

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

In the Matter of the Petition of)
Missouri-American Water Company for) File No. WO-2019-0184
Approval to Change an Infrastructure)
System Replacement Surcharge (ISRS).)

MAWC'S STATEMENT OF POSITION

COMES NOW Missouri-American Water Company ("MAWC" or "Company"), and, as its *Statement of Position* concerning the issue contained in the *List of Issues, List and Order of Witnesses, Order of Cross-Examination and Order of Opening* filed on May 14, 2019, respectfully states as follows to the Missouri Public Service Commission ("Commission"):

In determining MAWC's ISRS rates in this case, under the applicable statute, may MAWC's accumulated deferred income tax (ADIT) balance in rate base be reduced by the ADIT asset resulting from its net operating loss(es), if any?

MAWC Position: Yes. The ADIT balance included in rate base should be representative of the cost-free funds that became available to MAWC as a result of MAWC's incremental ISRS investments placed in service between October 1, 2018 and March 31, 2019. This ADIT balance should include the incremental change in all deferred tax balances, which include both Deferred Tax Liabilities ("DTL") and Deferred Tax Assets ("DTA"). The incremental change in DTL relates to additional accelerated tax depreciation and tax repair deductions, and the incremental change in DTA relates to incremental Net Operating Loss ("NOL") deductions that will be carried forward. Both components are relevant to this proceeding.

Section 393.1000(1)(a), RSMo, defines "Appropriate Pretax Revenues" as:

[T]he revenues necessary to produce net operating income equal to: (a) The water corporation's weighted cost of capital multiplied by the net original cost of eligible infrastructure system replacements, including recognition of accumulated

deferred income taxes and accumulated depreciation associated with eligible infrastructure system replacements which are included in a currently effective ISRS.

(emphasis added).

MAWC included total ADIT of (\$544,894) in this case, which was a decrease to rate base, and represents the amount of zero-cost capital made available to MAWC on an incremental basis.

DTL from Accelerated Tax Depreciation & Tax Repairs	(\$9,290,765)
DTL from Accelerated Tax Depreciation in Prior ISRS	(18,781)
DTA from Net Operating Loss	8,764,652
Total ADIT	(\$544,894)

Excluding the DTA from the incremental Net Operating Loss results in Total ADIT of (\$9,309,546), which implies an additional \$8,764,652 of interest-free capital became available to MAWC during the ISRS period. However, since MAWC is not currently a federal cash taxpayer, this interest-free capital has not been made available to MAWC.

In ratemaking, the main component of ADIT arises from differences in how a utility's assets are depreciated for ratemaking purposes versus how they are depreciated for federal income tax purposes. For example, tax law sometimes allows a company to claim accelerated depreciation in calculating its taxes. The same amount of taxes eventually must be paid using either accelerated or straight-line depreciation, as long as the tax rate is unchanged. However, the early period tax reductions provide companies that use accelerated depreciation with what amounts to an interest-free loan equal to the amount of their deferred taxes. To keep utility

customers from paying a rate of return on an interest-free loan, the utility's rate base is reduced by an amount equal to the utility's ADIT.¹

However, when bonus depreciation and other tax deductions grow so large as to push the company's taxable income into the negative, the available tax deduction cannot offset any tax liability and no "free" cash (or interest-free loan) is generated. In that circumstance, the company must record an offsetting DTA for Net Operating Loss Carryforward ("NOLC"). The NOLC offsets the ADIT liabilities and, therefore, the NOLC has the effect of increasing the rate base.²

The Staff has argued that the DTA reflected by MAWC is "hypothetical" and not directly attributable to the ISRS plant at issue. In fact, the calculation of the DTA from the NOL is no more "hypothetical" than the DTL from accelerated tax depreciation & tax repairs that Staff and OPC reflect in the ISRS calculation. Because MAWC is in a NOLC position, there is necessarily an impact on NOL resulting from the incremental ISRS plant investments. That impact can be calculated in a similar fashion to the DTL. MAWC computed the incremental and associated ADIT and zero cost capital that resulted from engaging in ISRS. Failure to reflect the NOL assumes the existence of an "interest-free loan" that does not exist for an amount MAWC must fund with debt and equity.

A failure to include the DTA resulting from NOL associated with eligible infrastructure system replacements is inconsistent with a normalized method of accounting as it assumes an interest-free loan that does not exist and as such, is inconsistent with the tax normalization rules.

¹ See *In the Matter of Union Electric Company d/b/a Ameren Missouri's Tariff*, 2015 Mo. PSC LEXIS 380, *22-23, 320 P.U.R.4th 330, ER-2014-0258 (April 29, 2015).

² *Id.*

It also impacts a Consent Agreement MAWC entered into in order to allow the utilization of the repair's deduction method.

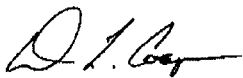
A finding by the Internal Revenue Service that the Company violated the tax normalization rules, or the terms of the Consent Agreement, could cause the loss of significant tax benefits currently benefiting customers. Specifically, MAWC could lose its ability to claim accelerated tax depreciation deductions and tax repair deductions, both of which would serve to increase the rate base upon which MAWC's rates are set and, thereby, harm customers.

The Staff's calculation of rate base should be increased by \$8,764,652, and its ISRS revenue requirement increased by \$827,383, to reflect the inclusion of Net Operating Loss associated with eligible infrastructure system replacements.

Wilde, Dir., All; Reb., All
LaGrand, Dir., All; Reb., All

WHEREFORE, MAWC submits this *Statement of Position* for the Commission's consideration.

Respectfully submitted,



William R. England III, MBE #23975
Dean L. Cooper, MBE #36592
BRYDON, SWEARENGEN &
ENGLAND P.C.
312 E. Capitol Avenue
P. O. Box 456
Jefferson City, MO 65102
(573) 635-7166
dcooper@brydonlaw.com
rmitten@brydonlaw.com

Timothy W. Luft, MBE #40506
Corporate Counsel
MISSOURI-AMERICAN WATER
COMPANY
727 Craig Road
St. Louis, MO 63141
(314) 996-2279 telephone
(314) 997-2451 facsimile
timothy.luft@amwater.com

ATTORNEYS FOR MISSOURI-AMERICAN WATER COMPANY

CERTIFICATE OF SERVICE

I hereby certify that a copy of the above and foregoing document was sent via electronic mail on this 15th day of May, 2019, to:

Mark Johnson
Casi Aslin
Office of the General Counsel
staffcounsel@psc.mo.gov
casi.aslin@psc.mo.gov
mark.johnson@psc.mo.gov

Lera Shemwell
Office of the Public Counsel
opc@ded.mo.gov
lera.shemwell@ded.mo.gov

