

EXHIBIT

Exhibit No.: _____
Issue(s): Net Operating Loss (NOL)
Witness/Type of Exhibit: Riley/Direct
Sponsoring Party: Public Counsel
Case No.: WO-2019-0184

DIRECT TESTIMONY

OF

JOHN S. RILEY

FILED

MAY 21 2019

Missouri Public
Service Commission

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WO-2019-0184

May 7, 2019

OPC Exhibit No. 12
Date 5/17/19 Reporter JNB
File No. WO-2019-0184

DIRECT TESTIMONY
OF
JOHN S. RILEY
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WO-2019-0184

1 **INTRODUCTION**

2 **Q. What is your name and what is your business address?**

3 A. John S. Riley, PO Box 2230, Jefferson City, Missouri 65102.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am employed by the Missouri Office of the Public Counsel ("OPC") as a Public Utility
6 Accountant III.

7 **Q. What is your educational background?**

8 A. I earned a B.S. in Business Administration with a major in Accounting from Missouri State
9 University.

10 **Q. What is your professional work experience?**

11 A. I was employed by the OPC from 1987 to 1990 as a Public Utility Accountant. In this capacity
12 I participated in rate cases and other regulatory proceedings before the Missouri Public
13 Service Commission ("Commission"). From 1994 to 2000 I was employed as a tax auditor
14 with the Missouri Department of Revenue. I was employed as an Accounting Specialist with
15 the Office of the State Court Administrator until 2013. In 2013, I accepted a position as the
16 Court Administrator for the 19th Judicial Circuit until April, 2016 when I joined the OPC. I
17 also prepared individual and small business tax returns for a local accounting and tax
18 preparation service during the 2015 -2017 tax seasons.

1 **Q. Are you a Certified Public Accountant (“CPA”) licensed in the State of Missouri?**

2 A. Yes, I have held a license for over 20 years and I am also a member of the Institute of Internal
3 Auditors (“IIA”)

4 **Q. Have you previously filed testimony before the Missouri Public Service Commission?**

5 A. Yes I have. A listing of my case filings is attached as JSR-D-1

6 **NOL EXCLUSION**

7 **Q. What is the purpose of your direct testimony?**

8 A. I explain what Net Operating Loss (“NOL”) is, and elaborate on the importance of excluding
9 NOL from a company’s Infrastructure System Replacement Surcharge (“ISRS”) calculations
10 for rate base and cost of service. I also concur with Staff’s recommendation to remove
11 Missouri American Water Company’s (“MAWC” or “Company”) purported NOL from the
12 ISRS revenue calculation.

13 **Q. Could you state what the term Net Operating Loss means and explain how a company
14 may use NOL accounting for income tax purposes?**

15 A. First and foremost, an NOL is a tax return adjustment not a regulatory item. Specifically, an
16 NOL is an accounting fiction where, for income tax purposes, a company reports deductions
17 that are higher than reported revenues. This is an item the Company recognizes on its tax
18 return as a taxable income loss. Typically a regulated utility does not incur losses in its regular
19 course of business. One of the major reasons “losses” are incurred for tax purposes is due to
20 the Internal Revenue Service rules that allow the use of accelerated depreciation when
21 determining taxable income. The Commission sets rates by applying a standard depreciation
22 rate that encompasses the expected life of the assets. An example of this would be plant
23 additions that are expected to have a useful life of 30 years are depreciated over 30 years,

1 while for tax purposes, this new addition would be depreciated over five years. This
2 difference creates a much higher deduction when determining taxable income but a much
3 lower expense for regulatory accounting of income.

4 **Q. Why did Staff disallow the NOL in the ISRS calculations?**

5 A. Staff removed the \$8,850,970 NOL due to it being an unsubstantiated calculation. The
6 timeframe for this ISRS period is October 1, 2018 through January 31, 2019 with true up
7 ending March 31, 2019. Essentially, Staff's argument is that there is no actual NOL that
8 can be associated to the ISRS timeframe due to the Company not generating an income tax
9 loss in that period. The Staff does not accept a "hypothetical" NOL applied to the ISRS
10 investment. To quote Staff's Revenue Calculation Section, point number 4:

11
12 Removal of MAWC's proposed net operating loss ("NOL") of
13 \$8,850,970 that has been used to offset the deferred tax liability
14 related to this ISRS investment. As of this date, Staff's
15 understanding is that no amount of net NOL has actually been
16 generated for income tax purposes by MAWC on an aggregate basis
17 since October 1, 2018, (the beginning of this ISRS period).
18 Alternatively, Staff has not been presented with any evidence that
19 imputation of a "hypothetical" NOL amount into ISRS rate base in
20 this case is required to comply with the normalization provisions of
21 the Internal Revenue Service Code.

22
23
24 As was pointed out earlier in my testimony, an NOL is a tax return item and no tax return has
25 yet been filed that covers this timeframe so no NOL should yet be claimed. Staff's conclusion
26 is accurate for this report. This argument does not need any further explanation, however,
27 additional points should be presented to distinguish an NOL from any sort of ISRS
28 consideration.

1 **Q. What other points should be considered?**

2 A. An NOL, as a tax return item, has nothing to do with the Company's infrastructure or plant
3 additions. As a result, an NOL has no connection to the Infrastructure System Replacement
4 Surcharge. If an NOL were actually to be considered, its possible inclusion in rates would
5 need to be addressed in a rate case, not an ISRS proceeding.

6 Another limitation that excludes an NOL from ISRS consideration is that an NOL is not asset
7 specific and cannot be tied to any specific ISRS qualifying or non-ISRS qualifying
8 infrastructure investment. This is in contrast to identifying deferred tax liability to an asset.¹

9 **Q. What is the difference between the recognition of the deferred tax and the NOL?**

10 A. A deferred tax liability is the difference between the tax amounts generated from accelerated
11 depreciation verses the tax calculated on regulatory depreciation. As previously established,
12 depreciation expense is higher when using IRS allowed accelerated depreciation as opposed
13 to the standard regulatory rates. A simple example to illustrate the difference would be that
14 a Company installs water lines costing \$1,000. Five years of Internal Revenue Service-
15 allowed accelerated depreciation deduction is \$200 a year. For regulatory purposes, say the
16 rate is 20 years or \$50 a year. With a 21% tax rate, the tax expense savings for \$200 is \$42
17 (\$200 x 21%). The tax calculated for regulatory purposes is \$10.50 (\$50 x 21%) and the
18 deferred tax is \$31.50 on the specific asset in this example. The same example cannot be used
19 to identify an NOL to this specific \$1,000 asset in my example.

20 An NOL, a tax return item, is the by-product of the summation of greater expenses (deductions
21 and credits) than the revenues (taxable income) reported for an entire tax return, not just an
22 isolated item. In this case, the income tax liability is the product of a consolidated tax return

¹ OPC has argued in prior cases that an NOL should not be included in rate base or the cost of service, however, we are limiting our argument in this case to the exclusion of an NOL in the ISRS calculation. Regulatory assets are recorded at cost not market value. The utility expended no monies to acquire the NOL asset which has no cost basis.

1 which is impacted by other entities besides the Missouri regulated utility. Even though the
2 accelerated depreciation plays a major part in a company's taxable income loss, there are still
3 many other factors that contribute to the Company's claimed NOL which are totally unrelated
4 to the \$1,000 asset used in my example.

5 **Q. Has MAWC or its parent company generated additional NOL since filing its last**
6 **consolidated federal tax return for 2017?**

7 A. Not to my knowledge. MAWC provided an answer to Staff data request no. 0005 in this case,
8 indicating that it would be using prior NOLs in both 2018 and 2019. That data request is
9 attached as JSR-D-2.

10 **Q Would the NOL that MAWC has included in this ISRS filing be essentially the same**
11 **NOL dollars that the Company attempted to insert into the ISRS calculations of its last**
12 **filing, WO-2018-0373?**

13 A. Yes. As the Company has pointed out, it will be applying prior NOL to this ISRS calculation

14 **Q. Does this conclude your direct testimony?**

15 A. Yes.

John S. Riley, CPA
Summary of Case Participation

ST LOUIS COUNTY WATER COMPANY	CASE NO. WR-88-5
SOUTHWESTERN BELL TELEPHONE COMPANY	CASE NO. TC-89-21
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. ER-2016-0023
KCP&L GREATER MISSOURI OPERATIONS COMPANY	CASE NO. ER-2016-0156
KANSAS CITY POWER & LIGHT COMPANY	CASE NO. ER-2016-0285
AMEREN MISSOURI	CASE NO. ER-2016-0179
EMPIRE DISTRICT ELECTRIC PRUDENCE REVIEW	CASE NO. EO-2017-0065
LACLEDE GAS COMPANY	CASE NO. GR-2017-0215
MISSOURI AMERICAN WATER COMPANY	CASE NO. WU-2017-0351
MISSOURI AMERICAN WATER COMPANY	CASE NO. WR-2017-0285
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. EO-2018-0092
LIBERTY (MIDSTATE NATURAL GAS)	CASE NO. GR-2018-0013
KANSAS CITY POWER AND LIGHT	CASE NO. ER-2018-0145
KCP&L GREATER MISSOURI OPERATIONS COMPANY	CASE NO. ER-2018-0146
EMPIRE DISTRICT ELECTRIC PRUDENCE REVIEW	CASE NO. EO-2018-0244
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. ER-2018-0228
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. ER-2018-0366
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. EO-2018-0092
AMEREN GAS COMPANY	CASE NO. GR-2018-0227
MISSOURI AMERICAN WATER COMPANY	CASE NO. WO-2018-0373
LIBERTY UTILITIES EMPIRE ELECTRIC CO	CASE NO. EA-2019-0010
SUMMIT NATURAL GAS OF MISSOURI, INC	CASE NO. GR-2018-0230
SPIRE NATURAL GAS, EAST/WEST ISRS	CASE NO. GO-2019-0115

Missouri Public Service Commission

Data Request

Data Request No.	0005
Company Name	Missouri-American Water Company-(Water)
Case/Tracking No.	WO-2019-0184
Date Requested	3/6/2019
Issue	Cost Recovery Mechanism - Infrastructure System Replacement Surcharge (ISRS)
Requested From	Brian LaGrand
Requested By	Casi Aslin
Brief Description	NOL Detail

Description	Reference Staff Data Request 0005 in Case No. WO-2018-0373. To the extent there is additional information available, provide and update to the following questions. Is MAWC currently expected to generate additional NOL amounts in 2018 and 2019 on an aggregate basis, or to use prior NOLs to offset taxable income in 2018 and 2019 in the aggregate? Please provide the projected net NOL amount generated or used for both calendar years. DR Requested by Karen Lyons (Karen.lyons@psc.mo.gov)
Due Date	3/26/2019

The attached information provided to Missouri Public Service Commission Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the Missouri Public Service Commission Staff if, during the pendency of Case No. WO-2019-0184 before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information.

If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the Missouri-American Water Company-(Water) office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to Missouri-American Water Company-(Water) and its employees, contractors, agents or others employed by or acting in its behalf.

Security	Public
Rationale	NA

Missouri Public Service Commission

Respond Data Request

Data Request No.	0005
Company Name	Missouri-American Water Company-(Water)
Case/Tracking No.	WO-2019-0184
Date Requested	3/6/2019
Issue	Cost Recovery Mechanism - Infrastructure System Replacement Surcharge (ISRS)
Requested From	Brian LaGrand
Requested By	Casi Aslin
Brief Description	NOL Detail
Description	Reference Staff Data Request 0005 in Case No. WO-2018-0373. To the extent there is additional information available, provide and update to the following questions. Is MAWC currently expected to generate additional NOL amounts in 2018 and 2019 on an aggregate basis, or to use prior NOLs to offset taxable income in 2018 and 2019 in the aggregate? Please provide the projected net NOL amount generated or used for both calendar years. DR Requested by Karen Lyons (Karen.lyons@psc.mo.gov)
Response	MAWC expects to use prior NOLs in both 2018 and 2019 because it is part of American Water Works (AWW) consolidated group which projects taxable income for those tax years. AWW projects to use approximately \$395 million in 2018, per the year end provision estimate. MAWC was allocated about \$60.6 million, which, when tax effected, reduced the deferred tax asset by approximately \$12.7 million (See MoPSC 0006 Attachment Update). AWW projects to use approximately \$320 million of NOL in 2019.
Objections	NA

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the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to **Missouri-American Water Company-(Water)** and its employees, contractors, agents or others employed by or acting in its behalf.

Security : Public
Rationale : NA