I want to pick up on something

1 that Mr. Woodsmall had mentioned and Mr. Thies had
2 mentioned. And I think it was glossed over a little
3 bit. I want to talk about the carrying costs of the
4 loss. The question that I heard asked previously was
5 was there any carrying cost on the net operating
6 loss. I would like to try and drill down into a
7 little bit more detail. Are there carrying costs on
8 the expenditures of the company -- yeah. Are there
9 carrying costs on the expenditures?

10 A. There's always carrying costs on
11 expenditures.

12 Q. Do you have any knowledge on how the
13 Commission has historically viewed those carrying
14 costs?

15 A. Through the CWC, the cash working
16 capital.

17 Q. Okay. Do the NOL amount totals and
18 total taxable income change depending on whether a
19 consolidated tax return is filed for Confluence
20 Rivers or multiple holding company tax returns are
21 filed?

22 A. That will not change for Confluence
23 Rivers going forward, they will be able to utilize
24 the full amount of NOLs for each of their utility
25 holding companies, past utility holding companies.

1 They were all merged into Confluence River Utility
2 Holding Company in 2021, I believe.

3 Q. Doesn't sound right.

4 A. Somewhere in there.

5 Q. Okay. Are you aware, in your history
6 of being with the Commission, of Staff, are you aware
7 of the Commission ever authorizing a deferred
8 liability or a deferred asset for net operating
9 losses when it's determining rate base?

10 A. We have had net operating losses that
11 offset the ADIT but they were all -- we had to do
12 that due to the fact that it was accelerated
13 depreciation was driving the --

14 Q. Just to clarify. The references to
15 accelerated depreciation, underlying that is federal
16 law. So when a company is taking that federal law
17 says the treatment is thus?

18 A. IRS, yes.

19 Q. It's not a distinguishment between
20 Staff likes to treat it this way when it's
21 accelerated depreciation and likes to treat it this
22 other way when it's not, it's a citation to a federal
23 law?

24 A. That we must normalize, yes.

25 Q. Okay. I don't know if this next

1 question is or should be amended because of the
2 pending settlement regarding the rate districts that
3 are -- just summarizing, the attorney statements were
4 two and two. That's two water systems and two sewer
5 systems.

6 How does Staff allocate the income tax
7 expense between the rate districts it proposed -- so
8 I think this is probably referring to the original
9 proposal by Staff of four -- I think it was four
10 water, five sewer. How was Staff proposing to divvy
11 up the income expense in that scenario?

12 A. I did it based on the 2021 income tax
13 returns that were separated by each utility holding
14 company. Now, if -- if two of the utility holding
15 companies were merged then that amount was merged
16 together. Say one had taxable income that wasn't
17 offset by an NOL and one did not, the amount would be
18 the same. It would be one merged amount. But going
19 forward this company will file one income tax return.

20 Q. Are there other reasons -- besides
21 the accelerated depreciation example, are there other
22 reasons the Staff is recommending the flow-through
23 method in this rate case?

24 A. When we look at the NOLs that they'll
25 be able to utilize they will not be paying income tax

1 expense for several years.

2 Q. Excellent. And that brought up -- I
3 want to clarify that. You've said several just
4 now, --

5 A. Uh-huh.

6 Q. -- in response to Chairman's question
7 you said a couple. And by my non tax mind brain we
8 were talking about a totally whole numbers, around a
9 nine million dollar loss, something around a million
10 dollar income. So just off the top of my head I'm
11 thinking at least nine years. And I know that -- I
12 know that that is impossible to put a definitive --
13 even a formula to apply to it. In your professional
14 expert opinion, what do you think that longevity is?
15 Because I'm having a problem reconciling two years
16 and almost a decade.

17 A. In the data response to the Company
18 -- from the data response to Staff from the Company,
19 the Company has calculated that they believe the
20 balance of net operating loss could potentially last
21 for six or more tax years. They also answered us
22 that they will have taxable losses in 2023 so that
23 would increase the NOL and then they will have
24 projected taxable income in 2024. That is their
25 projection.

1 We don't know. It depends on the tax, you
2 know, if they're going to pay taxes or not, it
3 depends on the expenses they claim and the revenues
4 they have.

5 Q. And the Company has a solution if
6 that situation arises in six years to come in for a
7 rate case?

8 A. Yes. They absolutely do.

9 Q. Okay. I'm going to reference your
10 direct testimony on Page 5. That testimony gives an
11 example of how the 80 percent NOL restriction from
12 the Tax Cuts and Jobs Act would work leaving \$10,000
13 of taxable income after applying \$40,000 or
14 80 percent of a \$50,000 net operating loss; is that
15 correct?

16 A. That is correct.

17 Q. How is that example in agreement with
18 your statement on the next page? That statement
19 reads, "If there are enough NOLs to cover the taxable
20 income Staff did not include any income tax in its
21 cost of service."

22 A. That is -- I look at each individual
23 utility holding company and if they had enough NOLs
24 up to 2018 I applied it and it went zero. But if
25 they had more taxable income than they had pre-2018

1 net operating losses then I applied the 80 percent to
2 those amounts. So my -- our case does have about
3 \$31,000 worth of tax built into it to account for --
4 say Osage Water, if you'll look on Page 3 of my
5 testimony, has no NOLs prior to 2018. So for that
6 company I had to do the 80 percent for that. So I
7 did build in an amount of tax for Osage Utility
8 Operating Company.

9 Q. Wouldn't that always leave a
10 remaining 20 percent of taxable income? I'm talking
11 about that 80/20 percent split. Wouldn't there
12 always be a 20 percent remainder similar to the
13 \$10,000 in the example on Page 5?

14 A. Once they exhaust any pre-2018, yes,
15 they would. But total Company wise they have
16 1.9 million of pre-2019 net operating losses they can
17 carryforward. And in this case taxable income is
18 roughly a million dollars.

19 Q. Your surrebuttal testimony states
20 that the Commission is not required to follow the
21 Financial Accounting Standards, that's the FAS, and
22 that is also what was introduced as Exhibit 215 by
23 OPC. If Confluence booked deferred taxes and used
24 accelerated depreciation for tax purposes would Staff
25 recommend following Financial Accounting Standards

1 for rate making purposes?

2 A. We don't have to follow them but we
3 would include income tax in that case, if they had
4 accelerated depreciation.

5 Q. Okay. I want to turn to Accounting
6 Schedule 11. That was sponsored by you and was filed
7 with Staff's rebuttal testimony?

8 A. I don't know if I have a copy of that
9 with me.

10 Q. I'm trying to ask about Column E and
11 the amount of \$26,480 on Line 15, if that helps
12 narrow things down. Otherwise let's all take a pause
13 and we'll try and find that paperwork.

14 A. That is in the rebuttal?

15 Q. Yes.

16 A. Accounting Schedule?

17 Q. Accounting Schedule 11.

18 MR. CLIZER: I believe that we have a copy
19 but it's marked on.

20 THE WITNESS: I have one just for Osage
21 Utilities. I'm not sure if it's on rebuttal or not,
22 a Schedule 11.

23 BY: JUDGE HATCHER

24 Q. Can you check Line 15, see if there's
25 a number around 26,000 there?

1 A. Line 15?

2 Q. Yes.

3 A. No, there's not.

4 Q. Okay. That's not it.

5 A. And is that our combined accounting
6 schedules or is that a certain individual one? If I
7 can get on this computer -- I don't know if I can or
8 not.

9 Q. I'm going to wait for further
10 information and hopefully any of those that are
11 listening that can give me further information will
12 do so. Let's move on to the next question. That
13 one's on -- gosh darn it. All of the next questions
14 are on this schedule.

15 A. I brought one little one.

16 Q. Yes. Yes. Go ahead and try and open
17 the browser on the witness computer.

18 COMMISSIONER HOLSMAN: Judge, I'll have
19 one more follow up when you're done. Maybe. Maybe,
20 maybe, maybe.

21 MR. THOMPSON: Judge, do you know what it
22 says on the cover sheet of the one you want? We have
23 quite a few here for individual systems.

24 JUDGE HATCHER: My question reads
25 Accounting Schedule 11, sponsored by witness Bolin --

1 THE WITNESS: You said it was --

2 JUDGE HATCHER: -- in rebuttal testimony.

3 BY: JUDGE HATCHER

4 Q. So I'm going to head to your -- to
5 your rebuttal testimony first and then work my way
6 out from there.

7 A. I have two different accounting
8 schedules, consolidated and individual runs. What
9 was the number you were looking for?

10 Q. I'm looking for \$26,480. And it
11 appears on Line 15.

12 A. I have it -- yes. I have it here on
13 the screen.

14 Q. Excellent.

15 MR. WOODSMALL: Your Honor, I'm sorry to
16 interrupt your flow. I don't have a copy of it. But
17 could you try to identify it for the clarity of the
18 record?

19 JUDGE HATCHER: Yes. Please.

20 BY: JUDGE HATCHER

21 Q. First tell me the EFIS number or the
22 date?

23 A. Of course. We don't have a back
24 button. It is EFIS Item Number 85. Filed on
25 June 29th, 2023.

1 Q. Oh, and at the bottom right corner
2 they are labeled accounting schedule by number. And
3 I'm going to scroll down. Accounting Schedule 11
4 which shows as Sheet 12 of 14 in the edge, Adobe
5 Reader.

6 THE WITNESS: Is that on the screen up
7 there, Mike?

8 JUDGE HATCHER: Oh, excellent. We have it
9 on screen. Thank you.

10 THE WITNESS: It's the combined accounting
11 schedules.

12 JUDGE HATCHER: Thank you.

13 THE WITNESS: Confluence consolidated it
14 says.

15 JUDGE HATCHER: Okay. We have Counsel
16 caught up.

17 BY: JUDGE HATCHER

18 Q. My question is Column E. And to read
19 that out loud it says 8.05 percent return. Line 15
20 in Column E reads 26,480. My question is how did --
21 can you explain how that amount was calculated?

22 A. That amount was calculated with me
23 applying the pre-2018 NOLs to each utility holding
24 operating company. And if there was additional tax
25 return -- taxable income beyond the NOL amount I then

1 had to figure out what tax they would pay based on
2 the 80 percent. So that should be the federal tax of
3 26,480 that we are building into our case for federal
4 income tax. If you go down further, Line 34 is the
5 state income tax. We also applied the same
6 methodology to that and then it gives a total of
7 \$31,051 for current income tax.

8 Q. To rephrase and to make sure that I
9 understand it, you took the pre-2018 net operating
10 losses, applied them to this systems too -- that
11 incurred them if there was -- I'm sorry to the
12 accountants, if there was extra NOL that could be
13 applied you then went up to the holding company
14 level?

15 A. I used it at the past holding company
16 levels. Those were what the most current income tax
17 returns I have. For 2022 they should be filing one
18 but for 2021 and previous they filed several income
19 tax returns.

20 Q. Okay. I am tracking now.

21 A. And then this program, our accounting
22 schedule just adds everything together for the
23 combined run.

24 Q. Okay.

25 JUDGE HATCHER: And my intent here is to

1 finish with Ms. Bolin, including cross, re-cross, and
2 re-direct, and then take a break.

3 BY: JUDGE HATCHER

4 Q. If you go to Page 2 of Schedule 11,
5 so just the next line down, Line 51, that is the
6 final line, and it reads total federal income taxes.

7 A. We should probably not include that
8 because we do not use -- are you talking about the
9 tax? It's got tax rights? Yeah.

10 Q. Yes. Why that amount is not
11 reflected in the cost of service?

12 A. Those amounts pre the Thies -- were
13 the amounts that they would have been pre the Tax Cut
14 and Job Acts. Now corporate income tax is a flat
15 21 percent and Governor Parsons passed a flat four
16 percent for state. So this table, in our accounting
17 schedules, you can't see it here, but we have the
18 ability to say disregard that tax table. And we
19 should probably do away with that tax table, to be
20 real honest with you, it doesn't apply anymore.
21 'Cause we used to have a graduated 34 percent,
22 39 percent, and it's just a flat 21.

23 Q. Understood. My next question. If
24 Staff calculated the Federal and Missouri State
25 income tax without consideration of any NOL or net

1 operating loss carryforward, so if you calculated
2 Federal and State income tax for Confluence not
3 counting any NOL or NOLC what would the tax amounts
4 be using Column E of Schedule 11?

5 A. As I stated in my sur -- in my
6 rebuttal -- surrebuttal testimony it would be
7 approximately \$264,793. That amount may change, you
8 know, depending on the case, how the outcome of this
9 case is.

10 Q. Staff's final reconciliation on Line
11 32, which reads, summary of current income tax, lists
12 the value of income tax issued to be \$447,099. Can
13 you provide the Confluence amount and the Staff
14 amount used to calculate the \$447,099 figure?

15 A. That is a very complicated
16 calculation. The -- we have different taxable
17 amounts, income -- yeah. Total taxable amounts are
18 different based on each case. It also impacts the
19 ROE when you apply the tax factors. So there's very
20 -- there's several different variables. I don't know
21 that I can give you that calculation.

22 Q. Okay. And where is Staff's treatment
23 of Confluence's net operating losses or NOLCs
24 reflected on Schedule 11?

25 A. We could not reflect them on Schedule

1 11. I had to do that calculation in my work paper
2 and then for each individual run I had to come up
3 with the tax rate to get the tax amount that you
4 would need to pay. So if you would open up the
5 individual runs on here you would see some have tax
6 rates and some don't.

7 Q. Okay. Thank you. Last question from
8 the Bench then we have a follow-up Commissioner
9 question, then we will hit re-cross, re-direct, and
10 take a break. The differences between Confluence and
11 Staff's income tax amounts result from both
12 differences in net income before taxes, that's Line 1
13 on Schedule 11, and the treatment of NOLs, correct?

14 A. Correct.

15 Q. Are there other cost of service items
16 that affect the income tax differences between
17 Confluence and Staff?

18 A. Yes. When you apply it to the
19 certain ROE, we have different ROEs. So that would
20 also impact the tax difference.

21 Q. I do remember reading about that.
22 Thank you, Ms. Bolin.

23 JUDGE HATCHER: Any Commissioner
24 questions? Commissioner Holsman.

25 COMMISSIONER HOLSMAN: One quick follow

1 up.

2 EXAMINATION CONDUCTED

3 BY: COMMISSIONER HOLSMAN

4 Q. As I was sitting here and thinking
5 about this, we've established that this is a
6 departure --

7 A. Yes.

8 Q. -- from the way it's been done. And
9 you had said that one of the reasons it was a
10 departure was because the amount of the NOL was up
11 there. Can you tell me a little bit about what that
12 threshold would be that if a Staff assisted was going
13 to say -- or it's a million dollars, it's five
14 million dollars, or nine million dollars. Like what
15 all of a sudden can the next company that comes in
16 with distressed rate cases consider their NOL to be
17 too high to get normal treatment?

18 A. We would have to look at what their
19 taxable income is going to be for the next several
20 years and look at the level of NOLs. Now, if it was
21 going to expire within a year --

22 Q. So who ultimately makes that
23 decision?

24 A. It would be the individual working
25 that case or they would have to --

1 Q. So would you suggest that that number
2 is an arbitrary number?

3 A. Yes, it is.

4 Q. Okay. Thank you.

5 JUDGE HATCHER: Thank you. Any other
6 Commissioner questions? And we'll go to re-cross.

7 MR. CLIZER: Yes.

8 JUDGE HATCHER: I got to think through
9 this. Mr. Clizer.

10 MR. CLIZER: Yeah.

11 EXAMINATION CONDUCTED

12 BY: MR. CLIZER

13 Q. Good afternoon, again.

14 A. Good afternoon.

15 Q. I'm going to bounce around a little
16 bit. You were asked a question from the Bench
17 regarding the Statement of Financial Accounting, do
18 you recall that. There were a lot of questions, I
19 know.

20 A. Yes, I think I recall that.

21 Q. And you were asked if you would
22 include income tax if there was accelerated
23 depreciation following the Statement of Financial
24 Accounting, do you recall that?

25 A. Yes.

1 Q. And to clarify, you would include
2 income tax if it was accelerated depreciation because
3 the normalization rules of the IRS require to you do
4 so, correct?

5 A. Yes, that is correct.

6 Q. It has nothing to do with following
7 the Statement of Financial Accounting?

8 A. Yes. We do not have to follow.

9 Q. It is the IRS rules that are driving
10 that?

11 A. You are correct.

12 Q. Now, let's talk about -- there were
13 several times where this was referred to as a
14 departure. Let's break that down. We have two
15 different possibilities I think in my mind, situations
16 where there is accelerated depreciation and
17 situations where there aren't accelerated
18 depreciation. Let's talk about the situations where
19 there are accelerated depreciation.

20 Now again, the IRS rules absolutely
21 mandate that you use straight line depreciation in
22 those situations, correct, for rate making purposes?

23 A. We have to normalize for rate making.

24 Q. You have to normalize for those?

25 A. Yes.

1 Q. That's set by U.S. federal law?

2 A. Yes.

3 Q. So this situation where there is no
4 accelerated depreciation is completely disanalogous
5 to that?

6 A. That's correct.

7 Q. It's an apples to oranges comparison?

8 A. That's correct.

9 Q. So to call it a departure from
10 something that's completely different from this
11 doesn't really make a whole lot of sense, wouldn't
12 you agree?

13 A. It is not a -- those situations were
14 different where they can use accelerated
15 depreciation.

16 Q. So it's not a departure from those
17 situations because those were different?

18 A. That is correct.

19 Q. So the past situations where they
20 have not used accelerated depreciation, those would
21 be Confluence's prior case, was that it?

22 A. That is -- they did not -- I am not
23 aware of them using it in prior cases, no.

24 Q. In the prior Confluence case?

25 A. Right.

1 Q. Was there any other case?

2 A. They have been in for several rate
3 cases for different utility holding companies.

4 Q. For each of those cases, was that a
5 Staff assisted rate case?

6 A. Yes, they were.

7 Q. And a Staff assisted rate case
8 requires the Staff to effectively perform a large
9 degree of the functions of bringing a normal rate
10 case on its own, correct?

11 A. That is correct.

12 Q. And you would agree with me that in
13 those cases obviously there's a higher level of
14 workload for the Staff, wouldn't you?

15 A. It is done in a shorter time period.

16 Q. So it's much more likely that
17 something could get missed, correct?

18 A. Things can get missed in any case.

19 Q. And you would agree with me also that
20 these small rate cases are going to have a much lower
21 income tax amount, correct?

22 A. They should.

23 Q. They should. In this case we have a
24 much larger income tax amount than what we see in
25 those past cases, correct?

1 A. I don't have a direct comparison, I
2 don't have the numbers in front of me.

3 Q. You would agree with me that if it
4 was a large much larger income tax -- income tax
5 expense the affect of the NOL issue on this case
6 would be much more dramatic in this case than in
7 prior cases?

8 A. If the amount was lower, the taxable
9 income.

10 Q. And earlier you were kind of talking
11 down this idea that if in the past it looked like the
12 NOL was going to expire in only a few years you
13 wouldn't have included it. Do you recall saying
14 that?

15 A. That is correct.

16 Q. And the reason for that, if I'm --
17 I'm going to guess, and I want to see if I'm correct,
18 is that because you assume what the Company's going
19 to do -- you don't assume the Company's going to come
20 in the next year for a rate case, right?

21 A. I hope they don't.

22 Q. So if they're going to lose the NOL
23 after maybe one or two years you're going to say,
24 well, they're not going to come in for a rate case in
25 those one or two years so we're not going to include

1 the NOL in that situation, correct?

2 A. Yes.

3 Q. But that's not the situation here,
4 correct?

5 A. They appear like they can -- per
6 their own answer in the DR, they will not exhaust
7 these for six years.

8 Q. And just to reaffirm, when we talk
9 about -- there was a question from the Bench, are
10 there other reasons why the flow-through. Is it
11 correct to understand that the central reason from
12 Staff is that this amount constitutes free money for
13 the Company, correct?

14 A. That is correct.

15 Q. And to the extent that we're
16 including this to incentivize what that means is that
17 Confluence's current customers are being expected to
18 front free money to the Company in order to encourage
19 the Company's continued expansion in Missouri?

20 A. That is -- yes.

21 Q. But if Confluence continues to expand
22 and it takes those new systems at their existing
23 rates the new customers won't be funding that
24 continued expansion, correct?

25 A. Could you repeat that question?

1 Q. If Confluence buys a new system and
2 it takes -- or sorry, it acquires a system and allows
3 the rates that are in effect to in essence continue,
4 those new customers will not be paying the free money
5 generated by these rates?

6 A. If they -- if Confluence adopts the
7 current rates the Company is charging, that is
8 correct.

9 Q. If Confluence adopts the current
10 rates of the company it's acquiring?

11 A. Acquiring, yes.

12 Q. Correct. So those customers won't be
13 paying for the expansion but the current customers
14 will be forced to pay for the expansion?

15 A. They will be paying income taxes,
16 yes.

17 Q. They will be paying income tax
18 expense that's not being remitted?

19 A. It is not being paid, correct.

20 Q. They will be paying the phantom tax
21 you referred to?

22 A. Yes.

23 Q. Just one last thing. I know there's
24 been discussion of, I think, exhausting the net
25 operating loss -- actually I take that back, it's not

1 going to be one last thing, sorry. I'll make it
2 quick though. A company wants to use every
3 availability to reduce its income tax each year,
4 right?

5 A. One would hope, yes.

6 Q. You would agree that it would be
7 imprudent for a company to not use an available
8 deduction to reduce its income tax expense, correct?

9 A. Yes.

10 Q. To your knowledge, are there any
11 other incentive mechanisms in place to encourage
12 customers to -- sorry, not customers, companies to
13 acquire distressed systems in the state?

14 A. I referred to the one rule we have.

15 Q. Are you familiar with the statute
16 that allows companies to acquire distressed systems
17 to take it at the value that an appraiser appraises
18 it at?

19 A. I'm aware of the statute that allows
20 a large utility to purchase a smaller utility using
21 the appraisals value.

22 Q. I think that's all my questions.

23 Thank you.

24 JUDGE HATCHER: Mr. Woodsmall.

25 MR. WOODSMALL: Thank you. I'll be brief,

1 I hope.

2 EXAMINATION CONDUCTED

3 BY: MR. WOODSMALL

4 Q. You had some questions from
5 Commissioner Holsman and he was asking why would any
6 company come in and acquire. And you made the
7 statement that there are times where Staff will allow
8 a rate base associated with net book value that's
9 greater than purchase price?

10 A. Yes.

11 Q. Do you recall that?

12 A. We always use net book value for the
13 purchase.

14 Q. Even --

15 A. For the company.

16 Q. Okay. So if the company buys a
17 distressed system for one dollar and it has a net
18 book value of a thousand dollars you always use that
19 thousand dollars?

20 A. We always use original cost.

21 Q. Okay. Just to clarify. Because -- I
22 think you clarified it but the Bench's question may
23 be different. I believe the question from the Judge
24 said something like federal law dictates accelerated
25 depreciation, do you recall that?

1 A. Dictates accelerated depreciation?

2 Q. I thought that was the question. I
3 think you're going to clarify. Go ahead.

4 A. Yeah. It dictates that if you
5 utilize accelerated depreciation we have to normalize
6 taxes.

7 Q. Okay. And accelerated depreciation
8 is an election by the company; is that correct?

9 A. That is correct.

10 Q. Okay. So there's nothing saying that
11 anybody has to use accelerated depreciation in any
12 particular time?

13 A. Correct.

14 Q. Okay. That clarified that. And to
15 your knowledge, the Company, or any of its
16 predecessor companies, they have never used
17 accelerated depreciation?

18 A. Per the tax returns that I looked at,
19 no.

20 Q. Okay. Lot of talk about the Staff's
21 position here is a change from its position in the
22 Staff assisted rate cases, do you recall that?

23 A. Yes, I do.

24 Q. Did -- after the last Staff assisted
25 rate case, when the Company kept acquiring systems,

1 did you ever indicate to the Company, you guys might
2 want to consider this, we're going to change our
3 mind?

4 A. No, we did not.

5 Q. Okay.

6 A. This is something we discovered in
7 this case.

8 Q. Okay. Do you understand the concept
9 of regulatory certainty?

10 A. I've heard of it.

11 Q. Okay. Would you believe that at
12 least for this company this introduces an element of
13 regulatory uncertainty?

14 A. I'm not sure if it does for this
15 company or not. I don't speak for the Company.

16 Q. Okay. There was some discussion
17 about free money from Mr. Clizer. But earlier you
18 said everything has a carrying cost?

19 A. I think I meant with expenses we
20 measure a carrying cost through the cash working
21 capital. If you have to pay up your expenses ahead
22 of time then you -- the Company -- they pay -- before
23 they get the revenue then we build that into rate
24 base and they get a return on cash working capital.

25 Q. Okay. But that cash working capital

1 element never considers the operating losses that
2 occur after rates are set; is that correct? It only
3 changes going forward?

4 A. That is correct.

5 Q. So carrying costs on these past
6 losses -- or let's say we acquire system X tomorrow
7 and we start incurring cash losses, operating losses.
8 There are carrying costs on that in reality, isn't
9 there?

10 A. The --

11 Q. Money's not free?

12 A. The amounts that you book in your
13 income tax return may not be the same that we would
14 consider just and reasonable and prudent rates for
15 the rate case.

16 Q. You establish cash working capital --

17 A. Going --

18 Q. -- forward looking; is that correct?

19 A. That is correct.

20 Q. So to the extent that tomorrow we
21 make an acquisition and start having operating
22 losses, there is no consideration of carrying costs
23 for those operating losses?

24 A. That's retroactive rate making.

25 Q. Okay. But even going forward, you

1 don't say, wow, you're giving authority to acquire X,
2 Y, Z system, going forward you can apply carrying
3 costs for the losses, you don't do that?

4 A. We do not do that, no.

5 Q. Okay. So -- but there are -- to the
6 Company there's a cost to that, would you agree?

7 A. Possibly to the company, yes.

8 Q. Okay. And there are carrying costs
9 for other elements. Would you agree that when a
10 utility builds a power plant you give what's called
11 construction costs to carry that entity forward to
12 the rate case to account for the cost of that capital
13 that they've invested?

14 A. What do you mean by construction
15 cost?

16 Q. Construction accounting.

17 A. We apply a rate -- a debt rate to the
18 construction amounts for the amounts they have to
19 expend.

20 Q. Okay. And so even though rates have
21 been set, they come in and build a power plant, you
22 give a carrying cost of some degree to account
23 outside of rates for the carrying cost on that
24 investment?

25 A. On the plant. But we don't on their

1 expenses. If they have more expenses we don't -- we
2 don't apply a carrying cost to that.

3 Q. But you acknowledge that there is a
4 cost for that money that the Company's invested that
5 they're not getting in rates?

6 A. They get it through their equity and
7 through their cost of debt.

8 Q. Did you -- or will you be willing to
9 apply a debt carrying cost going forward for the net
10 operating losses we incur after this case?

11 A. No.

12 Q. Okay. No further questions. Thank
13 you.

14 JUDGE HATCHER: Thank you, Mr. Woodsmall.
15 We will be in recess until 3:40. That gives everyone
16 20 minutes. Ms. Bolin, thank you for your testimony,
17 you are --

18 THE WITNESS: Are we going to do re-cross,
19 re-direct?

20 MR. THOMPSON: Yeah. We get re-direct,
21 right?

22 JUDGE HATCHER: Oh, gosh.

23 MR. THOMPSON: 'Cause I have a few
24 questions.

25 THE WITNESS: Sorry.

1 JUDGE HATCHER: No, no, no. Judge's
2 error. My apologies. Let's do re-direct. Thank
3 you. Mr. Thompson, you're up.

4 MR. THOMPSON: Thank you, Judge.

5 EXAMINATION CONDUCTED

6 BY: MR. THOMPSON

7 Q. First of all, Ms. Bolin, you were
8 asked by Ms. Clizer about Staff's alternative. Now,
9 did Staff make an alternative suggestion in case the
10 Commission decided to go with the Company's treatment
11 of income tax?

12 A. Yes.

13 Q. And could you briefly describe that
14 suggestion?

15 A. The suggestion would be if the
16 Commission decided to go with their income tax that
17 the difference between what was built into rates and
18 what they actually paid would be an offset in future
19 rate cases in rate base.

20 Q. So it would lower rate base in future
21 cases?

22 A. It would lower rate base in the
23 return the Company would receive.

24 Q. And that would recognize, would it,
25 the fact that this was capital provided to the

1 Company by the ratepayers?

2 A. Yes.

3 Q. And would the ratepayers get interest
4 on that money?

5 A. No, they would not.

6 Q. For example, ratepayers often pay an
7 amount of money to the Company up front as security
8 for their payments on their service, right, and the
9 Company holds that money for a certain time; isn't
10 that correct?

11 A. Customer deposits.

12 Q. Customer deposits?

13 A. Yes.

14 Q. Thank you. And do customers -- is
15 that a reduction to rate base?

16 A. That is reduction to rate base. But
17 we also build in the expense level that the Company
18 will have to pay the ratepayers in as an expense
19 level on those deposits.

20 Q. Right. So the Company pays interest
21 to the ratepayers on that, don't they?

22 A. They do.

23 Q. Okay. And the ratepayers do get it
24 back at some point in the future?

25 A. Yes. If they pay promptly and pay

1 their bills, yes.

2 Q. Okay. Now, let's compare that to the
3 alternative that Staff has suggested here in the
4 event that the Company gets the income tax treatment
5 that it wants. Would the ratepayers ever get that
6 money back?

7 A. Eventually when the Company has
8 taxable income that amount would lower but I don't
9 believe -- could you rephrase that question?

10 Q. Well, maybe I can come at it this
11 way. The amount of money given to the Company in
12 excess of the income taxes they are actually going to
13 remit, will that money ever be given to the IRS? In
14 other words, if their income taxes in the absence of
15 NOLs was going to be a million dollars a year let's
16 say, and with the NOLs it would be \$100,000 a year so
17 that they -- if you build that into rates they'd be
18 getting \$900,000 a year in excess of what they remit,
19 right? Isn't that the situation we're facing here
20 although --

21 A. Yes.

22 Q. -- I know the numbers are different?
23 Would that money ever be remitted to the IRS?

24 A. I'm not sure.

25 Q. You're not sure. Okay. So if they

1 have a tax liability for tax year 2023 and they have
2 sufficient NOLs to offset 80 percent of that taxable
3 income, so they're only going to pay taxes on
4 20 percent of that income, correct?

5 A. Correct.

6 Q. And if they receive money in rates
7 that covers 100 percent of the tax liability on that
8 income, in other words the 80 percent they're not
9 going to pay, would they ever pay that to the IRS or
10 would that just be free money in their pocket?

11 A. That would be free money in their
12 pocket.

13 Q. Okay. Free money in their pocket.
14 IRS doesn't get it. Do the customers ever get it
15 back?

16 A. The only way possibly under the
17 scenario would be if they pay more income taxes than
18 what we built into rates we would reduce that rate
19 base item.

20 Q. I see. Okay. So Staff's
21 alternative, while providing some sort of mitigation
22 to the ratepayers, in fact does not make them whole?

23 A. That is correct.

24 Q. Okay. NOLs in carrying costs. In
25 fact there are no carrying costs on net operating

1 losses, are there?

2 A. Not on a net operating loss.

3 Q. Okay. And if a company was
4 attempting to recover some kind of carrying costs on
5 operating losses from a prior year, would that
6 violate the prohibition on retroactive rate making?

7 MR. WOODSMALL: Object, your Honor. Legal
8 conclusion.

9 BY: MR. THOMPSON

10 Q. To the extent that you understand it
11 as an accountant, would that violate the prohibition
12 on retroactive rate making?

13 A. Yes.

14 Q. Now, I think some of the
15 Commissioners have been troubled to hear that the way
16 Staff proposes to treat income taxes in this case is
17 different than the way Staff has treated income taxes
18 in the Staff assisted rate cases that CSWR has
19 brought in the past, okay. Remember those questions?

20 A. Yes.

21 Q. Okay. And can you tell me, is there
22 an underlying policy that has driven the different
23 treatment that Staff has taken in the two different
24 kinds of cases?

25 A. What do you mean by policy?

1 Q. Well, in other words, when -- when
2 you gave a particular income tax treatment in the
3 Staff assisted rate cases, what drove that decision,
4 was it that the amount was insignificant, was it a
5 concern?

6 MR. WOODSMALL: Your Honor, he's leading
7 the question -- the witness now. If he wants to ask
8 the question, lead the question.

9 BY: MR. THOMPSON

10 Q. Answer, if you can.

11 A. I don't know that we considered that
12 the NOLs would have caused an impact of them not
13 paying income taxes in prior cases.

14 Q. Okay. And those Staff assisted
15 cases, would you agree that those were distressed
16 companies?

17 A. I don't know that they were all
18 distressed companies, no. These were companies that
19 Confluence Rivers owns right now.

20 Q. Okay.

21 A. Now, if you're talking about other
22 small assisted cases, some of those companies are
23 stressed.

24 Q. I'm just --

25 MR. THOMPSON: That's all the questions I

1 have, Judge.

2 JUDGE HATCHER: Thank you. We are now at
3 recess until 3:45. 3:45. That is 16 minutes. We
4 will reconvene with witness -- OPC witness Riley.
5 And then, depending on the time and because of the
6 light issue schedule and because today is Friday, I
7 think that will conclude today's --

8 MR. CLIZER: Hearing.

9 JUDGE HATCHER: -- evidence testimony.
10 Picture synonym.

11 MR. THOMPSON: Should we be ready to go
12 with the other two issues for today on Monday?

13 JUDGE HATCHER: That's what I'm thinking.
14 And I'm speaking out loud to give everybody kind of
15 the heads up and make sure that that complies with
16 everybody's plan.

17 Ms. Bolin, I just want to remind you that
18 acquisition related costs, the Company is likely to
19 have questions on that and that would be Monday
20 unless the parties all confer and rearrange that.
21 We're at recess until 3:45. Off the record. Thank
22 you.

23 (At this point in the proceedings, a short
24 recess was taken.)

25 JUDGE HATCHER: Let's go back on the

1 record. I apologize for the delay. First, a quick
2 announcement. Monday morning, ten a.m.

3 MR. THOMPSON: Ten a.m.?

4 JUDGE HATCHER: Ten a.m. We have a lot of
5 travel that will be accomplished on Monday morning
6 and that makes it much easier for all of us to do
7 that.

8 We have a witness. We are on the issue of
9 income taxes. I do intend for this to be the last
10 issue, the last witness for Friday.

11 Mr. Riley, R-I-L-E-Y, please raise your
12 hand and be sworn in.

13 * * * * *

14 JOHN RILEY,

15 The witness, having been first duly sworn
16 upon his oath, testified as follows:

17 * * * * *

18 JUDGE HATCHER: Thank you. Please take a
19 seat. And Mr. Clizer.

20 EXAMINATION CONDUCTED

21 BY: MR. CLIZER

22 Q. Since you've already -- well, let's
23 start at the beginning. Can you state your name for
24 the record?

25 A. John Riley, R-I-L-E-Y.

1 Q. And have you prepared or caused to be
2 prepared your surrebuttal testimony which has been
3 pre-marked as OPC Exhibit 203?

4 A. Yes, sir.

5 Q. Are the answers -- are the questions
6 and answers contained therein true and correct to the
7 best of your knowledge and belief?

8 A. Yes, they are.

9 Q. If I were to ask you those same
10 questions today, would your answers be the same or
11 substantially similar?

12 A. Yes, sir.

13 MR. CLIZER: I move to admit OPC
14 Exhibit 203, surrebuttal testimony of John S. Riley.

15 JUDGE HATCHER: You've heard the motion.
16 Are there any objections to the admission of
17 Exhibit 203? Hearing none, it is so admitted.

18 MR. CLIZER: I tender the witness for
19 cross-examination.

20 JUDGE HATCHER: Witness is tendered. Oh,
21 I need a hand. Who is -- Mr. Thompson. Thank you
22 guys.

23 MR. THOMPSON: No questions. Thank you,
24 Judge.

25 MR. WOODSMALL: No questions, your Honor.

1 JUDGE HATCHER: Okay. Any Commissioner
2 questions for Mr. Riley?

3 COMMISSIONER HOLSMAN: No questions,
4 Judge.

5 JUDGE HATCHER: No. Go ahead.

6 EXAMINATION CONDUCTED

7 BY: CHAIRMAN RUPP

8 Q. Are you a CPA?

9 A. Yes, sir.

10 Q. You're a great American.

11 MR. WOODSMALL: Mr. Thies is.

12 EXAMINATION CONDUCTED

13 BY: JUDGE HATCHER

14 Q. I would like you to respond to Mr.
15 Seltzer's rebuttal testimony Page 5. I'm just going
16 to read you the quote. "However, when those net
17 operating losses are limited or are no longer
18 utilized against future income a deferred tax
19 liability inherent in the NOLs will become due,
20 demonstrating that they are temporary not permanent
21 differences, parentheses, also referred to as, quote,
22 tax timing differences, end quote, end parentheses,
23 period." Mr. Riley, can you respond to that, please?

24 A. Well, I don't believe there's -- your
25 net operating losses carryforward now forever. So

1 there would never be a deferred tax liability
2 associated.

3 Q. I need to interrupt here. I've had
4 this discussion in a prior case with your counsel. I
5 have a problem with the use of the word never. Can
6 you clarify and give me either a time estimate,
7 whether it be in decades or centuries or years. But
8 I find the idea of never to be hard to implement from
9 the regulatory standpoint.

10 A. Okay. Sure. The net operating loss
11 prior to the TCJA was a 20 year time limit. When
12 they changed the tax laws they removed the 20 year
13 limit. So not using the word never, it is -- it will
14 go on as long as -- until the next tax law change.

15 Q. I didn't need clarification on the
16 statute. We're talking about Confluence and how long
17 will their -- the statement --

18 A. Oh.

19 Q. -- in non-accountant's terms -- as I
20 understand Mr. Seltzer's testimony, in non-accountant
21 terms I understand his testimony to say we're
22 probably going to have to pay taxes at some point and
23 this income tax expense will go to pay that once we
24 get there. That's where I'm distinguishing the
25 never. So how long is reasonable, do you think, to

1 have a -- to not include the full income tax expense
2 that they're requesting?

3 A. Okay. Now, with Ms. Bolin's
4 testimony and the answer to a data request they would
5 -- they estimate they will start paying income tax
6 again in six or seven years. Now, what happens with
7 this net operating loss, through those six years, is
8 as they make -- as they create income, net taxable
9 income, the net operating losses will be applied to
10 that. So absent the 20 percent limit the net
11 operating losses, which were created, you know, years
12 ago, will be applied to that so they will not have to
13 pay that income tax. So that expense doesn't exist
14 absent the 20 percent. But that -- that expense
15 doesn't exist.

16 So if you're going to include, if I get --
17 if I'm understanding this correctly. If you're going
18 to include -- or he would like to include the income
19 tax expense in the rate case. The income tax expense
20 will already be paid by the losses -- by finally
21 using the losses. So in essence, to include income
22 tax expense that doesn't exist is -- it's free money
23 to them. They don't need the income tax expense in
24 order to pay the income tax in future years because
25 that's what the net operating losses will do, they

1 will offset taxable income to a point of no income
2 tax absent the 20 percent. But -- that answer the
3 question?

4 Q. If I understood Staff's
5 recommendation, or alternative recommendation, they
6 were suggesting keeping track of the money, in
7 terrible non-accountant terms, to ensure that by the
8 next rate case there would be some sort of a true up
9 such that the Staff would then be looking at how much
10 income taxes they are paying and how much they have
11 collected and are in this account up until then. Was
12 that your understanding of their alternate
13 recommendation?

14 A. I think their recommendation was in
15 line with what I had suggested that you would offset
16 the net operating -- the income tax expense, which
17 I'm contending is not needed to be paid. And if you
18 include an income tax expense there should be some
19 sort of offset on the books which would be a deferred
20 tax liability because you're providing money -- you
21 would be providing money that would not go to the
22 IRS. And in that instance, typically in a rate -- in
23 rate making is we would consider that accumulated
24 deferred income tax. However, as we stated in
25 testimony, this income tax will never be paid.

1 But if you're going to give them money to
2 pay income tax you would -- you should -- and they
3 aren't going to pay income tax then you should offset
4 that with some sort of deferred liability. You could
5 call it a deferred tax liability but it's a liability
6 that should -- because it falls in line with the idea
7 of an interest free loan. And so you would -- you
8 would offset rate base in order to provide the
9 ratepayer with a return on their loan.

10 Q. Do you know if the revenues generated
11 by rates led to Confluence's net operating loss
12 because revenues weren't enough to cover expenses?

13 A. Well, that's my understanding that --
14 I mean, the loss that Confluence has incurred, as I
15 said in testimony, is an honest to goodness lack of
16 revenue, too much expenses, no income tax -- income
17 tax specific, you know, that -- how do I say it?
18 It's not generated by any income tax statute, they
19 actually did not have enough revenues to cover their
20 expenses. It's an honest to goodness financial loss,
21 not just an income tax loss. In this case they're
22 both the same, your income tax loss, your financial
23 tax -- your financial loss are the same. There's no
24 specific tax provision that caused the losses.

25 Q. So to my question, do you know if

1 revenue's generated led to the operating loss, I'm
2 hearing yes?

3 A. Yes.

4 Q. Okay.

5 JUDGE HATCHER: Thank you. I do have
6 Commissioner questions, we're going to circle back
7 around. Commissioner Holsman.

8 EXAMINATION CONDUCTED

9 BY: COMMISSIONER HOLSMAN

10 Q. In this alternative plan, help me
11 understand. So potentially the Company would receive
12 the money that they would otherwise be taking as
13 taxes but they wouldn't be able to pocket it, as has
14 been earlier suggested, but they would be able to
15 deploy it almost like a no interest loan and then
16 when they came back in for a rate case at some point
17 then that would offset what they could come in for at
18 that point so it would lower -- it would potentially
19 lower rates in the future in a future rate case but
20 that money would flow-through and be available for
21 deployment now, from the time that this case ends
22 until the next rate case, am I understanding that
23 correctly?

24 A. Well, the suggested alternative of
25 applying -- of creating an income tax liability

1 account would lower rate base and therefore would
2 reduce revenue requirement going forward in the next
3 rate case. The income tax expense built into rates
4 now would be available for the Company to use going
5 forward. But if -- and they essentially would not
6 have to pay it back. So in the future you would have
7 lower rates due to the offsetting with deferred tax
8 liability. But they would -- they would have the
9 income tax expense to use at their discretion.

10 Q. Okay. So the way -- so the way I
11 understand what you're explaining is that Staff's
12 position is two options. One option is to disallow
13 the taxes and say the net operating loss basically
14 zeros out any requirement for them to remit taxes to
15 the IRS, therefore they're not going to include it in
16 any of the rate base. Second option is is go ahead
17 and include it in the rate base, let them collect
18 what otherwise would have been the taxes had they
19 been treated the same as previous rate cases or in
20 the small Staff assisted rate cases but they would
21 not be able to pocket that money as profit, it would
22 be accounted for.

23 Is there -- you know, a deferred liability
24 I assume has some sort of accounting mechanism to
25 track it to see where that money goes. Would that

1 money be placed into an account that would be
2 separate and wholly from existing accounts that are
3 there today? Tell me how you would envision the
4 funds, once it's being collected from the rate base,
5 being set aside for deployment by the Company until
6 their next rate case?

7 A. Well, it wouldn't be set aside. They
8 would be able to use it as it, you know,
9 theoretically comes in.

10 Q. It would be tracked then?

11 A. Excuse me?

12 Q. It would be tracked then?

13 A. No.

14 Q. How would we know how much that
15 produced -- how much revenue that produced from the
16 time that it's approved until the time they come back
17 in for their next rate case?

18 A. Well, Staff -- Staff accounting
19 schedules are fairly accurate and I would say that
20 the income tax expense, or any expense for that
21 matter, isn't going to fluctuate very much through
22 the three or four years of rates here. So as the
23 money comes in they can use it as they choose. The
24 liability account is a bookkeeping feature that you
25 set aside a dollar figure to offset rate base in

1 order to reflect the ratepayers interest free loan.

2 Q. Right. Their contribution?

3 A. Yeah. I mean, because that's --

4 Q. And that would be applied to the next
5 rate case, correct?

6 A. Yes.

7 Q. Whatever that value was --

8 A. Yes.

9 Q. -- would then be applied? And so one
10 of the things that we heard in earlier testimony was
11 that there was no notice given to the Company that
12 this change was going -- and OPC wanted to argue that
13 it wasn't a departure but it was a material change in
14 process approach from the way things had been done,
15 rather it was appreciated -- appreciated -- or
16 accelerated depreciation or not, whether it was
17 federally required or not, the way that it has been
18 treated and applied is now different. So to me that
19 is a departure from the way that the Company had
20 previously gone through rate cases, small Staff
21 assisted, all the arbitrary reasonings for why that's
22 the case, now it's different. And there was no
23 notice given that it was going to be different.
24 Would you agree with that -- that testimony?

25 A. Well, it may be a departure for

1 Staff. I don't -- there's a legal -- as we've gone
2 through, there's a legal definite -- definitive act
3 with the IRS and accumulated deferred income tax.
4 However, to be honest with you it would not be a
5 departure on how I treat it. I would never have -- I
6 would always try and reduce taxes down to what they
7 actually are.

8 Q. Okay.

9 A. I think that's the way it should
10 always be. Now, I don't have all that much
11 experience with small water cases so, I mean, if
12 somebody was to say, well, John, it's --

13 Q. But it was testimony earlier that it
14 was based on the individual conducting that case and
15 it was also testified that it was an arbitrary amount
16 that triggered a change in direction for how it was
17 going to be applied. And it was also testified that
18 the Company was not given any notice that this was
19 going to occur. So would it be -- would it be fair
20 to say that the alternative proposal that Staff has
21 proposed by allowing for those taxes to be collected
22 but then not be pocketed as profit but to be applied
23 towards reducing rates in the future would be an
24 approach that gives the Company at least a middle
25 ground in the shift in how it's being treated in

1 terms of towards the property tax -- or towards the
2 income taxes, would that be fair that it's a
3 transitional -- that the alternative approach that
4 Staff is recommending is a transitional approach
5 versus just a denial or a disallowance?

6 A. I'm not quite sure I would
7 characterize it as fair or unfair. As you said
8 earlier, you said, you know, we're in this sandbox
9 and we have this regulatory framework. And I -- like
10 I said, this idea is not a departure from what I
11 would have argued, it would be the same as it is now.
12 The Company has been buying and -- they've been
13 expanding and buying small water companies for
14 several years now and now they're large enough that
15 they are considered, instead of small water company
16 where Staff is assisting, they're now big enough to
17 play with the big boys. You know, they've got all
18 these lawyers out here, you know.

19 Q. But in any large case prior to this
20 with any other company, have the taxes been treated
21 in this way?

22 A. Well, --

23 Q. I think we heard earlier --

24 A. -- this actually hasn't really
25 occurred before because there isn't an IRS mandate to

1 calculate taxes that way.

2 Q. Would you consider the change to be
3 regulatory certainty or regulatory uncertainty?

4 A. There's -- I'm not really sure if I
5 would -- not really sure I could answer that question
6 now that I've listened to the testimony. There's
7 several different ways to handle the -- this rate
8 case. So I -- I know that you're looking at it as a
9 change from what Staff has done in the past but
10 however the -- I don't -- I don't see it as a --

11 Q. So if -- if the second option that
12 Staff has proposed --

13 A. Yeah.

14 Q. -- would be adopted, the Company
15 would be able to collect those funds and deploy them
16 as like a no interest loan?

17 A. Uh-huh.

18 Q. But the accounting result of tracking
19 that would result in potentially lower rates in the
20 future when they come in for the next rate case; is
21 that accurate?

22 A. That's a possibility, yes.

23 Q. All right. Thank you.

24 COMMISSIONER HOLSMAN: Thank you, Judge.

25 JUDGE HATCHER: Thank you, Commissioner.

1 Are there any other Commissioner questions? That'll
2 take us to re-cross examination and I believe that
3 starts with Mr. Thompson.

4 MR. THOMPSON: Thank you, Judge.

5 EXAMINATION CONDUCTED

6 BY: MR. THOMPSON

7 Q. Just to follow up on the questions
8 that Commissioner Holsman was asking you. And you
9 agreed that Staff's alternative might lead to lower
10 rates in the future, do you recall that?

11 A. Yes, sir.

12 Q. But wouldn't you agree that treating
13 income taxes the way Staff has urged in this case
14 would lead to lower rates right now?

15 A. Yes, sir.

16 Q. Thank you. No further questions.

17 JUDGE HATCHER: Thank you. Mr. Woodsmall.

18 MR. WOODSMALL: Yeah.

19 EXAMINATION CONDUCTED

20 BY: MR. WOODSMALL

21 Q. I'm trying to get at this notion of
22 regulatory certainty and you said, well, Staff
23 changed its position. You don't believe Public
24 Counsel has changed its position; is that correct?

25 A. I don't think I would have, no.

1 Q. Okay. How long have you been with
2 Public Counsel?

3 A. First or second time?

4 Q. The most recent time.

5 A. I started in 2016.

6 Q. Okay. So there's been a number of
7 Confluence Rivers' rate cases since that time; is
8 that correct?

9 A. I'm going to take your word for it,
10 yes, but --

11 Q. Okay. We heard something about 20 --
12 2020, 2018. Now the way a small Staff assisted rate
13 case works, and correct me where I go astray, is
14 Staff will ask for the information and then they will
15 put together a revenue requirement. But that's not
16 binding on Public Counsel, is it?

17 A. I wouldn't think it is. I didn't
18 work on small water cases.

19 Q. But Public Counsel could then inquire
20 and object about that, the number that Staff comes
21 out with; is that correct?

22 A. I'm sure they have.

23 Q. Okay. So if Staff had not used these
24 net operating losses in the past you had the
25 opportunity to come in object and say that's not the

1 way to do it; is that correct? You had the
2 opportunity --

3 A. They had that opportunity, yes.

4 Q. Did you ever take that opportunity?

5 A. I did not work on a Confluence case.

6 Q. Okay. So even though Public Counsel
7 had that opportunity, did it ever notice the Company,
8 hey, this is not the way we're going to do it?

9 A. I'm not really sure of the answer
10 there.

11 Q. You're not aware that you ever did
12 it?

13 A. Not aware.

14 Q. Okay. Let's try and get at the real
15 crux of this argument. And I'm a little slow on the
16 uptake on some technical type issues. But it seems
17 to me what I'm seeing is Staff and Public Counsel
18 keep saying that if you give them taxes -- if you
19 give them money and rates for taxes when they don't
20 pay taxes that that's a gift. Is that essentially
21 what it boils down to?

22 A. It's -- it's free money. I mean,
23 it's -- yeah.

24 Q. Okay. Let's spin that around. Try
25 and look at it from the Company perspective here. If

1 the Company covers net operating losses when rates
2 aren't sufficient, isn't that a gift to the
3 ratepayers, to the customers?

4 A. I'm not quite sure I would call it a
5 gift. It's within your business model so I'm -- you
6 know, you want to call that a gift to the ratepayer.

7 Q. We don't ever get compensated for
8 that because you keep saying retroactive rate making
9 so we never recover that; is that correct?

10 A. That's incorrect.

11 Q. So when would we recover that?

12 A. You recover that when you start
13 making a profit and you don't have to pay income tax
14 with the -- because the net operating loss would be
15 used.

16 Q. Great point. So let's inquire into
17 that. We haven't had a net profit for eight years?

18 A. Yeah.

19 Q. We're not likely to have a net profit
20 for another eight years. There is a cost of money,
21 whatever that cost is. So we're going to go 16 years
22 with that cost of money and we're never going to get
23 it; is that correct?

24 A. That's not correct.

25 Q. Where will we get that cost of money?

1 A. Well, this is your business model.

2 Q. That's not my question.

3 A. Well, you were talking about
4 certainty. And you knew -- or the Company knew when
5 they got into this business that they were going to
6 -- they were going to incur some losses. So how they
7 planned on recouping those losses, I'm not really
8 sure other than if they thought they were going to
9 get income tax expense that they were never going to
10 spend on income taxes, if that was going to be the
11 way they were going to fund everything and then to
12 apply a net operating loss, I mean, that's kind of
13 double dipping.

14 Q. But --

15 A. That's how you would get it back.

16 Q. You're not going to give any
17 recognition for the carrying cost of those losses
18 that we incurred 16 years ago before we had a profit?

19 A. No.

20 Q. Okay. That's all the questions I
21 have. Thank you.

22 JUDGE HATCHER: Mr. Clizer.

23 MR. CLIZER: I'll try and make it
24 relatively quick.

25 EXAMINATION CONDUCTED

1 BY: MR. CLIZER

2 Q. Let's start with Mr. Woodsmall's
3 second round of cross, whatever that's called,
4 re-cross, that's the word. The Company made a choice
5 to acquire these systems at the existing rates,
6 right?

7 A. Yes, sir.

8 Q. No one forced them to?

9 A. No.

10 Q. Why did they do that?

11 A. You know, it's something -- it must
12 be something in their business model to -- they see
13 an opportunity to make money down -- you know, down
14 the road, so...

15 Q. Now they have to file a CCN to
16 acquire a system, right?

17 A. Yes.

18 Q. Does that CCN require you to consider
19 all of the rate impacts?

20 A. I'm not really sure of all the
21 particulars in that. But I heard testimony today
22 that they could file -- they could ask for rate
23 impact during the CCN but they haven't chose to.

24 Q. Would the CCN application
25 consideration change considerably if we knew that the

1 Company was going to attempt to retroactively claw
2 back money?

3 A. I guess it would then.

4 Q. And you would agree -- well, what is
5 retroactive rate making?

6 MR. WOODSMALL: Your Honor, I object,
7 legal conclusion.

8 BY: MR. CLIZER

9 Q. What is your understanding as an
10 accountant of the term retroactive rate making as it
11 is used in this case?

12 A. Retroactive rate making would be an
13 effort to include present rates for past expenses
14 that weren't included in rates earlier.

15 Q. So is any attempt by the Company to
16 claw back money because it didn't have enough from
17 the rates that were in existence when it required the
18 system that would constitute retroactive rate making?

19 A. Yes, I believe it would.

20 Q. I want to turn to questions you
21 received from Mr. Holsman. And I'm not going to
22 touch on departures, differences, any of that. I
23 just want to drill home exactly what the
24 representation is. First of all, there was a lot of
25 talk about Staff's representation. Now, you

1 basically made the same recommendation in your
2 surrebuttal, right?

3 A. Yes, sir.

4 Q. Okay. And am I -- that
5 recommendation would be if they're going to normalize
6 -- sorry. If the Commission's going to order
7 normalization you need to book the tax expenses that
8 aren't remitted to the IRS to some kind of tax
9 deferral account or some kind of deferred liability
10 account?

11 A. Yes, sir.

12 Q. And would your opinion -- how would
13 that deferred liability account effect rate base in
14 the future?

15 A. Well, deferred liabilities are an
16 offset to, you know, the calculated rate base and of
17 course it's rate base rate of return. So it has --
18 it would effect the revenue requirement by the rate
19 of return times rate -- times the deferred liability.

20 Q. And treating the deferred liability
21 in that manner would be consistent with how deferred
22 liabilities have always been treated by the
23 Commission?

24 A. As best I understand, yes.

25 Q. It would be consistent with how the

1 Commission treats ADIT, for example?

2 A. Exactly.

3 Q. So that proposal is in essence
4 exactly equivalent to how the Commission is currently
5 treating ADIT?

6 A. Yes, sir.

7 Q. There was a question regarding
8 whether the revenue generated by the systems acquired
9 I think generated the NOL. Just at a high level what
10 is an NOL, can you define it?

11 A. A net operating loss is basically
12 revenues less expenses equals your -- in this case
13 your financial income. And the revenues are not
14 enough to cover all the expenses.

15 Q. So it's not really revenues ever
16 generate the NOL it's expenses generate the NOL?

17 A. That's probably a better way to look
18 at it, yes.

19 Q. All right. The Judge's first
20 question to you was citing you to a portion of Mr.
21 Seltzer's testimony, do you recall that?

22 A. Yes, sir.

23 Q. And the section that was referred to
24 it described the inherent tax liability of the NOL.
25 Do you recall that?

1 A. Yes, sir.

2 Q. Is an NOL a tax liability or a tax
3 asset?

4 A. Well, a net operating loss is
5 considered a tax asset because it will be used to
6 reduce income tax in the future.

7 Q. So there is no inherent tax liability
8 in an NOL?

9 A. Not standalone, no, there is not.

10 Q. So the NOL's going to generate a
11 future tax reduction?

12 A. That's correct.

13 Q. So why does the Company need money
14 now to pay for the future tax reduction? Does the
15 Company -- let me rephrase that. Does the Company
16 need money now to pay for a future tax reduction?

17 A. Well, they shouldn't because as rates
18 are increased and they produce a taxable income their
19 ability to pay their income tax will be advanced
20 because of the net operating loss so --

21 Q. So how many times --

22 A. -- you don't need -- they would not
23 need any now. They would not need income tax expense
24 built into rates.

25 Q. How many times would the Company

1 benefit from the result of this treatment?

2 A. How many times? Well, every year
3 until the net operating loss is, you know, used up,
4 so I --

5 Q. I think you used the phrase double
6 benefit earlier?

7 A. Well, yes. There's a double benefit
8 if you're going to allow -- I didn't realize you were
9 talking about allowing income tax expense in rates.
10 Yes, there's a double benefit because they'll get
11 paid back as their net operating loss is consumed.
12 They won't have to pay income tax. But if you're
13 ignoring the net operating loss savings, because it
14 reduces income tax, and you include income tax
15 expense in, you've got -- you've got this savings
16 over here but now you even have money. So your
17 double benefit is -- you know, is how it -- is the
18 advantage that they're looking for.

19 Q. And let's go back really quick to
20 what you and Mr. Holsman -- Commissioner Holsman, my
21 apologies, were discussing regarding -- again, he
22 used the term Staff proposal, I'm going to say the
23 alternative proposal because both you and Staff refer
24 to it. Do you track what I'm saying so far?

25 A. Yes, sir.

1 Q. So if the Commission were to start --
2 order the Company to book excess income tax to a
3 deferred account, when would that deferred account
4 start to be depleted, when would it start to be
5 reduced?

6 A. If you -- if you take it at -- if you
7 take it at its theoretical definition the deferred
8 income tax -- the reason why you've created this
9 deferred income tax account is because the Commission
10 has allowed income tax expense to be included into
11 rates. That income tax expense will never be repaid.
12 So --

13 Q. I'm going to stop you because our
14 Judge has indicated, apologies, a strong distaste for
15 the word never.

16 A. Oh, that's --

17 Q. So let's --

18 A. All right.

19 Q. Let's kind of ground ourselves a
20 little bit here.

21 A. Okay.

22 Q. The Company's going to come in --
23 let's assume, first of all, the Company comes in with
24 no taxable income.

25 A. All right.

1 Q. Does that -- does that deferred tax
2 liability, that deferred liability start to decrease
3 if they have no taxable income?

4 A. No. I might be a little confused
5 with your question. What we started with was income
6 tax expense being included in rates creates the
7 deferred tax liability because you're providing them
8 money that isn't going to an expense. You know, even
9 it's called income tax expense, it's not going to be
10 paid to the IRS. And what I was getting at was if
11 you do that -- and you were asking when would the
12 deferred tax start to be reduced. It technically
13 would not ever reduce.

14 Q. Okay. Let's drill down on that,
15 let's make sure we have that understanding. Let's
16 say -- let's assume the Company has used up all of
17 its net operating losses carryforwards.

18 A. Okay.

19 Q. It has no net loss carryforwards, it
20 has this deferred income tax.

21 A. Yeah.

22 Q. What is it using to pay income taxes
23 moving forward?

24 A. Well, if you -- by then it would
25 be -- you know, we're making some assumptions here.

1 By then they would be coming back in for a rate
2 increase or rate adjustment. And with no net
3 operating losses probably both Staff and I would be
4 calculating an income tax expense to include in rates
5 then.

6 Q. I understand. So because income tax
7 expense would be include at that point you would
8 never use the money in the deferred tax account to
9 actually pay income taxes. Is that what you're
10 saying?

11 A. Yes.

12 Q. So that's what you mean when you say
13 that it would never -- it would probably never be
14 paid down because the Company would always have money
15 to pay income taxes and wouldn't have to dip into
16 that?

17 A. It would be an extended time that
18 would -- maybe I need to better explain something.
19 When we're talking about accumulated deferred income
20 tax and the usual arguments we have with Spire and
21 Missouri American and that, the idea is that
22 accumulated deferred income tax reverts back over
23 time and that is what -- the deferred income tax is
24 the interest free money the ratepayer has paid to the
25 Company and that's why it's getting a rate of return

1 off of that loan. And that -- and it is a loan
2 because it eventually, time coming back, it will
3 revert back to -- amortize off of the books as the --
4 as -- according to the Internal Revenue Service
5 rates. So it will fall back.

6 In this particular instance there is no --
7 there's no free -- there's no loan. There's no
8 payment that will -- that reverts back. It's just --
9 it's going to be free money. So in order to actually
10 amortize it back you'll have to manually, you'll have
11 to artificially say we're just going to amortize this
12 back just to get it back off the books. There's
13 nothing in the mechanism that would do that on its
14 own because there's nothing in this net operating
15 loss that was created by a tax change, or a tax
16 adjustment, that would sponsor this to revert back
17 over a period of time. It's free money from the
18 get-go because the net operating loss is not a tax
19 generated item, it is income doesn't cover expenses.
20 It's a financial loss that equals the tax loss but
21 it's not created by tax -- by a tax.

22 Q. If you just amortize it off the books
23 then how have customers seen any benefit?

24 A. Well, they lose their benefit over
25 the period of time because the deferred liability --

1 if you amortize it like that deferred liability will
2 eventually fall off of the reduction in rate base.
3 So, you know, over time they would lose their
4 benefit.

5 Q. And is that why you call it a
6 permanent tax savings?

7 A. Yes, sir.

8 Q. So just to summarize and make sure
9 everything's okay and I can finish this off. The
10 alternative proposal would be for the excess income
11 tax expense over what's actually remitted to the IRS
12 to be deferred to a liability account that would
13 decrease the Company's future rate base but it would
14 stick around for an extended period of time unless
15 the Commission decided to arbitrarily reduce it just
16 off the books?

17 A. That is the way I see it because
18 there isn't a time limit, there isn't a -- there
19 isn't a timeframe that created the liability.

20 Q. I think that does it. Thank you very
21 much?

22 JUDGE HATCHER: Thank you, Mr. Riley. You
23 are excused, subject to recall. Let's go ahead and
24 finish up our business for today.

25 As we discussed, this concludes the taking

1 of evidence by the Commission for today. We will
2 adjourn the hearing and reconvene at ten a.m., ten
3 a.m. on Monday. And --

4 MR. WOODSMALL: Your Honor.

5 JUDGE HATCHER: Yes.

6 MR. WOODSMALL: Real quick, just so I
7 understand where we're going. We have the
8 outstanding issue with when we're going to take up
9 Mr. Lyons, I will get you more information on that
10 Monday. Putting that aside, we're doing acquisition
11 related cost and time sheets?

12 UNIDENTIFIED SPEAKER: Judge, we can't
13 hear whatever's being said, they're not on the
14 microphone.

15 MR. WOODSMALL: My apologies. It was a
16 procedure related question. We have an issue. The
17 Commission wants to ask questions of the Company
18 witness on water usage rate design. He has
19 availability concerns that we're going to work out.
20 Putting that aside, we're going to start, as I
21 understand it, your Honor, with acquisition related
22 costs and time sheets and that will be it for Monday?

23 JUDGE HATCHER: I think that's a good
24 plan.

25 MR. WOODSMALL: Okay. And I only mention

1 that because the Company can't bump cost of capital
2 forward because its witness Decendes is flying into
3 town.

4 JUDGE HATCHER: As always, the Commission
5 remains flexible to the needs of witnesses traveling,
6 appearing by WebEx. So we will work around them.

7 MR. WOODSMALL: Thank you, your Honor.

8 JUDGE HATCHER: If the parties change
9 their minds on Monday's issues, please e-mail the
10 presiding officer so that he can get an e-mail heads
11 up to the rest of the persons.

12 MR. THOMPSON: Thank you, Judge.

13 MR. WOODSMALL: Thank you, your Honor.

14 MR. CLIZER: Really quick, before you go
15 off the record. You had previously indicated
16 something about wanting to hear from witnesses
17 regarding the consolidation of rate structures, the
18 settlement that had been reached. Is that still the
19 case? Do you want that as part of that hearing or
20 later on the record are we supposed to be getting
21 back to you?

22 JUDGE HATCHER: Given the witness's
23 availability that I haven't heard any hard
24 exclusions, given the Commission's flexibility, let
25 me get back to you on Monday.

1 MR. CLIZER: Okay.

2 JUDGE HATCHER: I think that's an evolving
3 issue. Okay. Nothing else. We are off the record
4 and we are adjourned for today, Friday. Thank you
5 all.

6 (Deposition was concluded at 4:43 p.m.)

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