Exhibit No.:	_______________
Issue(s):	Cash Working Capital/ Unprotected EADIT Amortization
Witness/Type of Exhibit:	Riley/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	WR-2020-0344

REBUTTAL TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2020-0344

January 15, 2021

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American	)	
Water Company's Request for	)	
Authority to Implement General Rate	)	Case No. WR-2020-0344
Increase for Water and Sewer Service	)	
Provided in Missouri Service Areas	)	

VERIFICATION OF JOHN S. RILEY

John S. Riley, under penalty of perjury, states:

1. Attached hereto and made a part hereof for all purposes is my rebuttal testimony in the above-captioned case.

2. My answer to each question in the attached rebuttal testimony is true and correct to the best of my knowledge, information, and belief.

*/s/ John S. Riley*__________

John S. Riley, C.P.A.
Senior Utility Regulatory Auditor
Office of the Public Counsel

REBUTTAL TESTIMONY

OF

JOHN S. RILEY

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2020-0344

Q. Are you the same John S. Riley who prepared and prefiled direct testimony in this case on behalf of the Office of the Public Counsel?

A. Yes.

Q. Why are you testifying in rebuttal?

A. This testimony responds to Staff witness Courtney Barron's Cash Working Capital ("CWC") section of Staff's direct Cost of Service Report and the corresponding accounting schedule 8. In Ms. Barron's calculation of the federal and state income tax lags, she failed to identify that Missouri American Water Company (MAWC) and its parent company have not paid income tax in over three years. This fact will greatly alter the net lag calculation for income taxes displayed on accounting schedule 8. I will also argue for the Commission to accept Missouri Industrial Energy Consumers (MIEC) witness Mr. Greg R Meyer's testimony that the excess accumulated unprotected deferred income tax balance ("EADIT") be amortized over a three year period.

Q. Could you provide a brief explanation of CWC?

A. Certainly. I concur with Ms. Barron's definition of CWC in the Staff Cost of Service report. To quote the report:

> " Cash Working Capital (CWC) is a rate base component that represents a measurement of the amount of funds, on average, required for the **payment** of a utility's day-to-day expenses, as well as an identification of whether a utility's customers or its shareholders are responsible for providing these funds in the aggregate"[1](emphasis added)

If the net lag is positive then the Company has been funding the expenditure and is allowed to recover those costs as well as earn a return on the monies through rate base inclusion. Conversely, if the net lag is negative then the ratepayer has been funding the expenditure payment and the amount is a deduction from the Company's working capital requirements and reduces rate base.

Q. What is the net lag for the income tax calculation?

A. Staff witness Barron work papers, income tax tab 16, indicates that the expense lag for income tax is an average of 52.88 days. This would make the net lag a negative 9.25 days.

Q. So a negative net lag indicates that the ratepayer has been funding this expense and there is deduction to rate base?

A. Yes. Staff has a negative $472,855 included as an offset to rate base.[2]

Q. Where do you disagree with Staff calculations?

A. Staff works from a premise that MAWC actually pays state and federal taxes. In reality, the parent company didn't pay federal tax in the last three years. MAWC did not pay federal tax in the last three years and the company as a whole only owed on average $120,915 annually

[1] Staff COS report, WR-2020-0344, page 35, line 19-22

[2] Staff accounting schedule 8, lines 26 & 27, federal and state offsets were combined

to the State of Missouri. So instead of working from a hypothetical cash outlay of $18,658,958, the real annual outlay is somewhere around $121,000. That is a very big difference. In fact, income taxes would be a candidate for a regulatory liability due to the difference between the amount of income taxes customers pay in rates vs. the amount of income taxes paid to the IRS and the State of Missouri

Q. What do you calculate the offset to be?

A. MAWC's answer to OPC data request 1300 was to provide the consolidated federal income tax returns and the Missouri state income tax returns for the years 2017, 2018 and 2019. I have included the confidential 2017, 2018 and 2019 American Water Works Company state and federal tax returns in schedule JSR-R-01.[3]

Taking into consideration that the Company paid no federal income tax, the expense lag for federal taxes changes from 52.88 to 365 days to reflect ratepayers paying an expense that never has a cash outlay if a tracker is not used. The state payments only reflect 4.3% of the total state income tax expense that is built into rates. I averaged the state payments over the three year period. The average payout of $120,915 should be separated from the unappropriated balance. Staff's expense lag of 52.88 can be used for that portion of the CWC calculation. The remaining $2,692,863 of state tax expense should be treated just like the federal balance and have a 365 day expense lag applied. Adding these three separate calculations together creates a negative $16,325,176 balance in the income tax calculations within CWC.

[3] Only the form 1120 are included.

		Revenue lag	Expense lag			
STAFF						
Federal	15,845,180.00	43.63	-52.88	-9.25	-0.025342	(401,555.93)
State	2,813,778.00	43.63	-52.88	-9.25	-0.025342	(71,308.07)
	18,658,958.00					(472,864.00)
OPC						
Federal	15,845,180.00	43.63	-365	-321	-0.880466	$(13,951,138.35)
State	120,915.00	43.63	-52.88	9.25	-0.025342	(3,064.28)
State	2,692,863.00	43.63	-365	-321	-0.880466	(2,370,973.65)
	$18,658,958.00					$(16,325,176.28)

Q. How can you justify a 365 day expense lag?

A. Let's look at what CWC entails. "The measurement of the amount of funds, on average, required for the **payment** of a utility's **day-to-day** expenses." The income tax returns prove that MAWC and its parent company do not pay federal income tax. None. There is no day-to-day expense. You cannot deny the fact that payment from the ratepayer is being collected to pay for these taxes, but the taxes themselves are never actually paid to the federal government. It is interest free money.

Q. What does the Commission normally do with interest free money?

A. They reduce rate base. The 365 days is used to recognize this lack of ultimate payment. To calculate, you have the steady revenue lag of 43.63 days offsetting the nonpayment of 365 days to develop a net lag of -321.

Q. Your argument is that taxes have not been paid so therefore the lag should cover the entire year?

A. Yes, but in actuality, income tax hasn't been paid since the last rate case so an argument could be made that the expense lag should go beyond the year. Or maybe a tracker could be instituted similar to how pension expense is handled.

Q. Doesn't MAWC make its tax payments to the parent company instead of to the tax agency?

A. Yes, they do make payments to American Water Works, but these are not arm's length transactions since they involve an affiliate.

Q. Why are these affiliate transactions unnecessary?

A. Even if you take into account some sort of intercompany taxing agreement, MAWC wasn't responsible for any federal tax. I've included schedule JSR-R-02, which displays MAWC's proforma completed annual tax return. This is something that the Company puts together to show what tax liability MAWC would be responsible for if it was a stand-alone Company. Thus substituting a myth for reality.

In 2017, MAWC reported a proforma taxable loss of $40,669,825. In 2018, it report taxable income of $3,108,647, however, that would be absorbed by the accumulated prior year losses. In 2019, the taxable loss was $43,691,602. In just three tax periods we have $81,252,780 in losses waiting for 2020's results. This income tax expense isn't getting spent or paid out. In fact, it isn't accumulating to be spent later. It is not only <u>interest</u> free money, it is actually <u>free money</u>. The Commission must recognize the complete timeframe that the Company has to use this money without having to pay the intended agency. Income tax expense is collected all year, every year and never paid to the intended agency and the CWC calculations must reflect that. It is important to understand that MAWC customers are making payments to non-regulated entities to help offset their tax losses.

Q. Could you summarize your proposed CWC adjustment?

A. Yes, Staff's $472,855 tax offset from rate base for federal and state income tax should be increased an additional $15,852,321 to reflect the Company's lack of federal income tax payments as well as the reduced payments made to the State of Missouri.

<u>3 YEAR AMORTIZATION OF UNPROTECTED EADIT</u>

Q. Mr. Meyer, witness for the MIEC, has proposed a three year amortization for the unprotected portion of the excess accumulated deferred income tax ("EADIT"). Do you agree with this timeframe?

A. Given all the circumstances I think this is a reasonable period to amortize this deferred amount.

Q. Has the OPC followed these guidelines in the past?

A. No, not necessarily. When the Tax Cuts and Jobs Act (TCJA) was enacted, Commissions hadn't dealt with excess deferred tax since the tax changes in 1986. A 40% decrease in the tax rates created an unusually large excess balance. The OPC was concerned that companies would have to finance the refund of such a large amount so it proposed a 10 year amortization period so financing would not be necessary. After a couple of years of addressing this issue, it doesn't appear that there will be a cash flow problem with a shorter amortization period.

Q. What advantages do you see with this three year period?

A. Well, actually MAWC has not started to amortize this EADIT since the TCJA enactment so really we are looking at a six year timeframe squeezed into three. As Mr. Meyer pointed out, MAWC doesn't expect to file another rate case for three years so the amortization period makes a clean cutoff with the next rate adjustment.

Q. What are your thoughts on MAWC's proposed average rate adjustment method (ARAM) for the unprotected EADIT?

A. ARAM is too slow a return to the ratepayer for what are essentially depreciating expense items. ARAM for the unprotected portion is not mandated by IRS regulations so dragging out the return for 30 plus years is unnecessary.

Q. Will the OPC treat this three year suggestion as a policy change going forward?

A. It is a change from our initial 10 year recommendation but I would not say that a three year amortization period will be our hard and fast recommendation for any case. We will review each case on its own evidence and circumstances and support the recommendation that best addresses the particulars of the case.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.

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Schedule JSR-R-1 to John S. Riley's Rebuttal Testimony has been deemed "Confidential" in its entirety

Case No. WR-2020-0344

Schedule JSR-R-2 to John S. Riley's Rebuttal Testimony has been deemed "Confidential" in its entirety