Exhibit No.: _____
Issues: Excess ADIT
Witness: Michael McCuen
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty
Case No.: GR-2024-0106
Date Testimony Prepared: August 2024

Before the Public Service Commission
of the State of Missouri

Rebuttal Testimony

of

Michael McCuen

on behalf of

Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty

August 22, 2024

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Michael McCuen. My business address is 602 South Joplin Ave., Joplin, MO 64801.

Q. Are you the same Michael McCuen who provided direct testimony in this matter on behalf of Liberty Utilities (Midstates Natural Gas) Corp. ("Liberty" or the "Company")?

A. Yes.

Q. What is the purpose of your rebuttal testimony in this proceeding before the Missouri Public Service Commission ("Commission")?

A. The purpose of my rebuttal testimony ("Rebuttal Testimony") is to address on behalf of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty ("Liberty" or the "Company") recommendations by Lisa M. Ferguson on behalf of the Missouri Public Service Commission Staff ("Staff") regarding the Company's Excess Accumulated Deferred Income Tax ("EADIT") as well as recommendations by John S. Riley on behalf of the Office of the Public Counsel regarding the Net Operating Loss ("NOL") balance in rate base.

II. RESPONSE TO STAFF WITNESS FERGUSON

Q. What is Staff Witness Ferguson's recommendation regarding the Company's NOL EADIT offset?

A. Ms. Ferguson does not specifically state the proposed method for determining how much of the Company's NOL should be used to offset the EADIT balance. Based on her supporting schedules, Ms. Ferguson is utilizing a pro-rata type approach However, the Internal Revenue Service ("IRS") normalization rules require the portion of the utility taxpayers' NOL EADIT offset related to accelerated depreciation to be "protected" and must be treated as an addition to rate base and comply with Average Rate Assumption Method ("ARAM") for EADIT due to the decrease in federal tax rates. The rationale for this rule for EADIT is that a portion of the EADIT due to accelerated depreciation has not been realized due to tax deductions exceeding tax revenue (producing the NOL). As a result, the EADIT due to accelerated depreciation must be identified to offset the accelerated depreciation EADIT so as not to return any accelerated depreciation EADIT too rapidly. Ms. Ferguson does not specifically state the proposed method for determining how much of the Company's NOL should be used to offset the EADIT balance. Based on her supporting schedules, Ms. Ferguson is utilizing a pro-rata type approach.

Q. Do you agree with Staff witness Ferguson's recommendation regarding the Company's NOL EADIT offset?

A. No. The approach used by Ms. Ferguson may create a normalization violation. The IRS has issued numerous Private Letter Rulings ("PLRs") that indicate that the "with or without method" is specifically designed to ensure that the portion of Net Operating Loss Carryforward ("NOLC") attributable to accelerated depreciation is correctly taken into account and that all other approaches (other than the with or without method) do not comply with IRS rules. The with or without methodology determines how much of a NOLC is attributable to accelerated depreciation by using the extent of the lesser of the accelerated depreciation or the NOLC.

Q. Do you think Ms. Ferguson's pro-rata approach to allocating the NOLC is reasonable?

A. No. Staff is using an approach that attempts to accumulate all deductions as the denominator and then uses the accelerated depreciation as the numerator to come up with a percentage to apply against the current year NOL. That pro-rate approach is concerning in that it distorts the gross deductions by including all of the cost of service deductions in the denominator, thereby artificially reducing the percentage applied to the current year NOL and understating the portion of the NOL attributable to the tax deduction for accelerated depreciation (which is the deduction protected by the IRS normalization rules). For example, using the Company's 2012 Federal Tax Return information, Ms. Ferguson is coming up with only a 14.4% inclusion percentage. The 2012 Federal Tax Return shows that there was only $1.2M in book income and the primary drivers (based on dollar amounts) of the book to tax differences were accelerated tax depreciation ($5.6M) and changes in regulatory assets and liabilities ($4.0M). This simplistic review shows that more than 50% of the reason for the NOL was accelerated tax depreciation, and yet Staff's pro-rata approach suggests only 14.4%. The pro-rata approach clearly understates the portion of the NOL caused by accelerated tax depreciation. Accordingly, the pro-rata approach does not appear to be reasonable.

Q. **Has the IRS issued any PLRs specific to an approved method to allocate NOLC?**

A. Yes. The IRS has issued numerous PLRs specific to the issue of allocating NOLCs to ADIT. Please see attached PLRs: 201438003; 201436037; 201436038; 201519021; 201534001; 20154807; and 201709008 as examples.

Q. **What has the IRS ruled regarding the methodology used to identify the correct amount of NOLC attributable to accelerated depreciation?**

A. The rulings come to the conclusion that the with or without method is approved by the IRS and provides clear protection against any possible normalization violation. See PLR 201436037, pg. 6:

> The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

There is no wiggle room allowed for other approaches to measure the portion of the NOLC for accelerated tax depreciation in this conclusion.

Q. **Do you believe the with or without method is a reasonable method?**

A. Yes. The Company shares the benefit of the government provided interest free loan for accelerated tax deductions, primarily accelerated depreciation, through a reduction to rate base for the ADIT balance. The primary driver for this ADIT is accelerated depreciation, and in most cases, the Company would not be in a NOL position if we did not take accelerated depreciation. To protect this specific customer benefit and to allow the Company to continue to use accelerated depreciation, we must avoid any possible normalization violation. The IRS has issued numerous rulings stating that the with or without method is the best (and only) safeguard.

Q. **Are there changes to the amount the Company requested in the original filing?**

A. Yes. Ms. Ferguson did identify the proper Missouri four-factor allocation percentage to use by year. This has the effect of lowering the gross Missouri NOL requested by $2.2M. In addition, based on the IRS-approved with or without method, the 2012 tax year would have a limitation. This limitation would reduce the gross NOL requested by approximately $661,000. Please refer to **Rebuttal Schedule MM-1** for a revised calculation of the Company's proposed EADIT liability.

Q. **Ms. Ferguson has created EADIT associated with a stub period from January 1, 2018, through June 30, 2018, do you agree with that stub period calculation**?

A. No. There are numerous issues with this recommendation. First, there is no such thing as a stub period EADIT after the TCJA remeasurement date of 12/31/2017. All ADIT was already remeasured to provide customers with the benefit of the reduced federal tax rate. Second, Ms. Ferguson's workpapers seem to capture plant additions from January 1, 2018, through June 30, 2018, and apply the tax rate reduction to these gross plant additions. If the goal of Ms. Ferguson's adjustment has anything to do with tax or ADIT, it would be appropriate to use the difference between book and tax timing difference created by the different depreciation methods. The actual cost plant numbers being used would be the same for both book and tax therefore creating no timing difference. Even if there were some sort of stub period impact of EADIT, you would use the difference between book depreciation and tax depreciation, which would be a very immaterial difference for a six-month period. It also does not state whether the plant additions are actually in service; if they are not, there would be no difference.

Q. What does a stub period related to TCJA usually refer to?

A. The use of the phrase "stub period" was typically used when rates charged to customers did not include the reduced tax rate from TCJA. This stub period amount was calculated using a revenue requirement model to ascertain the amount by which customer rates were based on utilizing a higher income taxes compared to the revenue requirement calculation based on the reduced tax rate. Some Commissions established a regulatory liability for this difference in revenue requirement calculations and ultimately returned this regulatory liability back to customers over an agreed upon timeframe. This calculation had nothing to do ADIT or plant additions. Company witness Charlotte Emery addresses the stub period related revenue adjustment in her rebuttal testimony.

Q. Do you agree with the approach taken by Staff regarding the impact of the Missouri state tax reduction?

A. No. Ms. Ferguson has generally explained the issue of state EADIT correctly and has properly identified that state taxes are not bound by the federal normalization rules. The disagreement is with the amount of NOLC that is being remeasured. This is the same issue as identified above for TCJA, the Company should use the same calculation for both federal and state purposes. Additionally, the Company is not aware that the Commission requested that Missouri Investor Owned Utilities establish a regulatory liability associated with the decrease in state taxes. This contrasts to the approach the Commission took when federal taxes were lowered.

III. RESPONSE TO OPC WITNESS RILEY

Q. What is OPC witness Riley's recommendation regarding the Company's NOL balance in rate base?

A. Mr. Riley recommends that no NOL be included in rate base. Mr. Riley alleges that the Company has not substantiated the NOL.

Q. Do you agree with Mr. Riley's recommendation and allegation?

A. No.

Q. OPC Witness Riley states that the 2018 through 2022 tax returns were never provided, do you agree?

A. No. Data Request No. 124 submitted by Staff, requested copies of these returns and the Company tax returns were provided on March 18, 2024.

Q. OPC Witness Riley states that the NOL seemed to move, and he could not figure it out. Do you agree that the NOL moved?

A. No. I do not know what has led to Mr. Riley's confusion. It may be due to his misunderstanding of Company responses to data requests, each of which was requesting data that was a little different or requested at a different time. Staff Data Request ("DR") 132 asked for details around each ADIT item along with a breakdown of the NOL Deferred Tax Asset ("DTA"). The Company provided schedules based on December 31, 2022 provision numbers. This showed that the total Liberty Utilities (Midstates Natural Gas) Corp. had a cumulative NOL of $53,745,669 as of December 31, 2017, with $37,520,757 allocated to Missouri. In addition, these schedules showed that the December 31, 2022 Provision had a cumulative NOL balance of $36,944,979 with the Missouri allocated portion being $25,791,912. Staff DR 182 asked for additional information about the Company's NOL, allocation approach and future income. The Company response provided the same NOL information as Staff DR 132 with details on how the allocation between jurisdictions was done. The data provided by the Company was accurate and needs to be thought through and understood in relation to the specific request.

Q. OPC Witness Riley identifies WP 3.10 ADIT and indicates that the NOL balances are greater than the $12,949,593 listed as a 190 DTA, can you explain?

A. Yes. First, Mr. Riley seems to be comparing gross NOL numbers with tax-effected numbers. WP 3.10 ADIT shows the tax impact of numbers (ADIT are tax effected). In addition, the WP 3.10 ADIT includes other non-property related timing differences in addition to the DTA created by the NOLC.

Q. Are there other reasons why the NOL should be included as an ADIT offset in rate base?

A. Yes. The approach of not including the NOL in rate base recommended by Mr. Riley would likely result in a normalization violation. As I have stated previously, the Internal Revenue Code is clear that the NOL ADIT Asset must be included in rate base to offset the ADIT Liability recorded for the book-tax depreciation difference. That ADIT Liability has not been realized (due to the NOL) and it is inappropriate and unfair to reduce rate base for the unrealized accelerated depreciation ADIT Liability. The interest-free loan represented by ADIT is not available or providing a source of funds. Further, a normalization violation would result, denying the Company the ability to claim accelerated depreciation, thus losing significant rate base reducing ADIT to the detriment of the Company's customers.

IV. <u>REQUEST</u>

Q. What is the Company's request related to both federal and state EADIT?

A. The Company requests that the with or without method be used to calculate the portion of NOLC that is attributable to accelerated tax depreciation for both the 2017 TCJA and the 2020 Missouri state rate change. In addition, the Company requests that the stub-period EADIT calculation and the state tax approach proposed by Staff be denied entirely. Finally, OPC's NOL recommendation should also be denied entirely.

Q. Does this conclude your rebuttal testimony at this time?

A. Yes.

VERIFICATION

I, Michael McCuen, under penalty of perjury, on this 22nd day of August, 2024, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ Michael McCuen