

Exhibit No. 10

Exhibit No:
Issues: Pensions, OPEBs, tax and
ratemaking treatment for
ADIT
Witness: Alan D. Felsenthal
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SPIRE MISSOURI INC.

CASE NO. GR-2021-0108

DIRECT TESTIMONY

OF

ALAN D. FELSENTHAL

DECEMBER 11, 2020

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1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Alan Felsenthal. My business address is One North Wacker Drive, Chicago,
4 Illinois, 60606.

5 **Q. WHAT IS YOUR EMPLOYMENT?**

6 A. I am a Managing Director at PricewaterhouseCoopers LLP (“PwC”).

7 **Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?¹**

8 A. I am submitting this testimony on behalf of Spire Missouri Inc. (“Spire” or “Company”),
9 including its two operating units, Spire East and Spire West .

10 **Q. PLEASE STATE BRIEFLY YOUR EDUCATIONAL BACKGROUND AND**
11 **EMPLOYMENT EXPERIENCE.**

12 A. I graduated from the University of Illinois in 1971 and began my career at Arthur Andersen
13 & Co (“Arthur Andersen”), where I was an auditor, and focused on audits of financial
14 statements of regulated entities. In 2002, I joined PwC and became a Managing Director
15 in their Power and Utilities Group and continued performing audits for regulated entities.
16 I was hired by Huron Consulting Group (“Huron”) in 2008 and returned to PwC in
17 November of 2010. At both Arthur Andersen and PwC, I supervised audits of financial
18 statements on which the firms issued audit opinions that were filed with the SEC, the
19 Federal Communications Commission, the Federal Energy Regulatory Commission
20 (“FERC”) and various state commissions. At Arthur Andersen, PwC and Huron, I

¹ This testimony was prepared in connection with the current Spire Missouri Inc. rate case and for the use and benefit of Spire Missouri Inc. PwC disclaims any contractual or other responsibility to others based on their access to or use of this direct testimony and the information contained herein.

1 consulted on a significant number of utility rate cases and helped develop testimony for
2 myself and others on a variety of issues, including construction work in progress in rate
3 base, projected test years, lead-lag studies, cost allocation, several accounting issues (e.g.,
4 pension accounting, regulatory accounting, income tax accounting, cost of removal) and
5 compliance with the income tax normalization requirements.

6 **Q. PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES AT PWC.**

7 A. I am currently a member of the firm's Complex Accounting and Regulatory Solutions
8 ("CARS") practice which focuses on rate-regulated utility accounting, tax and ratemaking
9 issues. Throughout my career, my focus has been on the regulated industry sector,
10 primarily electric, gas, telecommunication and water utilities. I have focused on utility
11 accounting, income tax and regulatory issues, primarily as a result of auditing regulated
12 enterprises. The unique accounting standards applicable to regulated entities embodied in
13 Accounting Standards Codification ("ASC") 980, Regulated Operations (formerly,
14 Statement of Financial Accounting Standards ("SFAS") 71, SFAS 90, SFAS 92, SFAS
15 101 and various Emerging Issues Task Force ("EITF") issues, all need to be understood
16 so that auditors can determine whether a company's financial statements are fairly
17 presented in accordance with generally accepted accounting principles ("GAAP"). I have
18 witnessed the issuance of these standards and have consulted with utilities as to how they
19 should be applied. At both Arthur Andersen and PwC, I worked with the technical industry,
20 accounting and auditing leadership to communicate and consult on utility accounting and
21 audit matters. My curriculum vitae is attached as Exhibit A.

1 **Q. HAVE YOU PREVIOUSLY TESTIFIED OR SUBMITTED TESTIMONY**
2 **BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION (“COMMISSION”)**
3 **OR ANY OTHER REGULATORY COMMISSION?**

4 A. Yes. While I have not testified in Missouri, I have testified before the Arizona Corporation
5 Commission, the Florida Public Service Commission, the Hawaii Public Utilities
6 Commission, the Illinois Commerce Commission, the Indiana Utility Regulatory
7 Commission, the Maine Public Utilities Commission, the Public Utility Commission of
8 Ohio, the Public Utility Commission of Texas, the Public Service Commission of Utah, the
9 Washington Utilities and Transportation Commission and FERC. My curriculum vitae
10 lists the various issues and testimony I have presented as well as the jurisdiction.

11 **Q. HAVE YOU PROVIDED TRAINING ON THE APPLICATION OF GAAP TO**
12 **REGULATED ENTERPRISES?**

13 A. Yes. At Arthur Andersen, Huron and PwC, I developed and instructed utility accounting
14 seminars focusing on the unique aspects of the regulatory process and the resulting
15 accounting consequences of the application of GAAP. I have presented seminars as well
16 as delivered training on an in-house basis. Seminar participants have included utility
17 company and regulatory commission staff accountants, utility rate departments and internal
18 auditors, tax accountants and others. I have also conducted these seminars for FERC and
19 several state commissions and presented at various Edison Electric Institute and American
20 Gas Association ratemaking and accounting seminars. The income tax training programs
21 I have presented include topics such as the normalization requirements for public utilities
22 in the Internal Revenue Code (“IRC”), protected and unprotected deferred taxes and the
23 mechanics and application of the Average Rate Assumption Method (“ARAM”).

1 **PURPOSE OF TESTIMONY**

2 **Q. WHAT ISSUES ARE YOU ADDRESSING IN THIS CASE?**

3 A. My testimony will:

- 4 • Provide a summary of the accounting and ratemaking for pension and postemployment
5 benefit (“OPEB”) costs;
- 6 • Describe the Company’s request for recovery of pension and OPEB costs including both
7 the test year pension and OPEB contributions as well as the rate base treatment and
8 amortization of the pension and OPEB regulatory asset/liability;
- 9 • Explain why it is appropriate to allow recovery of contributions to the pension trust at an
10 amount above the minimum funding required under The Employee Retirement Income
11 Security Act of 1974 (“ERISA”);
- 12 • Provide a background on the accounting and ratemaking for income taxes, including
13 Accumulated Deferred Income Taxes (“ADIT”);
- 14 • Describe the changes to the IRC resulting from the Tax Cuts and Jobs Act of 2017
15 (“TCJA”) and the general impact of the changes on regulated utilities;
- 16 • Explain the ratemaking treatment proposed by the Companies for “protected” excess ADIT
17 and how such treatment complies with the TCJA requirement for such excess including the
18 ratemaking treatment of the difference between amounts returned to customers since the
19 last rate case based on estimates and the amounts that should have been returned in this
20 period if the actual protected excess ADIT amounts were known at the time; and
- 21 • Explain the ratemaking treatment proposed by the Companies for “unprotected” excess
22 ADIT including the ratemaking treatment of the difference between amounts returned to
23 customers since the last rate case based on estimates and the amounts that should have been

1 returned in this period if the actual unprotected excess ADIT amounts were known at the
2 time.

3 **Q. ARE THERE EXHIBITS OR SCHEDULES ATTACHED TO YOUR TESTIMONY?**

4 A. Yes. The schedules I am supporting are attached in the following Exhibits attached to my
5 testimony:

6 **Exhibit A** –Curriculum Vitae of Alan Felsenthal

7 **Exhibit B** – Average Rate Assumption Method Example

8 These schedules and the calculations reflected therein were prepared by me or under my
9 supervision and direction. I will refer to and explain each of the schedules in my testimony.

10 **PENSIONS AND OPEB ACCOUNTING AND FUNDING REQUIREMENTS**

11 **Q. PLEASE BRIEFLY SUMMARIZE THE ACCOUNTING FOR PENSIONS UNDER**
12 **GAAP.**

13 A. For accounting purposes under GAAP, an employee’s pension is “accrued” (recognized as
14 an expense) over the employee’s service life. In that manner, a portion of the pension that
15 is “earned” each year by the employee providing service for that year is an expense of that
16 year. Estimates of the amount that the employee will eventually receive as a pension
17 payment are developed by actuaries considering how long the employee will live after
18 retirement, the promised benefits, etc. The expense is recognized each year of the
19 employee’s service life with a corresponding increase to the pension liability. Once the
20 employee retires, his/her service cost expense accrual is stopped. At this point, pension
21 payments begin. Adjustments for non-service cost, for true-ups from estimated to actual
22 experience, will continue until the liability promised to the retiree is fully met and paid.

23 The journal entry to record pension expense is:

1 Dr. Pension Expense XXX

2 Cr. Accrued Pension Liability XXX

3 **Q. HOW IS THE PENSION COST FUNDED? IS THE FUNDING BASED ON GAAP?**

4 A. No. Apart from the determination of pension expense for GAAP, companies must be able
5 to fund the future retiree payments. It is a prudent business decision to put away amounts
6 prior to the time such retiree payments are to occur and most companies have established
7 a pension trust to accomplish this. This is the “funding” part of the equation. Pension
8 funding is based on requirements established by the Federal Government known as the
9 ERISA laws. ERISA laws govern pension trust funding. The IRS sets minimum and
10 maximum funding requirements and imposes penalties and other limitations for less well-
11 funded pension plans. The Pension Protection Act of 2006 (PPA) expanded on the
12 protections provided by ERISA and increased the cost to companies that underfund pension
13 plans through insurances premiums paid to the Pension Benefit Guarantee Corporation
14 (“PBGC”).

15 The journal entry to record a contribution to the pension trust is:

16 Dr. Accrued Pension Liability XXX

17 Cr. Cash XXX

18 While the ERISA funding rules are complex, it is most important to understand the ERISA
19 objectives. The reason Congress passed ERISA was because of outside pressures resulting
20 from companies being unable to pay the promised pensions to rank-and-file workers. One
21 of the highest profile examples was the Studebaker Corporation, which closed its South
22 Bend, Indiana, facility in 1963. Because its pension plan was woefully underfunded,
23 thousands of vested Studebaker employees received just a small portion of benefits earned

1 and many others received nothing. While the ERISA funding requirements apply to
2 corporate pension plans, they do not apply to public or governmental plans and that is why
3 a number of states and municipalities have to deal with the well-publicized, negative
4 consequences of significant unfunded pension benefits due their employees.

5 **Q. HOW DO THESE CONTRIBUTIONS IMPACT RATEMAKING?**

6 A. Assets in the pension trust cannot be removed for any purpose other than retiree pension
7 payments. Amounts in the fund can be invested in securities and other vehicles to earn a
8 return—thus reducing the amount that eventually needs to be contributed to the fund in
9 order to have enough cash accumulated to pay the retiree benefits once they begin. If, for
10 example, \$50,000 was needed to fund pension benefits for an employee that will retire in
11 10 years (the payments beginning in year 11), it is possible to contribute less than \$50,000
12 to the pension trust as long as the earnings on the amounts invested produce the required
13 \$50,000 when payment to the retiree becomes due. Further, the sooner that contribution is
14 made, the longer that contribution is available to earn within the plan; thus, allowing a
15 lower overall contribution. The sooner and greater the contribution, the less the company
16 will be required to contribute over time to be able to make the pension payments. As a
17 result, and importantly from a ratemaking standpoint, pension trust earnings reduce
18 ongoing annual pension expense. As pension expense is included as a recoverable cost in
19 the ratemaking process, these trust earnings accrue to the benefit of customers. Similarly,
20 in Spire's case where contribution amounts have historically been included in the
21 determination of cost of service, larger contributions earlier in an employee's service
22 period will reduce the total amount of contributions required and, therefore, lower the
23 amount required to be collected from customers over time.

1 For example, assume an employee is expected to receive a benefit payout when they retire
2 in 20 years of \$50,000 and that the annual return on plan assets is 10%.

3 Scenario One: Contribute \$7,000 at the beginning of year one.

$$4 \quad \$7,000 \times (1 + 10\%)^{20} = \$47,092.50$$

5 In this scenario, after 20 years there will be \$47,092.50 in the trust
6 to use to pay the benefit such that only \$2,907.50 will need to be
7 contributed in year 20 to pay the benefit.

8 Scenario Two: Contribute \$3,500 at the beginning of year one.

$$9 \quad \$3,500 \times (1 + 10\%)^{20} = \$23,546.25$$

10 In this scenario, after 20 years there will be only \$23,546.25 in the
11 trust to use to pay the benefit such that an additional \$26,453.75
12 must be contributed in year 20 to pay the benefit.

13 In summary, as a result of only contributing \$3,500 more to the trust in year one, the total
14 contributions required to pay the benefit are \$20,046.25.25 less (after considering the
15 additional \$3,500 starting contribution). As a result, regardless of whether pension expense
16 or contributions are included in determining the revenue requirement, the total revenue
17 requirement will be less if higher contributions are made earlier.

18 **Q. PLEASE SUMMARIZE THE DIFFERENCE BETWEEN PENSION**
19 **ACCOUNTING AND PENSION CONTRIBUTIONS.**

20 A. Pension accounting is based on GAAP and follows an accrual concept, while pension
21 funding/contributions are based, in part, on the requirements of ERISA. It is important to
22 understand that there is no correlation between pension accounting and pension funding
23 under ERISA. In a paper on the subject of pensions prepared by the Pension Committee of

1 the American Academy of Actuaries, it states clearly that “amounts calculated under
2 pension funding rules are completely different than those calculated for pension
3 accounting, and one must be careful not to mix the two topics.”²

4 In addition, in the Basis for Conclusions in Statement of Financial Accounting for Pensions
5 No. 87, Employer’s Accounting for Pensions the Financial Accounting Standards Board
6 (FASB), as codified in ASC 715, stated:

7 “This Statement reaffirms the APB’s conclusion that funding decisions
8 should not necessarily be used as the basis for accounting recognition of
9 cost. The amount funded (however determined) is, of course, given
10 accounting recognition as a use of cash, but the Board believes this is one
11 of many areas in which information about cash flows alone is not sufficient,
12 and information on an accrual basis is also needed. **The question of when
13 to fund the obligation is not an accounting issue.** It is a financing question
14 that is properly influenced by many factors (such as tax considerations and
15 the availability of attractive alternative investments) that are unrelated to
16 how the pension obligation is incurred.” (Emphasis added).

17 When a company makes contributions in excess of GAAP pension expense, a prepaid
18 pension asset results. The amount of that prepaid pension asset is the cumulative amount
19 of contributions in excess of cumulative GAAP pension expense.

20 **Q. PLEASE PROVIDE A SIMPLIFIED EXAMPLE TO ILLUSTRATE THE**
21 **ACCOUNTING AND FUNDING REQUIREMENTS?**

² See Fundamentals of Current Pension Funding and Accounting For Private Sector Pension Plans, an analysis by the Pension Committee of the American Academy of Actuaries, July 2004.

1 A. Assume that cumulative GAAP pension expense is \$100 and cumulative pension
2 contributions (pursuant to ERISA) are \$150. The journal entry to record the pension
3 expense and pension contribution is:

4 Dr. Pension Expense \$100

5 Cr. Accrued Pension Liability \$100

6 Dr. Accrued Pension Liability \$150

7 Cr. Cash \$150

8 The net position on the GAAP balance sheet is a \$50 prepaid pension asset. The above
9 example does not include the ultimate payments made to the pensioners after they retire –
10 which will come from the pension trust – such payments to retirees from the trust are not a
11 factor in this cause.

12 **Q. ARE OPEB’S TREATED IN THE SAME MANNER?**

13 A. From a GAAP perspective, yes. From a contribution/funding perspective, no. In addition
14 to pensions, many employers provide other retiree benefits such as for medical costs and
15 life insurance and the accounting rules for OPEB’s are similar to those of pensions.
16 However, the contributions for OPEB’s are quite different than for pensions in that there
17 are no specific requirements to pre-fund these obligations (i.e., no ERISA minimums). But
18 both Spire East and Spire West are contributing the majority of their OPEB obligations
19 using a tax deductible Voluntary Employees’ Beneficiary Trust (“VEBA”) and to a lesser
20 extent through a Rabbi Trust.

21 **PENSION AND OPEB RATEMAKING TREATMENT**
22

1 **Q. TRANSITIONING TO THE RATEMAKING TREATMENT FOR PENSION AND**
2 **OPEB COSTS FOLLOWED BY SPIRE, IS THE RATEMAKING TREATMENT**
3 **BASED ON GAAP OR SOME OTHER AMOUNT?**

4 A. The ratemaking treatment for pensions is based on contributions/funding not GAAP.
5 While, for a period of time, the GAAP accounting for pensions was used to determine the
6 pension expense to be included in determining revenue requirements, since the early 2000's
7 both Spire East and Spire West have been permitted to recover the test year amounts
8 contributed to the pension trust or OPEB funding vehicles. In addition, any difference,
9 positive or negative, in amounts actually contributed to these trusts compared to the
10 pension and OPEB amounts included in the test year determination of revenue
11 requirements is deferred as a regulatory asset or regulatory liability and
12 recovered/refunded, through amortization, in the succeeding rate case. In this manner,
13 actual pension and OPEB contributions are recovered in the ratemaking process.

14 **Q. WHAT IS THE AMORTIZATION PERIOD FOR THE PENSION AND OPEB**
15 **REGULATORY ASSET/LIABILITIES BEING PROPOSED IN THIS**
16 **PROCEEDING?**

17 A. The amortization period for the pension/OPEB regulatory asset or pension/OPEB
18 regulatory liability proposed in this proceeding is 8 years. This was the period approved
19 in Spire's last rate cases of (GR-2017-0215 and GR-2017-0216).

20 **Q. WHAT CONTRIBUTION FUNDING LEVELS IS THE COMPANY PROPOSING**
21 **IN THIS RATE CASE?**

22 A. Spire is proposing to include pension contributions at a level that is projected to achieve
23 100% pension benefit obligation (PBO) funding status over a 5-year period. No

1 contributions to OPEB obligations are proposed as those plans combined are adequately
2 funded.

3 **Q. WHAT ARE THE BENEFITS OF CONTRIBUTING TO THE PENSION TRUST**
4 **ABOVE THE MINIMUM LEVEL WITH A PLAN TO ACHIEVE 100% FUNDED**
5 **STATUS?**

6 A. There are a number of benefits of contributing at this level. First, eventually, assets in the
7 pension trust will be used to pay pension benefits which are benefits already earned by
8 Spire employees. In the meantime, the pension trust will earn returns for the pension plan,
9 reducing every year the net annual pension cost charged to Spire and, ultimately, the
10 amount needing to be contributed and, therefore, reflected in the ratemaking process. In
11 addition to the reduction of the ultimate retiree pension payments, which accrues to
12 customers, customers also benefit from the company's ability to attract and retain qualified
13 employees knowing their pension is adequately funded. Further, companies with a well-
14 funded pension plan are viewed as having less risk to the investment community which, all
15 else being equal, should reduce the required return which also benefits customers. Said
16 another way, less well-funded pension plans likely affect investment ratings, increasing
17 risk and potentially increasing the cost of capital to the detriment of customers. A well-
18 funded pension plan offers a variety of advantages in addition to stable, predictable
19 contribution levels. For example, funding policy contributions help position the plan to be
20 able to absorb adverse experience (e.g., the 2008 stock market crash and volatility in the
21 stock market seen in the Spring of 2020 due to coronavirus) without necessitating a
22 significant change in annual funding and expense.

1 Finally, by contributing above the minimum ERISA funding level, the Companies avoid
2 certain payments that are charged when funding is based on the minimum.

3 **Q. CAN YOU EXPLAIN WHAT YOU MEAN BY ADDITIONAL PAYMENTS**
4 **REQUIRED WHEN CONTRIBUTION LEVELS RESULT IN A FUNDED STATUS**
5 **BELOW 100%?**

6 A. Yes. While funding pension trust contributions over the minimum level in any particular
7 year, such contributions would have eventually been required to fund the plan. The
8 Companies also are charged PBGC premiums based on several factors including a flat rate
9 amount per covered employee as well as a variable rate calculated as a percentage of the
10 unfunded vested liability. Thus, to the extent that contributions are made above the
11 minimum and improve funding levels, the variable premium payment is
12 reduced/eliminated. In Spire's case , such underfunding on a market value exists, such
13 that the PBGC variable premium is currently capped at \$561 per participant, per the
14 Company's actuary Willis Towers Watson, which could be reduced to zero if the plan was
15 fully funded on a market basis. This is another benefit that would accrue to customers. In
16 2006, the Pension Protection Act ("PPA") changed the ERISA funding rules so that
17 required contributions would drive the plans towards a 100% funding level on a market
18 basis. In the years since, funding relief legislation caused an artificial decrease in the
19 liability, as the ERISA rules disconnected from market interest rates. Spire's approach in
20 this rate case is to return to the original intent of PAA and fund towards a 100% level based
21 on a market liability (PBO).

22 **Q. CAN YOU EXPLAIN USING THE SIMPLE EXAMPLE YOU PROVIDED, HOW**
23 **PENSION COSTS WOULD BE TREATED IF THE PENSION CONTRIBUTIONS**

1 **ARE PERMITTED TO BE RECOVERED IN THE RATEMAKING PROCESS AS**
2 **YOU HAVE DESCRIBED?**

3 A. Yes. For ratemaking purposes, the \$150 would be treated as a recoverable cost in
4 determining revenue requirements. If in the years subsequent to the rate case, contributions
5 to the pension trust were:

6 Amount included in test year and recoverable:	\$150 (a)
7 Amount contributed in first following year	\$160 (b)
8 Amount contributed in second following year	\$162 (c)
9 Amount contributed in third following year	\$152 (d)

10 Then a pension regulatory asset would be recorded as follows:

11 Pension regulatory asset after first following year: \$10 (e)

12 Actual contribution vs. Test Year (\$160(b)-\$150(a))

13 Pension regulatory asset after second following year: \$22 (f)

14 Actual contribution vs Test Year plus prior year

15 regulatory asset (\$162(c)-\$150(a)) plus \$10(e)

16 Pension regulatory asset after third following year: \$24 (g)

17 Actual contribution vs. Test Year plus prior year

18 regulatory asset (\$152(d)-\$150(a)) plus \$22(f)

19 In the *next* rate case, the company would include a \$24(g) regulatory asset in rate base and,
20 assuming an eight-year amortization period, an amortized pension cost of \$3 (\$24 divided
21 by 8=\$3). This amortized cost would be in addition to the estimated test year pension
22 contribution.

1 **Q. IN THIS EXAMPLE, WOULD AMOUNTS RECORDED FOR PENSION COSTS**
2 **UNDER GAAP BE RELEVANT IN DETERMINING THE RATEMAKING**
3 **TREATMENT OF PENSION COSTS?**

4 A. No. The prepaid pension asset that would be recorded for GAAP is \$50 (the difference
5 between the amount contributed to the pension trust \$150 in excess of the pension expense
6 recorded under GAAP (\$100)). However, in this example, the GAAP prepaid pension asset
7 has no relevance in the ratemaking process as, for ratemaking purposes, recovery is based
8 entirely on pension trust contributions. Similarly, the pension expense recorded under
9 GAAP is not relevant in the ratemaking process as pension cost recovery is based on
10 contributions.

11 **Q. WHAT LEVEL OF RETURN IS BEING APPLIED TO THE PENSION/OPEB**
12 **REGULATORY ASSET OR REGULATORY LIABILITY?**

13 A. The Companies are including the estimated balance of the unamortized pension/OPEB
14 regulatory asset or regulatory liability in rate base so that the overall weighted cost of
15 capital is applied.

16 **Q. WHY WOULD APPLYING THE OVERALL RATE OF RETURN TO THE**
17 **UNAMORTIZED PENSION/OPEB REGULATORY ASSET OR REGULATORY**
18 **LIABILITY BE APPROPRIATE?**

19 A. The difference between the pension and OPEB amounts included in the ratemaking process
20 in a rate case (included in the revenue requirement and charged to customers) compared to
21 actual pension and OPEB amounts contributed in the intervening years between rate cases
22 is, by definition, attributable to investor funding. Thus, such amounts should receive a
23 return on this funding similar to the return provided for all other investor sourced funding.

1 **TEST YEAR PENSION AND OPEB COSTS**

2
3 **Q. WHAT AMOUNTS OF PENSION AND OPEB COSTS IS THE COMPANY**
4 **INCLUDING IN THIS RATE CASE FILING?**

5 A. Spire East is including \$52.1 million as a recoverable pension cost in this rate proceeding,
6 consisting of estimated test year contributions of \$41.5 million and amortization of the
7 pension regulatory asset, \$84.8 million, over 8 years, of \$10.6 million (\$84.8 million
8 divided by 8=\$10.6 million). In addition, the pension regulatory asset of \$84.8 million is
9 included in rate base.

10 Spire East is including \$1.0 million as a recoverable OPEB cost in this rate proceeding,
11 consisting of zero estimated test year contributions and amortization of the regulatory asset,
12 over 8 years, of \$ 1.0 million (\$7.8 million divided by 8=\$1 million). In addition, the
13 regulatory asset of \$7.8 million is included in rate base.

14 Spire West is including \$4.4 million as a recoverable pension cost in this rate proceeding,
15 consisting of estimated test year contributions of \$6.9 million and amortization of the
16 pension regulatory liability, over 8 years, of \$\$2.5 million (\$19.8 million divided by 8 =
17 \$2.5 million). In addition, the pension regulatory liability of \$19.8 million is included as
18 a rate base reduction.

19 Spire West is including \$0.2 million as a recoverable OPEB cost in this rate proceeding,
20 consisting of zero estimated test year contributions amortization of the regulatory asset,
21 over 8 years, of 0.2 million (\$1.5 million divided by 8=\$0.2 million) In addition, the
22 pension regulatory asset of \$1.5 million is included in rate base.

23
24 **VI. INCOME TAX ACCOUNTING BASICS**

1 **Q. TURNING TO INCOME TAXES, PARTICULARLY THE TREATMENT OF**
2 **ADIT AND EXCESS ADIT, CAN YOU PLEASE DESCRIBE THE**
3 **FUNDAMENTALS OF INCOME TAX ACCOUNTING UNDER GENERALLY**
4 **ACCEPTED ACCOUNTING PRINCIPLES?**

5 A. Yes. One of the complicating factors when it comes to accounting for income taxes is
6 that there are basically two sets of rules that entities must follow. One is GAAP which
7 governs accounting and financial reporting. Under GAAP, the accrual method of
8 accounting is followed and guidance exists for determining the amount of revenue,
9 income, expenses, assets, and liabilities to report. The other is the Internal Revenue Code
10 (“IRC”) which provides guidance on when revenue and income are taxable and when
11 expenditures are deductible. Most items that enter into pre-tax accounting income
12 (financial statement or “book” income) also enter into taxable income (tax return income)
13 in the same year. Some events, however, are recognized for book purposes and for tax
14 purposes in different years. Over time, most of these differences reverse (meaning that in
15 early years, the book amount will be higher/lower than the tax return amount, but in later
16 years, the tax return amount will be lower/higher than the book amount) and will
17 eventually offset each other on a cumulative basis (known as temporary or timing
18 differences). The income tax effects of these temporary differences are recorded as
19 accumulated deferred income taxes (“ADIT”) in the intervening periods. The ADIT
20 balance represents the asset (debit) or liability (credit) amount, at the balance sheet date,
21 for future income taxes caused by differences between the financial statement basis and
22 tax return basis of assets and liabilities.

1 **Q. CAN YOU PLEASE EXPLAIN WHAT YOU MEAN BY TIMING/TEMPORARY**
2 **DIFFERENCES AND PROVIDE AN EXAMPLE?**

3 A. In order to appreciate the accounting for income taxes concept, it is important to have an
4 understanding of what a timing/temporary difference is and how such a difference
5 originates and reverses. It might be helpful to first illustrate the concept using the very
6 simple example of an individual who participates in his/her company's 401K plan. An
7 individual is not taxed on his/her pre-tax contributions to a 401K in the year of the
8 contribution. However, when an individual takes withdrawals from the 401K plan, that
9 withdrawal is taxable. In the year of the contribution to the 401K plan, that portion of the
10 individual's wages are not taxable; thereby, reducing the amount of his/her *current income*
11 *taxes payable*. However, by contributing to the plan, the individual has incurred a *deferred*
12 *income tax liability*, an obligation for future income taxes that will be incurred in a future
13 year when the cash in the 401K investment is withdrawn. The individual has deferred the
14 income tax obligation by contributing to the plan and a deferred tax liability measures that
15 future tax obligation. The 401K contribution is an example of a timing/temporary
16 difference.

17 **Q. CAN YOU PROVIDE AN EXAMPLE OF A TIMING/TEMPORARY**
18 **DIFFERENCE THAT IS APPLICABLE TO CORPORATIONS?**

19 A. To illustrate another book/tax difference that is more relevant to corporate entities,
20 consider the accounting for the depreciation of property/fixed assets. For GAAP purposes,
21 a fixed asset is capitalized (recorded on the balance sheet) when constructed or acquired
22 and depreciated (expensed on the income statement) over its estimated useful life in a
23 systematic and rational manner. This depreciation is typically "straight line," meaning

1 that the same amount of depreciation expense is recorded each year of the asset's life.
2 Through book depreciation, the cost of a fixed asset is allocated to the income statement
3 as depreciation expense in the various periods in which the asset is being used (providing
4 service). Thus, if the cost of a fixed asset constructed or acquired in Year 1 is \$1,200, that
5 amount is capitalized on the balance sheet in Year 1 and charged to the income statement
6 (depreciation expense) over its estimated useful life. If that life was estimated to be, say,
7 three years, each of Year 1, Year 2, and Year 3 would contain depreciation expense of
8 \$400. In this manner, each income statement has an expense (depreciation expense)
9 representing the cost of using that asset in that year.

10 For income tax purposes, the IRC permits an acceleration of depreciation for
11 property/fixed assets. The intent of permitting accelerated depreciation for income tax
12 purposes is to encourage capital investment. By accelerating the write-off of an asset's
13 tax basis, the entity reduces its current income tax payments and can deploy the resulting
14 income tax benefit for additional capital investment or other corporate purposes. Over the
15 years, there have been a variety of tax depreciation methods that have been used to
16 depreciate property for income tax return purposes. In some years, a shorter life, an
17 accelerated method, or both, could be claimed for income tax purposes accelerating the
18 depreciation deduction. The current tax depreciation accelerated depreciation method is
19 known as the Modified Accelerated Cost Recovery System ("MACRS") which permits
20 generally shorter lives than used for determining book/regulatory depreciation expense as
21 well as an accelerated method.

22 The important point is the amount of tax depreciation that can be claimed, over time, is
23 also limited to the cost (basis) of the property. Thus, for income tax return purposes, that

1 same \$1,200 fixed asset may result in greater tax depreciation deductions (compared
2 to book depreciation) in the early years, but because the total depreciation claimed, over
3 time, cannot exceed the cost of the fixed asset, there will be a reversal or turnaround period
4 where book depreciation expense will exceed tax depreciation. Assume that for tax
5 purposes, the allowed depreciation income tax deduction would be \$600 to be claimed on
6 the Year 1 income tax return, \$400 to be claimed on the Year 2 income tax return and
7 \$200 to be claimed on the Year 3 income tax return. Over the three-year period, \$1,200
8 of tax depreciation has been deducted, fully depreciating the fixed asset/property for
9 income tax return purposes. (It should be noted that prior to the 2017 Tax Cuts and Jobs
10 Act, the IRC had permitted as much as 100% “bonus depreciation” for income tax
11 purposes, meaning the cost of the constructed or acquired asset can all be written off in
12 the year of construction/acquisition).

13 **Q. CAN YOU FURTHER DESCRIBE THIS SIMPLE DEPRECIATION BOOK-TAX**
14 **DIFFERENCE EXAMPLE?**

15 A. In the example of the \$1,200 fixed asset described above, where book depreciation is \$400
16 in each of Years 1, 2 and 3 and tax depreciation would be \$600 in Year 1, \$400 in Year 2
17 and \$200 in Year 3, the result of comparing book depreciation to tax depreciation would
18 be as follows:

19

1

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Cumulative Total</u>
Book Depreciation	\$400	\$400	\$400	\$1,200
Tax Depreciation	<u>\$600</u>	<u>\$400</u>	<u>\$200</u>	<u>\$1,200</u>
Difference (Tax over Book Depreciation)	\$200	(\$ 0)	(\$200)	\$ 0

2

3

4

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6

As can be seen, the \$200 tax depreciation over book depreciation difference originating in Year 1 turns around, or reverses, in Year 3 when book depreciation exceeds tax depreciation. Income tax accounting is based on an understanding of the concept of originating and reversing book/tax differences.

7

Q. WHAT ARE SOME EXAMPLES OF OTHER TIMING/TEMPORARY DIFFERENCES SEEN AT REGULATED UTILITIES?

8

9

A. Some of the other timing/temporary differences commonly seen at regulated entities include:

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- Pension and Other Post-Employment Benefits (“OPEB”) (deductible for income tax purposes based on cash contributions but expensed based an accrual basis);
- Repairs (certain expenditures are capitalized/depreciated for books but under tax rules, can be deducted currently for income tax purposes);
- Various regulatory assets (capitalized/deferred for books, but deducted currently on the tax return, e.g., rate case expense, storm costs); and
- Various accrued expenses (accrued under GAAP for books, only deductible for tax

1 when paid, (e.g., bonus pay and vacation accruals)).

2 **Q. WHERE IS INCOME TAX ACCOUNTING GUIDANCE LOCATED IN GAAP?**

3 A. The authoritative guidance on accounting for income taxes under GAAP is contained in
4 Accounting Standards Codification 740, Income Taxes (“ASC 740”). The basic
5 objectives are explained in ASC 740- 10-10-1 as follows:

6 “There are two primary objectives relating to accounting for income taxes:

- 7 1) To recognize the amount of taxes payable or refundable for the current year; and
- 8 2) To recognize deferred tax liabilities and assets for the future tax consequences
9 of events that have been recognized in an entity’s financial statements or tax
10 returns.”

11 Thus, under ASC 740, financial statements should reflect the current and deferred
12 income tax consequences of **all events that have been recognized in the financial**
13 **statements or income tax returns.** To accomplish this goal, the following basic
14 principles were established:

- 15 • A current tax liability or asset is recognized for the estimated taxes payable or
16 refundable on income tax returns for the current year and
- 17 • A deferred tax liability or asset is recognized for the estimated future effects
18 attributable to temporary differences and carryforwards.

19 **Q. HAS THE ACCOUNTING FOR INCOME TAXES UNDER GAAP BEEN**
20 **ADOPTED BY THE FEDERAL ENERGY REGULATORY COMMISSION’S**
21 **(“FERC”) UNIFORM SYSTEM OF ACCOUNTS (“USOA”)?**

1 A. Yes. Most rate-regulated entities maintain their books and records in accordance with the
2 FERC USoA. The FERC has embraced deferred income tax accounting and the USoA
3 contains the following income tax accounts for current and deferred income taxes:

4

5 Income Statement Accounts – Current

6 409.1 Income Taxes, Utility Operating Income

7 409.2 Income Taxes, Other Income and Deductions

8 409.3 Income Taxes, Extraordinary Items

9

10 Income Statement Accounts – Deferred

11 410.1 Provision for Deferred Income Taxes, Utility Operating Income

12 410.2 Provision for Deferred Income Taxes, Other Income and Deductions

13 411.1 Provision for Deferred Income Taxes-Credit, Utility Operating Income

14 411.2 Provision for Deferred Income Taxes-Credit, Other Income and Deductions

15

16 Balance Sheet Accounts – Current

17 236 Taxes Accrued

18

19 Balance Sheet Accounts – Deferred

20 190 Accumulated Deferred Income Taxes

21 281 Accumulated Deferred Income Taxes-Accelerated Amortization Property

22 282 Accumulated Deferred Income Taxes-Other Property

23 283 Accumulated Deferred Income Taxes-Other

1 Note that the FERC USoA contains multiple balance sheet accounts for ADIT. To
2 determine a company's net deferred tax liability or deferred tax asset all ADIT balance
3 sheet accounts must be aggregated.

4 **Q. CAN YOU ILLUSTRATE THE CALCULATION AND ACCOUNTING FOR**
5 **CURRENT AND DEFERRED INCOME TAXES USING THE DEPRECIATION**
6 **EXAMPLE YOU PROVIDED PREVIOUSLY?**

7 A. Yes. It is important to understand the interaction between current and deferred income
8 taxes on the income statement and balance sheet in order to determine the appropriate
9 accounting for income taxes for GAAP, USoA, and regulatory purposes. Assume the
10 following facts:

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>
11 Utility Revenue:	\$2,500	\$2,500	\$2,500
12 Various Operating Expenses:	1,100	1,100	1,100
13 Book/Regulatory Depreciation Expense	400	400	400
14 (Fixed Asset Cost: \$1,200. Three-year			
15 life, straight-line method)			
16 Tax Depreciation			
17 (Fixed Asset Cost: \$1,200, Three-year	600	400	200
18 life, accelerated method)			
19 Tax Rate	25%	25%	25%

21
22 The first step is to compute taxes payable in the current year. In Year 1, the estimated
23 amounts to be included on the income tax return are:

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Year 1 Tax Return

Revenue	\$2,500
Various Expenses (also deductible for tax)	(1,100)
Tax Depreciation	<u>(600)</u>
Taxable Income	800
Tax Rate	<u>25%</u>
Current Taxes Payable	\$200

The entry to record current income taxes would be:

409.1	Income Taxes-Utility Operating Income	\$200
236	Taxes Accrued	\$200

Next, deferred income taxes need to be recorded. Comparing Year 1 tax depreciation to book depreciation (\$600 minus \$400) produces a \$200 timing/temporary difference. As a result, ADIT of \$50 (\$200 book/tax difference x 25% tax rate) is required.

The entry to record deferred tax expense and ADIT would be:

410.1	Provision for Deferred Income Taxes, Utility Operating Income	\$50
282	Accumulated Deferred Income Taxes-Other Property	\$50

Total income tax expense in Year 1 totals \$250 (\$200 currently payable, \$50 deferred). Pre-tax book income (book income before income taxes) in Year 1 is \$1,000 (revenue of \$2,500 minus \$1,500 of operating expenses (\$1,100 and book depreciation of \$400)). The \$250 of income tax expense relates to the \$1,000 of book income before income taxes and applying the 25% income tax rate. By claiming accelerated tax depreciation, the company is able to reduce its *current* income tax obligation by \$50 – while recording a future

1 obligation (ADIT) of \$50 for the taxes that will be payable in Year 3 when there is book
2 depreciation that will be recorded in excess of tax depreciation on this one asset.

3 While I have used a fixed asset with a three-year life to illustrate the issue, most utility
4 property have significantly longer lives, but the concept is the same.

5 **Q. WHAT DOES THE ADIT REPRESENT?**

6 A. In addition to representing the amount of income taxes that will be payable in the future
7 when the book-tax difference reverses, the ADIT is often characterized as an “interest free
8 loan” from the Federal Government – by accelerating deductions in the current year (Year
9 1), the company reduces its payment to the U.S. Treasury, receiving a “loan” that is
10 subsequently repaid in Year 3. In a rate case, rate base is generally reduced by the ADIT
11 as a portion of the rate base has been financed at zero cost. Thinking about ADIT as an
12 interest free loan from the Federal Government is quite helpful in understanding and
13 applying the concept from an accounting and ratemaking perspective.

14 It is important to note that for every dollar of ADIT, there is an equal and offsetting
15 reduction in currently payable income taxes. In each year of the example, total tax expense
16 (current plus deferred) is equal to the book income before taxes multiplied by the income
17 tax rate (\$1,000 of pre-tax book income x 25%). Because the ultimate expense on the
18 books (in this case, book depreciation of \$400 per year for 3 years or \$1,200) will be the
19 same as the ultimate deduction on the income tax return (in this case, \$600 of tax
20 depreciation claimed on the tax return in Year 1, \$400 of tax depreciation claimed on the
21 tax return in Year 2 and \$200 of tax depreciation claimed on the tax return in Year 3), the
22 book/tax difference in Year 1 will “turn around” or “reverse” in the future, requiring a

1 higher taxes payable that will be offset by negative deferred tax expense. ADIT are just a
 2 deferral, not forgiveness of taxes.

3 **Q. CAN YOU SHOW THIS REVERSAL AND THE RELATED ACCOUNTING?**

4 A. Yes, in Year 2, book and tax depreciation is the same, so there is no additional, nor any
 5 reversal that requires ADIT accounting. The calculations for Year 3 demonstrate the
 6 reversal of the depreciation timing difference and the required accounting:

7 Year 2

	<u>Books</u>	<u>Tax Return</u>	<u>Difference</u>
Revenue	\$2,500	\$2,500	
Operating Expenses	1,100	1,100	
Depreciation	<u>400</u>	<u>400</u>	<u>(0)</u>
Pre-Tax Income/Taxable Income	1,000	1,000	<u>(0)</u>
Tax Rate		<u>25%</u>	<u>25%</u>
Current Tax Expense (a)	250	←→ 250	
Deferred Tax Expense (b)	<u>(0)</u>		←→ <u>(0)</u>
Total Income Tax Expense (a + b)	<u>250</u>		
Net Income	\$750		

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Year 3

	<u>Books</u>	<u>Tax Return</u>	<u>Difference</u>
Revenue	\$2,500	\$2,500	
Operating Expenses	1,100	1,100	
Depreciation	<u>400</u>	<u>200</u>	<u>(200)</u>
Pre-Tax Income/Taxable Income	1,000	1,200	(0)
Tax Rate		<u>25%</u>	<u>25%</u>
Current Tax Expense (a)	300	← 300	
Deferred Tax Expense (b)	<u>(50)</u>		← (50)
Total Income Tax Expense (a + b)	<u>250</u>		
Net Income	\$750		

1
2 The above format shows the calculations of current and deferred income taxes. Current
3 income taxes are based on the treatment for revenue, income and expenses to be claimed
4 on the income tax return. Deferred income taxes are based on originating or reversing (in
5 this case reversing) differences between book and tax treatment of revenue and expense.
6 By lining up the books and tax return amounts, the differences can be tracked. This format
7 also clearly shows that deferred income taxes originate and reverse based on differences
8 between book and tax treatment. In the above example, the \$50 reversing difference
9 occurs in Year 3 when book depreciation (\$400) continues to be recorded on a straight-
10 line basis and exceeds tax depreciation in that year.

11 The journal entries would be:

12
13 Year 2:

1	409.1	Income Taxes-Utility Operating Income	\$250
2	236	Taxes Accrued	\$250
3	282	Accumulated Deferred Income Taxes – Other Property	\$0
4	410.1	Provision for Deferred Income Taxes,	
5		Utility Operating Income	\$0
6		(as book depreciation is the same as tax depreciation in Year 2, there are no	
7		timing differences to account for)	

8 Year 3

9	409.1	Income Taxes-Utility Operating Income	\$300
10	236	Taxes Accrued	\$300
11	282	Accumulated Deferred Income Taxes – Other Property	\$50
12	410.1	Provision for Deferred Income Taxes,	
13		Utility Operating Income	\$50

14 Over the three-year period, the sum of current and deferred income tax expense each year
15 would be \$250, based on \$1,000 of pre-tax book income and an assumed 25% income tax
16 rate. This is the total income tax expense recorded on an accrual basis that relates to the
17 other elements of revenue and expense reviewed and eventually permitted by the regulator
18 in the ratemaking process. ADIT would be \$50 at the end of Year 1 and Year 2, reduced
19 by \$50 in Year 3 when the timing difference reverses. In Year 3, the interest free loan is
20 “repaid” to the Federal Government through a “higher” current income tax payment.

21 The ADIT balance at each year end is:

22			
23		<u>Year 1</u>	<u>Year 2</u>
			<u>Year 3</u>

1 ADIT (USoA account 282) \$50 \$50 \$0

2 **Q. YOUR EXAMPLE ILLUSTRATED INCOME TAX ACCOUNTING FOR THE**
3 **BOOK-TAX DEPRECIATION DIFFERENCE. WOULD SIMILAR**
4 **ACCOUNTING OCCUR FOR OTHER BOOK-TAX DIFFERENCES?**

5 A. Yes. In this example, only one book/tax difference (accelerated depreciation) was assumed.
6 As I previously described, regulated entities have many book/tax differences that are not
7 related to depreciation. These other book/tax differences (not accelerated depreciation) are
8 recorded in USoA accounts 283 and 190 depending on whether the resulting ADIT is a
9 future income tax obligation (like it would be for repairs) or a future tax benefit (as it would
10 be for OPEBs where the current period book expense is often greater than the current period
11 tax deduction). The ADIT amounts included in USoA 283 are also “interest free loans”
12 from the Federal Government. The ADIT amounts included in USoA 190 represent
13 “prepaid income taxes” where the income tax benefit of future income tax deductions can
14 be realized.

15 **Q. THUS FAR YOU HAVE DESCRIBED THE ACCOUNTING FOR A DEFERRED**
16 **INCOME TAX LIABILITY, WHERE TAX DEDUCTIONS EXCEED BOOK**
17 **EXPENSES YET BOOK INCOME AND TAXABLE INCOME RESULT. WHAT**
18 **IS THE ACCOUNTING FOR THE SITUATION WHERE NET OPERATING**
19 **LOSSES OCCUR?**

20 A. As explained above, current income taxes are generally recorded by the following entry:

21
22 409.1 Income Taxes, Utility Operating Income \$ XXX
23 236 Taxes Accrued \$ XXX
24

1 This would be the case when the entity has an obligation for income taxes. There are
2 situations in which an entity would have negative taxable income producing an operating
3 loss for income tax purposes, resulting in no obligation to pay income taxes. This is
4 referred to as a “net operating loss” or NOL. This could result from many things including
5 claiming significant amounts of tax deductions for depreciation.

6 The entry to record a “negative” current income tax provision would be:

7			
8	236	Taxes Accrued	\$ XXX
9	409.1	Income Taxes, Utility Operating Income	\$ XXX
10			

11 The taxes accrued debit is akin to a receivable from the IRS. It may be possible for an
12 entity to realize this receivable by way of carrying back the tax loss to obtain a refund of
13 previous tax amounts paid. An entity can also carry forward an NOL to offset future taxes
14 that would otherwise be payable. There are specific provisions in the IRC that govern the
15 use and extent of both carrybacks and carryforwards, and depending on a company’s facts
16 and circumstances, either option may be chosen.

17 For GAAP purposes under ASC 740, if it is probable that an NOL can be realized in the
18 future, the 236 taxes accrued will be reclassified to ADIT account 190 representing a
19 Deferred Income Tax Asset for the future benefit of the unrealized deductions.

20 Thus, to the extent bonus depreciation (or other tax deductions in advance of book
21 expense) results in an entity reporting an NOL, there would be separate ADIT Liabilities
22 recorded in USoA 282 or USoA 283 for the temporary difference caused by accelerated
23 tax deductions which have not been realized together with NOL ADIT Assets in USoA

1 190, recognizing the future benefit of the unrealized deductions. (the amount of the
2 interest free loan from the US Treasury that has not yet been realized)

3
4 **RATEMAKING TREATMENT OF INCOME TAXES, INCLUDING INTERNAL**
5 **REVENUE CODE NORMALIZATION REQUIREMENTS**
6

7 **Q. HOW IS ADIT TYPICALLY INCORPORATED IN THE RATEMAKING**
8 **PROCESS?**

9 A. To the extent that there is an “interest free loan” from the government in the form of an
10 accumulated deferred tax liability, the benefit of this amount is typically shared with
11 customers by using such balance to reduce rate base. That is to say that customers pay
12 for total tax expense (current plus deferred) as a component of operating expense, but
13 receive a rate reduction (benefit) through the reduction of rate base from accumulated
14 deferred tax liabilities. Similarly, to the extent that there are accumulated deferred tax
15 assets where the utility has “prepaid” its tax obligation and the customer is paying for total
16 tax expense such accumulated deferred tax assets are added to rate base. Additionally, in
17 situations where a NOL ADIT asset exists, for rate case purposes, if the NOL ADIT Asset
18 TA in USoA 190 is caused by ADIT Liabilities in USoA 282 or 283, such NOL ADIT
19 Asset in USoA 190 should be added to rate base to offset any rate base reduction for ADIT
20 in USoA 282 or USoA 283 to reflect the fact that no interest free loan has been realized.
21 It should be noted that accumulated deferred taxes should only impact ratemaking to the
22 extent that the associated cost or revenue is also included in ratemaking. For example, if
23 there is an accumulated deferred tax liability associated with a book asset that has been
24 disallowed for ratemaking purposes, the related ADIT liability should not reduce rate
25 base.

1 **Q. WHAT WOULD BE THE APPROPRIATE RATEMAKING RESULT IN THE**
2 **PREVIOUS EXAMPLE?**

3 A. In the previous example, \$250 of total income tax expense would be recorded in each of
4 Years 1, 2 and 3 and included as an operating expense in a test period. The \$250 of total
5 income tax expense relates to the \$1,000 of pre-tax operating income and includes both
6 current and deferred income tax components. The pre-tax operating income includes
7 allowable revenue, income and expenses (pre-tax) determined as allowable/recoverable
8 costs in the rate case and, in this manner, the total income tax expense is matched to the
9 pre-tax operating income.

10 In addition, the rate base would be reduced by the resulting ADIT (\$50 in Years 1 and 2)
11 representing the interest-free loan from the U.S. Treasury, providing customers the time
12 value of such loan.

13 **Q. ARE ALL BOOK-TAX DIFFERENCES TIMING/TEMPORARY?**

14 A. No. While most book-tax differences are timing/temporary, certain items of revenue,
15 income and expense are treated differently for financial reporting purposes than for income
16 tax purposes and are included in only one of either taxable income or financial reporting
17 income. These are referred to as permanent differences.

18 An example of a permanent difference is the cost of meals and entertainment. These costs
19 are reported as expenses in the financial statements for a given period, but, based on the
20 IRC, are not entirely deductible in determining taxable income on the income tax return.

21 Thus, over time, the financial statement reporting of meals and entertainment expenses will
22 differ from the related amounts on the income tax return.

1 Deferred income taxes are not required on permanent differences because the difference
2 will never reverse, it is “permanent.” In the case of meals and entertainment costs, in the
3 period reported, current income taxes will be adjusted to reflect the non-deductibility of a
4 portion of these costs and there will be no deferred income taxes since these amounts, under
5 the current IRC, will never be deducted on the tax return.

6 **Q. IS THE DISTINCTION BETWEEN PERMANENT AND TEMPORARY**
7 **DIFFERENCES IMPORTANT IN THE INCOME TAX CALCULATION?**

8 A. Yes. Because permanent differences do not require deferred income tax accounting, the
9 income tax effects of such items increase or decrease total income tax expense. With
10 timing/temporary differences, each and every item that impacts current income tax
11 expense has an equal and offsetting impact to deferred income tax expense. Because total
12 income tax expense affects net income under GAAP and total income tax expense is
13 typically recoverable in a rate case, permanent differences need to be separately identified
14 and included in the income tax calculation.

15 **Q. HOW DO YOU BELIEVE THIS COMMISSION SHOULD DETERMINE**
16 **INCOME TAX EXPENSE FOR RATE-MAKING PURPOSES?**

17 A. Income taxes should be determined in accordance with GAAP which require deferred
18 income tax accounting, sometimes referred to as inter-period income tax allocation or
19 normalization. Normalization, which I consider to be theoretically correct, distributes
20 income tax expense to time periods and, therefore, to customers' revenue requirements
21 consistently with the costs (depreciation) that are affecting income tax expense. As the
22 rate-making process necessarily involves the deferral of costs such as plant investment

1 and the distribution of these costs over time, normalization is used to produce a consistent
2 determination of income tax expense.

3 **Q. IS THERE ANOTHER METHOD SOMETIMES USED TO ACCOUNT FOR**
4 **INCOME TAXES IN RATE REGULATED ENTITY?**

5 A. Yes. In some jurisdictions, there is a concept called “flow-through” used to account for
6 book-tax timing differences. Flow through is an accounting/rate-making method of
7 determining income tax expense by exclusive reference to amounts currently payable, with
8 no accounting for the inter-temporal effects on income tax expense of the costs, such as
9 property investment, that are "deferred" and distributed over time.

10 Under a flow-through method, deferred income taxes are not recorded on book-tax timing
11 differences. Instead, the tax reducing effect of claiming accelerated deductions on the
12 income tax return are “flowed-through” to ratepayers in the form of lower income tax
13 expense and lower revenue requirements. However, under a flow-through approach, when
14 the book-tax timing difference reverses (as it will, because it is a timing difference),
15 income tax expense and revenue requirements are higher than they would be under a
16 deferred tax (or normalized) approach because there are no ADIT to reverse to offset the
17 higher current income taxes that will occur when the tax deduction is less than the book
18 expense.

19 **Q. CAN YOU ILLUSTRATE THE FLOW THROUGH CONCEPT USING THE**
20 **PREVIOUS EXAMPLE?**

21 A. Yes. In the previous example, in Year 1, tax depreciation exceeded book depreciation.
22 The additional tax depreciation (\$200) lowered current income tax expense by \$50 (\$200
23 x 25% income tax rate). At the same time, deferred income tax expense was increased by

1 \$50 ($\$200 \times 25\%$ income tax rate). The resulting *total* income tax expense is the same as
2 it would have been if there were no accelerated depreciation. The ratepayers receive a
3 benefit under deferred income tax accounting in that the \$50 ADIT reduces rate base.

4 Under a flow through approach to accounting/rate-making, income tax expense is
5 calculated by exclusive reference to amounts currently payable, with no accounting for the
6 inter-temporal effects on income tax expense of the costs, such as property investment, that
7 are "deferred" and distributed over time.

8 Because increases/decreases in test year operating expenses result in corresponding
9 increases/decreases in revenue requirements, under the flow-through method, the \$50
10 reduction in taxes currently payable for Year 1 FIRST produces a reduction of \$50 in
11 revenue requirements. However, because income taxes are not deductible when computing
12 income tax expense, a \$50 reduction in current income taxes results in a \$66.67 reduction
13 in customer revenue requirements by applying an "income tax gross-up" formula ($1 + \text{tax}$
14 $\text{rate}/(1 - \text{tax rate})$) or $\$50 \times (1 + (.25/75))$ or $\$50 \times 1.33 = \66.67). So instead of a \$2,000 Year
15 1 revenue requirement, as shown in the deferred tax example, the revenue requirement
16 under flow-through would be \$1,933.33 ($\$2,000$ minus $\$66.67$). The flow-through method
17 stops here as it is based only on taxes currently payable. There is no reduction/adjustment
18 to rate base in this scenario as there are no deferred taxes being recognized.

19 While the use of flow-through for book-tax timing differences may reduce income tax
20 expense and revenue requirements in the years that tax deductions are greater than book
21 expenses, at the point in time that the book-tax timing difference reverses, the opposite is
22 true. When, in the future, the tax deduction is less than book depreciation, current tax
23 expense will be increased without any ADIT to offset the increase. In the depreciation

1 example, this means that in Year 3, the revenue requirement would be \$2,066.67, or \$66.67
2 higher than under a deferred tax concept.

3 Importantly, under the flow-through method, there are no ADIT, so the rate base would not
4 be reduced by \$50 in each of Year's 1 and 2, a detriment to customers.

5 **Q. CAN YOU SUMMARIZE THE FLOW THROUGH RATEMAKING**
6 **APPROACH?**

7 A. Yes, using the example I just described, the customer in Year 1 has the revenue requirement
8 reduced by \$66.67 in Year 1 because the tax expense in that year is based on the amounts
9 included in that year's tax return which reflected an accelerated depreciation tax deduction,
10 reducing that year's income tax payment to the Federal Treasury. However, the Year 3
11 customer's revenue requirement is increased by \$66.67 because the Year 3 tax return has
12 less tax depreciation available as a result of the tax basis being used up in Year 1.

13 Over the life of this asset, revenue requirements will include and recover \$750 of income
14 tax expense, but the pattern of recovery will be subject to the depreciation claimed on the
15 income tax return in each year—greater tax depreciation (compared to books) in the early
16 years (Year 1 in the example) and less tax depreciation (compared to books) in the later
17 years (Year 3 in the example).

18 **Q. IS FLOW-THROUGH AN APPROPRIATE METHOD WHEN**
19 **INTERGENERATIONAL EQUITY IS CONSIDERED?**

20 A. No. In the above example, the customer in Year 1 is using property, plant and equipment
21 and the revenue requirements include book/ratemaking depreciation expense determined
22 on a straight-line basis. But because the IRC permits accelerated depreciation which
23 reduces the Year 1 tax payment based on that accelerated method, under flow-through, the

1 customer receives a \$66.67 reduction in revenue requirements compared to what he/she
2 would have received if there was no accelerated depreciation.

3 In Year 3, while that same asset continues in service and the revenue requirements again
4 include book/ratemaking expense determined on a straight-line basis, because there is
5 much less tax depreciation available to reduce the tax payment, current income taxes are
6 increased compared to what he/she would have paid if there was no accelerated
7 depreciation. As a result, the revenue requirement for the customer in Year 3 is increased
8 by \$66.67.

9 This generational inequity is caused by determining expenses (other than income taxes) on
10 an accrual basis (such as straight-line depreciation), but using the cash basis to determine
11 income tax expense which is lower in the early years and greater in the later years due to
12 using accelerated depreciation for income tax return purposes.

13 Under the normalization approach, there is a matching of income tax expense to the
14 revenues, income and expenses used to determine allowable operating costs, each
15 determined on a consistent (accrual) basis.

16 Said another way, the customer in Year 1 receives a benefit (in the form of reduced income
17 tax expense and revenue requirements) that the customer in Year 3, who may not have been
18 a customer in Year 1, is asked to pay for (increased income tax expense and increased
19 revenue requirements) even though it relates to the same asset with both customers getting
20 the same service from said asset.

21 **Q. HOW DOES THE INCOME TAX GROSS-UP APPLY TO THE**
22 **NORMALIZATION METHOD FOR DETERMINING INCOME TAX EXPENSE?**

1 A. In contrast to the flow-through method, in order to recognize the tax deferral for the \$200
2 timing difference, a provision of \$50 for deferred income taxes is made. This provision
3 has effect of increasing revenue requirements by \$66.67 ($\50×1.33), the increase in
4 revenue requirements being equal to (offsetting) the current reduction. Therefore, as the
5 customer has experienced a \$66.67 benefit and a \$66.67 detriment, the net effect on him or
6 her is zero before considering the substantial benefit of deducting the reserve from rate
7 base. While my example, for sake of simplicity, relates to a single unit of property, the
8 effect for multiple units with various in-service dates, service lives, etc., such as is the case
9 for Spire, is merely a summation of these effects for all property units.

10 **Q. IT IS SOMETIMES ASSERTED THAT, IN A GROWTH SITUATION, THE**
11 **DEFERRED TAX AMOUNTS WILL CONTINUE TO GROW SO THERE WILL**
12 **BE NO NET PAYMENT OF DEFERRED TAXES AND, THEREFORE, "ACTUAL**
13 **TAXES PAYABLE" SHOULD BE THE SOLE MEASURE OF INCOME TAX**
14 **EXPENSE. IN YOUR OPINION, IS THIS VIEW CORRECT?**

15 A. No, it is not. "Actual taxes paid" is a cash-flow concept not an accrual accounting concept.
16 I believe the so-called "actual taxes paid principle" is not a principle at all, but an overly
17 simplistic view which omits important economic realities of income taxation. Because
18 these omissions are so significant, the "principle" is not sound for accounting or rate setting
19 where correct determinations of costs are required for time periods which are shorter than
20 the lives of property investments. Stated another way, the "actual taxes paid principle"
21 produces an incorrect tax allowance because it is based exclusively on the timing of cash
22 flows associated with income taxation.

1 The normalization concept is also supported by authoritative accounting literature. In the
2 Basis of Conclusions section of Financial Accounting Standards Board Statement No. 109,
3 Accounting for Income Taxes (which is codified in ASC 740), the FASB rejected the
4 concept of computing income tax expense based solely on the income tax return as follows:

5 “201. The Board believes that the tax consequences of an individual event are
6 separable from aggregate taxable income. For example, if the gain on an installment
7 sale is taxable, both the sale and the tax consequences of the gain on the sale should
8 be recognized in financial income for the same year. The tax law may permit an
9 election to include some or all of the gain in the determination of taxable income in
10 future years. That election, however, only affects when and not whether the gain
11 will be included in determining taxable income. The tax consequences arose at the
12 time of the sale and result from the gain on the sale.

13 202. As the installment sale receivable is collected, pro rata amounts of the gain are
14 included in determining taxable income. Reporting the uncollected balance of the
15 receivable at its net realizable value in the statement of financial position reflects
16 an assumption that the receivable will be recovered and, therefore, that the gain will
17 become taxable. Recognition of the sale and the gain on the sale on an accrual basis
18 requires concurrent recognition of the tax consequences of the gain on the sale. For
19 example, commission expense attributable to the installment sale is recognized on
20 an accrual basis even if the commissions are paid as the receivable is collected and,
21 likewise, income tax expense should also be recognized on an accrual basis. To do
22 otherwise would result in accounting for the sale and the gain on an accrual basis

1 and the related tax consequences on a cash basis—a result that the Board believes
2 is inconsistent and inappropriate.”

3 **Q. CAN YOU FURTHER EXPLAIN WHY YOU BELIEVE THAT THE**
4 **NORMALIZATION APPROACH IS SOUND FROM THE VIEWPOINT OF**
5 **DETERMINING COSTS FOR RATE MAKING?**

6 A. Yes. Unlike other expenses, income tax expense has no independent existence. A correct
7 allowance cannot be determined merely by reference to amounts paid, as is done under
8 flow-through. This is true because income taxes are a direct function of revenues, income
9 and expenses which are determined for the most part on an accrual accounting basis which
10 corresponds to the accrual basis used for regulatory and financial statement purposes.
11 Income tax expense is a simple arithmetic function of the components of revenue
12 requirements, including return, which are appropriate for setting rates. Once this
13 Commission determines the other components of revenue requirements, allowable income
14 tax expense can be computed simply and accurately. Normalization merely allocates the
15 result of this computation between current and deferred classifications.

16 The very essence of determining costs for rate-making purposes is resolving the question
17 of the amount of costs which are to be recognized as current-period costs and those which
18 are to be "deferred." For instance, the amount to be deferred is the question to be resolved
19 in determining amounts to be capitalized and the amounts to be expensed. It is also the
20 question in determining the portion of plant investment costs which are to be recognized
21 currently as depreciation expense as distinguished from the portion to be "deferred."

22 Having determined which costs are to be recognized currently and which are to be deferred,
23 it makes no sense whatsoever to handle their income tax effects inconsistently. The income

1 tax effects must be handled consistently ("matched") or the initial cost determination is
2 effectively countermanded to that extent.

3 **Q. HAS THE FERC TAKEN A POSITION ON THE APPROPRIATENESS OF**
4 **DEFERRED INCOME TAX ACCOUNTING?**

5 A. Yes. The FERC requires comprehensive inter-period income tax allocation for all book-
6 tax timing/temporary differences. The FERC's landmark orders, Orders 144 and 144A
7 provide guidance in this area. This has been the FERC methodology since the early 1980's.
8 The FERC Uniform System of Accounts ("FERC USOA") and many FERC rate orders
9 require normalization.

10 In a study attached to the Notice of Proposed Rulemaking that eventually was adopted in
11 FERC Order 144 and 144a (Docket No. RM-80-42, dated March 31, 1980), the Staff of the
12 FERC confirmed the propriety of the normalization method for rate making:

13 "The staff analysis concludes that normalization produces rates that are more
14 equitable to customers over time than flow-through. Under normalization, rates
15 reflected ('match') the tax effects of transactions (tax reductions, or benefits, and
16 tax additions) in the same periods that the transactions are themselves recognized
17 in rates ... In general, flow-through allocates the tax effects of timing difference
18 transactions to customers in different periods than the transactions themselves are
19 allocated"

20 It also noted that:

21 "While the primary rationale used to support flow-through is the 'actual taxes paid'
22 (in each period) doctrine, the staff study notes that this doctrine is inconsistent with
23 the treatment accorded other costs."

1 **Q. WHAT HAPPENS IF A REGULATED ENTITY IS A MEMBER OF A**
2 **CONSOLIDATED GROUP, WHERE THERE ARE OTHER REGULATED AND**
3 **NON-REGULATED ENTITIES INCLUDED IN THE AMOUNTS REFLECTED**
4 **ON THE CONSOLIDATED INCOME TAX RETURN?**

5 A. In situations where a regulated entity is part of a consolidated group that combines the
6 various entities into a single, consolidated income tax return, the regulated company should
7 compute its income tax expense using the “stand-alone method”.

8 **Q. WHAT IS THE STAND-ALONE METHOD?**

9 A. Most state commissions and FERC use the traditional “stand-alone” method for calculating
10 the amount of income taxes to be incorporated into a regulated utility company’s rates.
11 This method calculates ratemaking income taxes based on the regulated revenues and
12 operating costs of the utility itself without regard to the utility’s unregulated activities or
13 the operations of its parent and other affiliated companies. The stand-alone calculation is
14 used so that taxes in utility rates are based on the costs of providing the regulated utility
15 service.

16 This method is consistent with fundamental principles of basing utility rates on the utility’s
17 costs and revenues and prohibiting cross-subsidization between utility and non-utility
18 operations or between jurisdictions. The primary principle here is that consumers should
19 bear only the costs for which they are responsible. Under this principle, there is a well-
20 reasoned, and widely recognized, postulate that taxes follow the events they give rise to.
21 Thus, if customers are held responsible for operating costs and a return (cost of service),
22 they are entitled to the tax benefits associated with such costs. If ratepayers do not bear
23 the pre-tax costs, they are not entitled to the tax benefits associated with the costs.

1 Non-regulated operations involve financial risks that are different from a utility’s regulated
2 operations. It would be inappropriate for the regulated ratepayers to share the income tax
3 burden of profits generated by the nonregulated entity, just as it would be inappropriate for
4 the regulated entity to reduce its income tax burden by losses generated by the nonregulated
5 entity. Thus, a “stand-alone” method (as opposed to considering entities or transactions
6 outside of the regulated entity but members of the consolidated group) for computing the
7 income tax expense component of cost of service is the proper and equitable method to be
8 followed for ratemaking purposes.

9 **Q. IS THE STAND-ALONE METHOD CONSISTENT WITH GAAP?**

10 A. Yes. Under ASC 740, there are several alternatives provided for allocating income taxes
11 among the entities included in the consolidated group. ASC 740 (ASC 740-10-30-27):
12 states:

13 “The consolidated amount of current and deferred tax expense for a group that files
14 a consolidated tax return shall be allocated among the members of the group when
15 those members issue separate financial statements. This Subtopic does not require
16 a single allocation method.

17 The method adopted, however, shall be systematic, rational, and consistent with the
18 broad principles established by this Subtopic. A method that allocates current and
19 deferred taxes to members of the group by applying this Topic to each member as
20 if it were a separate taxpayer meets those criteria. In that situation, the sum of the
21 amounts allocated to individual members of the group may not equal the
22 consolidated amount. That may also be the result when there are intra entity
23 transactions between member of the group. The criteria are satisfied, nevertheless,

1 after giving effect to the type of adjustments (including eliminations) normally
2 present in preparing consolidated financial statements.”

3 This is known as the “separate return” method in which each affiliate computes its income
4 tax provision as if it were filing their own income tax return.

5 Another method, called the “Benefits-for-Loss” approach is also acceptable. Under this
6 method, the consolidated revenues, income and deductions are allocated to the affiliate
7 generating such revenue, income or deduction. The benefits-for-loss method is consistent
8 with the stand-alone method I previously described.

9 **Q. IS THE STAND-ALONE METHOD USED TO DETERMINE REVENUE**
10 **REQUIREMENTS IN MOST JURISDICTIONS?**

11 A. Yes, virtually every regulatory jurisdiction, including FERC, has adopted the stand-alone
12 method when determining revenue requirements for a regulated utility. The FERC decided
13 this issue in a landmark opinion, FERC Opinion No. 173 and reiterated this position in
14 Interpretation AI93-5-000, Accounting for Income Taxes.

15 In AI93-5-000 the FERC provided this question and answer:

16 “Will the FERC permit an entity to use a separate return method for FERC
17 financial accounting and reporting?”

18 Response: No. The FERC has issued several decisions rejecting the use of
19 the separate return method for determining income tax expense when an
20 entity files as part of a consolidated group. Instead, the FERC relies on the
21 standalone method of allocating income taxes between members of a
22 consolidated group.”

1 Under the stand-alone method the consolidated tax expense is allocated to
2 individual members through recognition of the benefits/burdens contributed by
3 each member of the consolidated group to the consolidated return. Under the
4 standalone method, the sum of amounts allocated to individual members equal the
5 consolidated amount.

6 **Q. RETURNING TO THE CONCEPT OF FLOW-THROUGH, IN THE FLOW-**
7 **THROUGH EXAMPLE YOU PROVIDED, YOU USED AN ACCELERATED**
8 **DEPRECIATION BOOK-TAX DIFFERENCE TO ILLUSTRATE THE CONCEPT.**
9 **CAN BOOK-TAX DEPRECIATION DIFFERENCES ACTUALLY BE SUBJECT**
10 **TO FLOW THROUGH?**

11 A. No. The IRC contains provisions/rules that prohibit the flow-through of book-tax method
12 and life depreciation differences and certain contributions in aid of construction. However,
13 other book-tax timing/temporary differences can be flowed-through. I used the example
14 of a depreciation timing/temporary difference because I used a similar example to explain
15 deferred tax accounting and it clearly shows the intergenerational equity issue.

16 **Q. CAN YOU DESCRIBE THESE IRC PROVISIONS GOVERNING THE USE OF**
17 **DEFERRED INCOME TAX ACCOUNTING FOR RATE-REGULATED**
18 **UTILITIES?**

19 A. Yes. Under the present normalization provisions, with respect to method and life
20 depreciation differences created by tax accelerated depreciation, a regulated utility is
21 required to provide deferred taxes on these differences and reduce rate base (or treat as zero
22 cost capital) for such ADIT. Flow-through of these differences would result in a violation
23 of the normalization rules and severe penalties will result. The basics of the deferred tax

1 accounting under the normalization provisions work as described in the fundamental
2 examples discussed previously with ADIT being recorded in the USoA 282 accounts from
3 a ratemaking perspective.

4 The IRS normalization provisions (based on a number of private letter rulings) also require
5 that Deferred Income Tax assets relating to NOL's (recorded in USoA Account 190)
6 resulting from claiming accelerated depreciation for income tax purposes be added to rate
7 base offsetting the rate base reducing impact of ADIT Liabilities recorded in USoA
8 Account 282.

9 **Q. WHY ARE SUCH PROVISIONS INCLUDED IN THE IRC?**

10 A. In the late 1960's, as accelerated tax depreciation became more prevalent, Congress
11 became concerned about the negative revenue impacts to the government from the trend of
12 flowing through the effects of accelerated depreciation in taxes. Under flow through, the
13 tax reducing effects of accelerating depreciation deductions for income tax purposes,
14 lowering current income tax expense, are not offset by increasing deferred income tax
15 expense. In the ratemaking process, there is less tax expense and a lower revenue
16 requirement in the early years of an asset's life when accelerated tax depreciation exceeds
17 book depreciation. When the turnaround of this book/tax depreciation difference occurs,
18 the current expense increases and, because there are no deferred taxes to reverse against
19 the higher current income tax expense, revenue requirements increase. Flow through is
20 more of a taxes payable or cash concept rather than an accrual concept that exists for ADIT
21 under GAAP and FERC rules.

22 Congress was concerned because if the various regulatory authorities could mandate flow
23 through accounting for accelerated depreciation, tax recoveries through rates would be

1 less (only permitting the recovery of current income taxes without a component for
2 deferred tax expense), lowering the revenue requirement for utilities, thus reducing taxes
3 paid to the government. As a result, starting with the Tax Reform Act of 1969, Congress
4 enacted normalization provisions in the IRC to prevent the flow through of income taxes
5 for the benefits of accelerated depreciation on public utility property. The current
6 normalization provisions are located in IRC Section 168(i)(9).

7 **Q. WHAT IS THE PENALTY FOR VIOLATING THE IRC NORMALIZATION**
8 **RULES?**

9 A. The penalty for violating the normalization requirements is the loss of the ability to claim
10 accelerated depreciation for income tax purposes on all assets as of the violation date and
11 on subsequent additions. It is a severe penalty to both the utility and its customers.

12 **TAX CUTS AND JOBS ACT OF 2017 (“TCJA”) AND EXCESS ADIT**
13

14 **Q. PLEASE GENERALLY DESCRIBE THE TCJA.**

15 A. The TCJA was enacted by the United States Congress on December 20, 2017 and was
16 signed into law by the President on December 22, 2017. *See Tax Cuts and Jobs Act of*
17 *2017*, Pub. Law 115-97, 131 Stat. 2054 (2017). The TCJA amends the IRC and contains
18 the most significant set of changes to the federal income tax laws since the Tax Reform
19 Act of 1986. The TCJA makes major changes in many areas of our nation’s tax laws, some
20 of which directly affect regulated utilities like the Company.

21 **Q. PLEASE DESCRIBE THE PROVISIONS OF THE TCJA THAT HAVE THE**
22 **GREATEST IMPACT ON REGULATED UTILITIES LIKE SPIRE AND THEIR**
23 **CUSTOMERS.**

1 A. The TCJA has significant, though varying, impacts on most utilities in terms of reported
2 tax expenses charged against the company’s operations, cash flows and the calculation of
3 revenue requirements and cost of service.

4 The most significant provision of the TCJA for regulated utilities, including Spire, is the
5 reduction of the Federal Income Tax Rate from 35 percent to 21 percent, which reduced
6 current income tax expense and originating deferred tax expense. Further, as a result of
7 the lower 21 percent income tax rate becoming effective under the TCJA, all companies,
8 including utilities, were required under ASC 740 to “remeasure,” as of December 31, 2017,
9 the amounts of ADIT in their financial statements.

10 **Q. WHAT ARE “EXCESS” ADIT AND HOW ARE THEY CALCULATED?**

11 A. Excess ADIT is the portion of the ADIT balance existing immediately prior to the reduction
12 in the corporate tax rate (the ADIT balance at December 31, 2017) less the amount that
13 would have been in the ADIT balance had that balance been determined using the revised
14 lower corporate income tax rate. In effect, a portion of the ADIT “interest free loan from
15 the U.S. Treasury” has been forgiven. In other words, if there was an existing book-tax
16 difference of \$10 million with \$3.5 million of ADIT (at a 35% tax rate) at December 31,
17 2017, remeasuring the ADIT using the lower 21% income tax rate provided in the TCJA,
18 would result in a remeasured ADIT of \$2.1 million (the \$10 million book-tax difference
19 times 21%) producing a \$1.4 million excess ADIT (\$3.5 million minus \$2.1 million = \$1.4
20 million). This is the calculated benefit from the forgiveness of the Treasury’s interest free
21 loan.

22 **Q. WHAT IS THE ACCOUNTING FOR EXCESS ADIT?**

1 A. Under GAAP, for enterprises in general, the remeasurement of ADIT reduces the ADIT
2 balance with a corresponding reduction in income tax expense. In my simple example
3 above, the \$1.4 million reduction of ADIT upon remeasurement would result in a \$1.4
4 million reduction (benefit) in income tax expense in the period of remeasurement, year-
5 end 2017.

6 However, for rate-regulated entities subject to ASC 980 (e.g., Spire), the reduction in ADIT
7 is subject to rate regulation. As a result, instead of immediately reducing income tax
8 expense upon remeasurement of ADIT, regulated utilities reclassify the reduction in ADIT
9 to a regulatory liability representing the excess ADIT that will be used to reduce future
10 revenue requirements. Thus, in the example above, a regulatory liability of \$1.4 million
11 would initially be recorded upon remeasurement.

12 Because reductions in income tax expense will reduce revenue requirements and those
13 reduced revenue requirements will affect income taxes, the excess ADIT regulatory
14 liability is “grossed-up” for income taxes at the previously described gross-up rate, with an
15 ADIT offset. At the previous 35 percent federal income tax rate, revenue of \$1.5385 was
16 required to provide \$1.00 of after-tax income. A corporate tax rate of 21 percent requires
17 \$1.2685 of revenue to generate \$1.00 of after-tax income.

18 A separate Missouri state income tax rate of 6.25 percent exists prior to October 1, 2020
19 for the Company. Effective October 1, 2020, the Missouri state income tax rate is reduced
20 to 4%. The Missouri state income tax rate is deductible for federal income tax purposes so
21 the “combined federal and state income tax rate” used for determining regulatory ADIT
22 and excess ADIT has gone from 38.3886 percent to 25.4483 percent (pre-Missouri law
23 change). The combined income tax gross-up factor before and after the TCJA has been

1 reduced from 1.623 to 1.341, respectively. The additional “gross-up” entry would increase
2 the regulatory liability with an offset to ADIT.

3 **Q. CAN YOU EXPLAIN HOW THE REDUCTION IN THE FEDERAL CORPORATE**
4 **INCOME TAX RATE AFFECTED THE COMPANY’S ADIT INCLUDING**
5 **EXCESS ADIT?**

6 A. Yes. The Companies calculated the excess ADIT amounts at September 30, 2017 (as a
7 proxy for the balances before the passage of the TCJA) by comparing the ADIT existing
8 at that date to the ADIT that would have been recorded had the lower 21 percent income
9 tax rate always been in effect. The difference is the excess ADIT, which was estimated as
10 \$309.1 million for Spire East and \$23.1 million for Spire West as of the previous rate cases.
11 The excess ADIT were then separated into two “buckets”: excess ADIT relating to
12 property-related book-tax differences (comprised mostly of protected excess ADIT) and
13 excess ADIT relating to non-property related differences (comprised entirely of
14 unprotected book-tax differences). The reason for separating the excess ADIT is because
15 of different ratemaking treatment, in some cases required to comply with the IRS
16 normalization rules, for the reversal. In Spire’s prior rate cases, an estimate of the
17 protected and unprotected excess ADIT “split” was made (50% to protected, 50% to
18 unprotected), with the protected estimate amortized over 20-years and the unprotected
19 excess ADIT estimate amortized over 10-years. I will address both the true-up of these
20 estimated amounts as well as the excess ADIT amortization to be included in this rate case
21 in subsequent questions and answers in this direct testimony.

22 **Q. DID THE TCJA DISCUSS HOW REGULATED PUBLIC UTILITIES WERE TO**
23 **TREAT PROTECTED EXCESS ADIT?**

1 A. Yes. The TCJA addressed how ADIT on protected book-tax differences (primarily
2 depreciation-related method and life differences, including NOL's associated with method
3 and life differences) are to be treated in the ratemaking process. The TCJA requires that
4 excess ADIT on such protected book-tax differences reduce customer rates over the book
5 lives of the related property no more rapidly than under the Average Rate Assumption
6 Method ("ARAM") which I will describe subsequently. If the necessary books and records
7 are not available to compute the reversal under ARAM, an alternative approach, referred
8 to as the Reverse South Georgia Method ("RSGM"), can be used. The RSGM is
9 straightforward: Determine the excess ADIT balance and spread that balance over the
10 estimated remaining useful lives of the assets giving rise to the excess ADIT. The choice
11 of ARAM vs. RSGM is not optional, ARAM must be used unless the records needed to
12 compute ARAM are not available.

13 **Q. HOW IS THE ARAM COMPUTED?**

14 A. The ARAM requires the development of an average rate which is determined by dividing
15 the aggregate normalized protected timing/temporary differences into the ADIT that have
16 been provided on such timing/temporary differences. The average rate so calculated is
17 applied to reversing temporary differences to derive the deferred taxes that are debited (in
18 the case of excess ADIT on deferred tax assets) or credited (in the case of excess ADIT on
19 deferred tax liabilities) to income tax expense. Under this approach, protected ADIT are
20 increased/reduced over the remaining lives of the property which gave rise to the ADIT as
21 the timing/temporary differences reverse. Public utilities must take care to properly apply
22 the ARAM to protected ADIT because a normalization violation could occur if the amount
23 of protected excess ADIT is reduced more rapidly or to a greater extent than under the

1 ARAM. If the normalization rules were so violated with respect to reversing protected
2 excess ADIT, two negative results would occur: 1) current income taxes would become
3 payable for the more rapid reduction plus, more importantly, 2) accelerated depreciation
4 methods would not be permitted for income tax purposes going forward. Rather, book
5 depreciation would have to be used for income tax purposes.

6 **Q. HAVE YOU PREPARED AN EXHIBIT THAT DEMONSTRATES HOW THE**
7 **ARAM IS TO BE CALCULATED?**

8 A. Yes, Exhibit B provides an example describing the originating and reversing book-tax
9 differences and the required ADIT each year when there is a change (in this case, a
10 reduction) in the federal income tax rate. This example is based on the assumptions used
11 in my previous example describing depreciation book-tax differences and how such
12 differences originate and reverse. I begin with an income tax rate of 35 percent in the early
13 years that is reduced to 21 percent before the asset is fully depreciated. The example again
14 assumes a \$1 million asset placed in service in 2016 with a 10-year book life and a five-
15 year tax life using MACRS depreciation, with no bonus tax depreciation. The MACRS rate
16 is shown in Column B and each year's tax depreciation is shown in Column C. Book
17 depreciation is \$100,000 each year and Column E contains the difference between tax and
18 book depreciation each year. Column F contains the cumulative difference between book
19 and tax at the end of each year. Column G contains the income tax rates, beginning with
20 35 percent in 2016 and 2017, reducing that rate to 21 percent at the beginning of 2018.
21 Columns H and I show each year's deferred tax expense, with Column H showing the
22 deferred tax expense on originating book-tax differences and Column I showing the
23 deferred tax expense on reversing book-tax differences. Column J shows the ADIT

1 balance, increasing and decreasing the previous year's balance by the deferred tax expense.
2 Column M shows the excess ADIT balance, decreasing as it reverses according to the
3 ARAM methodology.

4 **Q. CAN YOU WALK THROUGH THE DETERMINATION OF EXCESS ADIT AND**
5 **HOW THE ARAM IS USED TO REVERSE THE EXCESS ADIT FOR THE TAX**
6 **RATE CHANGE?**

7 A. Yes. When the tax rate changed at the end of 2017, the balance of ADIT was \$112,000
8 (Column J). This balance was derived by applying the 35 percent tax rate to the cumulative
9 book-tax differences at that time in Column F (\$320,000). The remeasurement necessitated
10 by the change in tax rates is shown on Line 2a where the ADIT balance at December 31,
11 2017 is allocated into two components: The "normal" ADIT amount and the excess ADIT
12 amount. The normal ADIT balance is calculated by applying the new 21 percent tax rate
13 to those cumulative book-tax differences at the time of the rate change ($\$320,000 \times 21$
14 $\text{percent} = \$67,200$) and comparing that amount to the then existing ADIT balance with the
15 difference representing the excess ADIT ($\$112,000 - \$67,200 = \$44,800$).

16 Under the ARAM, this excess ADIT balance does not begin reversing until 2021 when the
17 book-tax difference begins to reverse. In 2018 through 2020, book-tax differences continue
18 to originate, now at the lower 21 percent income tax rate with no reversal permitted for
19 excess ADIT. This is a key distinction between ARAM and RSGM. Under RSGM, the
20 excess ADIT begins to reverse immediately, while under ARAM, reversal does not begin
21 until the book-tax difference begins to reverse. In this example, if RSGM was applied, the
22 excess ADIT at December 31, 2017 would begin reversing in 2018 and continuing through
23 the end of 2025.

1 At the end of 2020, the combined ADIT and excess ADIT balance is \$137,704 (Column
2 H: $\$35,000 + \$77,000 + \$19,320 + \$3,192 + \$3,192$) and the cumulative book-tax difference is
3 \$442,400 (the 2016 through 2020 differences in Column F). The average rate at which the
4 \$137,704 combined ADIT and excess ADIT balance was accumulated is thus 31.1266
5 percent ($\$137,704 / \$442,400$). This is the average rate that must be applied to the book-
6 tax differences reversing in each year beginning in 2021 (Column E) broken into two
7 components: 1) the statutory rate (21 percent) applied to the reversing book-tax differences
8 beginning in 2021 to reduce the normal ADIT balance (Column I) and 2) the excess ADIT
9 rate (31.1266 percent minus 21 percent = 10.1266 percent, shown in Column K) also
10 applied to the reversing book-tax differences beginning in 2021.

11 At the end of its useful life, the originating and reversing deferred tax expense (consisting
12 of both the normal ADIT reversal plus the excess ADIT reversal) equal one another and
13 the ADIT balance is 0.

14 **Q. HOW IS THIS TYPICALLY REFLECTED IN A RATE CASE?**

15 A. As discussed previously, reversal of ADIT is included in the normal calculation of total
16 income tax expense (i.e., the current statutory rate multiplied by pre-tax income).
17 However, to reflect the reversal of the excess ADIT occurring at a different tax rate (i.e.,
18 the tax rate calculated under ARAM), once the normal calculation of income tax expense
19 is determined, the reversal of the calculated excess ADIT must be added/subtracted to
20 obtain the amount that is included in the calculation of revenue requirement.

21 **Q. IN YOUR ARAM EXAMPLE, IF A RATE HIGHER THAN THE COMBINED**
22 **AVERAGE RATE OF 31.1266 PERCENT WERE USED TO REDUCE THE**
23 **REVERSING ADIT OR IF ANY OF THE EXCESS ADIT WERE REVERSED**

1 **PRIOR TO 2020 WHAT WOULD HAPPEN?**

2 A. Flowing back protected ADIT more rapidly than permitted under the ARAM will result in
3 a violation of the normalization rules. I have already discussed the two-fold penalty for
4 violating the normalization rules for excess ADIT: (1) currently payable income tax is
5 increased by the amount by which the utility reduced its excess tax reserve more rapidly
6 than permitted under the ARAM or the RSGM, and (2) the utility will be unable to claim
7 accelerated depreciation for income tax purposes.

8 **Q. DOES THE TCJA PRESCRIBE A METHOD FOR REVERSING EXCESS ADIT**
9 **ON “UNPROTECTED” EXCESS ADIT?**

10 A. No. Prior to the TCJA, the ADIT provided on all book-tax differences typically reversed
11 at the tax rate used to record the deferred tax expense when the book-tax difference
12 originated; however, the TCJA does not contain such a requirement on the excess ADIT
13 on unprotected book-tax differences. Reversal of the balance of unprotected ADIT is thus
14 up to a decision by the utility and its regulator.

15 **SPIRE TEST YEAR TREATMENT OF PROTECTED AND UNPROTECTED ADIT**

16
17 **Q. HAS SPIRE REVERSED ANY OF THE EXCESS ADIT AMOUNTS AT THIS**
18 **POINT?**

19 A. Yes. This issue was addressed in Spire’s previous rate cases, GR-2017-2015 and GR-
20 2017-2016. In the Amended Report and Order, the Commission concluded:

21 “One additional consequence of the TCJA is its effect on ADIT. The parties
22 presented evidence regarding the estimated effects, but because of the complex
23 nature of deferred income taxes and the potential effect on cash flows to the
24 company if the flow back of excess ADIT is not done correctly, this calculation as
25 presented to the Commission still remains an estimate. The estimates of the

1 percentage of “protected” versus “unprotected” ADIT and the lack of evidence
2 surrounding the appropriate amortization periods for each category, convinces the
3 Commission that effects of the TCJA on ADIT are not sufficiently known and
4 measurable to include in the current rate case with any certainty beyond an estimate.
5 However, Spire Missouri and Staff indicated that they will be able to determine,
6 based on the former composite tax rate of 38.3886 percent and the new effective
7 composite tax rate of 25.4483 percent, an appropriate estimated amount to set as a
8 reduction to ADIT. That amount calculated by Staff’s witness Lisa Ferguson is
9 \$11.5 million per annual period (a \$10.7 million reduction for Spire East and an
10 \$815,000 reduction for Spire West). As part of its calculation, Staff applied a 50/50
11 split between the “protected” and “unprotected” ADIT applying a 20-year
12 amortization to protected ADIT and a 10-year amortization to unprotected ADIT.
13 However, the calculations and the determination of the actual split between
14 protected and unprotected excess ADIT and the appropriate amortization period for
15 the protected and unprotected excess ADIT have not been completed as of the date
16 of this order. The protected component to be flowed back to the ratepayers shall be
17 computed by Spire Missouri in accordance with the normalization requirements of
18 the TCJA. The Commission orders that the ADIT amount for purposes of rates in
19 this case shall be reduced by \$11.5 million. Additionally, the Commission orders
20 that a tracker be established to defer any amounts in excess ADIT over or under the
21 \$11.5 million amount refunded in rates, from the effective date of rates resulting
22 from this case, forward, for possible inclusion in a later rate case. Further, the
23 determination of the actual split between protected and unprotected ADIT and the

1 appropriate amortization periods will be determined in Spire Missouri's next rate
2 case."

3 In short, in their last rate case, Spire East's excess ADIT was \$10.7 million per year and
4 Spire West's excess ADIT was \$0.8 million per year. However, these amounts were clearly
5 estimates based on an assumed 50-50 protected/unprotected split and using a 20-year
6 straight-line amortization period for protected ADIT and a 10-year amortization period for
7 unprotected ADIT. In this rate case, Spire is proposing to true-up such estimates and
8 provide the actual protected balance and unprotected balance, as well as the amortization
9 period to be applied to each. . For the protected reversal period, the actual ARAM reversal
10 period, which is dependent on the timing of tax versus book depreciation on individual
11 assets and vintages was used for determining the ARAM reversal instead of the 20-year
12 straight line amortization period used in the last rate case.

13 **Q. HAS SPIRE DETERMINED THE ACTUAL EXCESS ADIT AND THE**
14 **APPROPRIATE SPLIT BETWEEN PROTECTED AND UNPROTECTED**
15 **EXCESS ADIT?**

16 A. Yes. Spire has calculated the actual excess ADIT at September 30, 2017 and determined
17 how much of the excess ADIT is protected versus unprotected. Instead of a 50%-50% split
18 between protected and unprotected ADIT, the split should have been 46.33% of protected
19 ADIT, 53.67% unprotected ADIT for Spire East and 27.81% protected, 72.19%
20 unprotected for Spire West.

21 **Q. HAS SPIRE RECALCULATED THE ARAM REVERSAL THAT WOULD HAVE**
22 **OCCURRED IN THE LAST RATE CASE IF THE ACTUAL BALANCES OF AND**

1 **SPLITS BETWEEN PROTECTED AND UNPROTECTED ADIT WERE KNOWN**
2 **AT THE TIME?**

3 A. Yes. Using the actual ARAM reversal versus the 20-year straight line reversal used in the
4 last rate case, Spire has been able to compute the difference between amounts that have
5 been used to reduce customer rates since that last case to amounts that should have been
6 used to reduce customer rates if the actual amounts and reversal periods were known at
7 that time. Applying the actual ARAM calculation for 2018 through September 30, 2020
8 to the actual protected excess ADIT amounts results in an actual cumulative ARAM
9 reversal of protected excess ADIT for Spire East of \$4,688,387 compared to \$6,295,231
10 that has reduced customer billings based on the estimates established in the last rate case.
11 For Spire West, the actual ARAM reversal calculation for the protected excess ADIT from
12 2018 to September 30, 2020 is a reduction of \$73,087 compared to a reduction of \$471,464
13 based on the estimate determined in the last rate case, for a difference (customer billings
14 were reduced too quickly) of \$1,606,844 for Spire East and \$398,377 for Spire West.

15 **Q. WHAT DOES SPIRE PROPOSE WITH RESPECT TO THE PROTECTED**
16 **EXCESS ADIT DIFFERENCE BETWEEN THE ESTIMATED AND ACTUAL**
17 **ARAM REVERSALS?**

18 A. As previously discussed, the TCJA rules prohibit the reversal of protected excess ADIT
19 too quickly. Because of the high-level estimates of protected amounts and the reversal
20 period for these protected amounts, the companies have reduced rates too quickly since the
21 last rate case. If customer rates are reduced too quickly for this item, a normalization
22 violation occurs. However, the IRS has provided guidance for such situations where the

1 impacts of the TCJA were considered by regulators with a subsequent revision to estimates.
2 In Revenue Procedure 2020-39, the following guidance is provided:

3 “(6) Transition Rules. Many utilities have already been required to adjust rates due
4 to the TCJA. Utilities may correct any method of reversing ETR that is not in accord
5 with this revenue procedure at the next available opportunity. The methods adopted
6 prior to the publication of this revenue procedure that are not in accord with this
7 revenue procedure are not considered to be a violation of the normalization rules if
8 so corrected. This corrective action will require the utility to consult with its
9 regulator and obtain its regulator’s consent. Utilities are not in conflict with section
10 13001(d) of the TCJA if the utilities follow such a path to correct potential
11 normalization violations prospectively. These rules extend to companies that may
12 not have started the amortization of ETRs or may be re-deferring the amortization
13 as they evaluate their records.” (Revenue Procedure 2020-39, Effective August 14,
14 2020).

15 In short, the IRS stated that a normalization violation would not occur if, in the next rate
16 case, amounts that were returned too rapidly were cured. That is the case here. The
17 companies are proposing to recover the over-returned amounts over a three-year period,
18 the estimated time period between rate cases. The amount of the required adjustment is
19 thus \$535,615 (\$1,606,844 divided by 3= \$535,615) for Spire East and \$132,792 (\$398,377
20 divided by 3 = \$132,792) for Spire West.

21 **Q. IS THE THREE-YEAR PERIOD SELECTED BY THE COMPANY TO ADDRESS**
22 **THE RECOVERY OF THE PREVIOUSLY OVER-REFUNDED PROTECTED**

1 **EXCESS ADIT AN ACCEPTABLE APPROACH TO AVOID A**
2 **NORMALIZATION VIOLATION?**

3 A. While the IRS would make the ultimate decision as to whether a three-year recovery period
4 is acceptable, based on the guidance in the Revenue Procedure a three-year period is not
5 unreasonable. However, I would suggest that any period longer than three-years to recover
6 the over-refunded protected excess ADIT would increase the risk of a potential
7 normalization issue. As previously stated, the penalties for a normalization violation are
8 severe.

9 **Q. THE ADJUSTMENT YOU JUST DESCRIBED ADDRESSES THE ISSUE OF**
10 **RETURNING PROTECTED EXCESS ADIT TOO QUICKLY. WHAT IS THE**
11 **AMOUNT OF THE ARAM REVERSAL IN THE TEST YEAR EXCLUDING THIS**
12 **ADJUSTMENT TO ADDRESS THE PRIOR OVER-RETURNING AMOUNT?**

13 A. Based on the updated September 30 actual balances, Spire East has reduced income tax
14 expense in this case by \$2,066,229, the amount of the ARAM reversal of the protected
15 excess ADIT in the test year (FY2020). Spire West has reduced income tax expense in this
16 case by \$15,955, the amount of the ARAM reversal of the protected excess ADIT in the
17 test year.

18 **Q. WHAT DO THE COMPANIES PROPOSE WITH RESPECT TO THE**
19 **UNPROTECTED EXCESS ADIT.**

20 A. Based on the actual, corrected balances, the unprotected excess ADIT balances at
21 September 30, 2020, are \$43,118,253 for Spire East and \$6,624,504 for Spire West. These
22 are the adjusted balances, correcting for the estimated balances established in the prior rate
23 case, and will reverse over the remaining portion of the 10-year period established in the

1 A. The net impact of truing-up estimated excess ADIT reversals to actual excess ADIT
2 reversals is as follows:

	Spire East	Spire West
3		
4 True-up of protected excess ADIT over three years		
5 (over refunded),	\$535,615	\$132,792
6 True-up of unprotected excess ADIT over three years		
7 (under refunded)	<u>(383,507)</u>	<u>(389,393)</u>
8 Net impact	(\$152,108)	\$256,601

9 **Q. WHY IS IT IMPORTANT TO TRACK THE OVER RETURN OF PROTECTED**
10 **EXCESS ADIT SEPARATE FROM THE SHORTFALL IN RETURNING**
11 **UNPROTECTED EXCESS ADIT?**

12 A. The IRC & TCJA have stringent requirements for protected ADIT. The IRC & TCJA
13 contain the previously described normalization rules, establishing guidance as to the
14 appropriate ratemaking treatment of protected ADIT. The IRC & TCJA do not address
15 ADIT relating to other book-tax differences (unprotected differences). As mentioned, the
16 IRS has provided guidance on how to remedy potential normalization violations due to
17 implementing the TCJA based on estimates. This guidance does not address unprotected
18 differences which can be adjusted in a rate proceeding based on the decisions of the
19 regulator. Said another way, the normalization rules cover only the protected ADIT and
20 do not allow for mixing of protected and unprotected ADIT. That is why the adjustment
21 to cure the actual versus estimated differences from the last rate case MUST be made for
22 the protected differences.

23 **Q. WHAT IS THE RATE BASE IMPACT OF EXCESS ADIT?**

1 A. The companies have reduced rate base for the excess ADIT relating to the book-tax
2 differences included as a rate base reduction. For Spire East, the amount of the rate base
3 reduction for excess ADIT is \$87,522,035. For Spire West, the amount of the rate base
4 reduction for excess ADIT is \$9,916,026. These balances represent the result of what total
5 excess ADIT should have been on September 30, 2017 (in lieu of the estimated balances
6 established at that time) less amounts actually refunded to customers based on the 2018
7 rate case settlement through September 30, 2020.

8 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

9 A. Yes, it does.

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

In the Matter of Spire Missouri Inc.'s Verified)
Request for Authority to Implement a)
General Rate Increase for Natural Gas)
Service Provided in the Company's)
Missouri Service Areas.)
)

Case No. GR-2021-0108

AFFIDAVIT

STATE OF ILLINOIS)
)
COUNTY OF COOK)
)

SS.

Alan D. Felsenthal, of lawful age, being first duly sworn, deposes and states:

1. My name is Alan D. Felsenthal. I am a Managing Director at PricewaterhouseCoopers LLP. My business address is 1 North Wacker Drive, Chicago, Illinois, 60606.
2. Attached hereto and made a part hereof for all purposes is my direct testimony on behalf of Spire Missouri, Inc.
3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief



Alan D. Felsenthal

December 11, 2020

CURRICULUM VITAE
ALAN D. FELSENTHAL

EDUCATIONAL BACKGROUND

June, 1971	B.S. in Accounting University of Illinois Champaign, Illinois
May, 1972	Certified Public Accountant

EMPLOYMENT

2010-	Managing Director, Power and Utilities PricewaterhouseCoopers LLP
2008-2010	Managing Director-Utilities Industry Huron Consulting Group
2002-2007	Managing Director—Utilities Industry PricewaterhouseCoopers LLP
1985-2002	Principal in Utilities and Telecommunications Practice, Arthur Andersen LLP, Chicago
1976-1985	Manager in Utilities and Telecommunications Practice, Arthur Andersen LLP, Chicago
1971-1976	Staff and Senior Accountant, Arthur Andersen LLP, Utilities and Telecommunications Division, Chicago

TESTIMONY EXPERIENCE

Testified before the Illinois Commerce Commission on behalf of Town Gas Company of Illinois, 1985. Accounting witness covering cost of service issues.

Testified before the Illinois Commerce Commission on behalf of Town Gas Company of Illinois, 1986. Generic hearing regarding high gas costs.

Testified before the Florida Public Service Commission on behalf of Central Telephone Company of Florida (1991). Testimony addressed projected test year,

a computer model we developed to simplify forecast procedures and propriety of including pension asset in rate base.

Submitted an expert report and testified in an appeal by Yellow Cab Company versus the City of Chicago, (2000). Topic dealt with the adequacy of taxicab lease rates. Yellow Cab was appealing the lease rates they were permitted to charge lessees. The model developed by the City of Chicago to set lease rates was based on traditional utility ratemaking principles. Was hired by the City of Chicago to review Yellow Cab's appeal compared to traditional ratemaking principles and submit a report. Yellow Cab appealed the decision and a hearing before a judge resulted.

Testified before the Arizona Corporation Commission on behalf of Tucson Electric Power Company, 2008. Rebuttal testimony addressed application of FAS 71 when a portion of the business was opened to competition and appropriate treatment of the FAS 143 cost of removal regulatory liability.

Testified before the Florida Public Service Commission on behalf of Tampa Electric Company and Peoples Gas, (2008). Direct testimony on income taxes, including the appropriate accumulated deferred income tax calculation when a projected test period is used.

Testified before the Washington Utilities and Transportation Commission on behalf of Avista Corporation, (2008).

Testified before the Illinois Commerce Commission on behalf of The Peoples Gas, Light and Coke Company/North Shore Gas Company (2009). Rebuttal and Surrebuttal testimony on the appropriate treatment of prepaid pension asset in rate base.

Testified before the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2009). Rebuttal testimony on the appropriate treatment of cost of removal vis a vis FAS 143.

Submitted an expert report and a reply expert report to a Seattle-based arbitration panel in a dispute involving Grays Harbor Energy LLC vs. Energy Northwest, 2009. Subject involved the appropriate determination of fixed costs and cost of capital pursuant to a purchase and sale agreement.

Testified before the Public Utility Commission of Texas on behalf of Centerpoint Energy (2010). Direct and Rebuttal testimony on a number of income tax issues including consolidated income tax adjustments and FIN 48.

Testified before the Indiana Utility Regulatory Commission on behalf of Indianapolis Power & Light Company (2015). Rebuttal testimony on including prepaid pension asset in rate base.

Testified before the Public Utility Commission of Ohio on behalf of Dayton Power & Light Company (2015). Direct testimony on the results of a lead-lag study.

Submitted rebuttal testimony to the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2016) on the appropriateness of including the prepaid pension asset in rate base.

Submitted an expert report to the Virginia State Corporation Commission regarding the allocation of Dominion Resources Inc. shared service costs to Virginia Electric Power Company (2016).

Submitted an expert report to the Oregon Public Service Commission regarding the capitalization of administrative and general overhead costs. (2017).

Testified before the Florida Public Service Commission on behalf of Tampa Electric Company and Peoples Gas on the subject of the appropriate treatment of excess Accumulated Deferred Income Taxes resulting from the Tax Cuts and Jobs Act (2018).

Testified before the Indiana Utility Regulatory Commission on behalf of Indianapolis Power & Light Company (2018). Rebuttal testimony supporting a return on the Company's prepaid pension asset.

Testified before the FERC on behalf of GridLiance West (2018). Direct testimony supporting the derivation and reasonableness of the Company's Start-Up Regulatory Asset.

Submitted rebuttal testimony to the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2019) on reasons why including a return on the Company's prepaid pension asset is appropriate.

Submitted direct testimony to the New Jersey Board of Public Utilities on behalf of Elizabethtown Gas Company (2019) discussing consolidated income tax adjustments and Excess Accumulated Deferred Income Taxes being passed on to customers after the acquisition of the Company from Southern Company by South Jersey Industries.

Submitted direct testimony to the Hawaii Public Utilities Commission on behalf of Young Brothers (2019) on a number of income tax topics (Excess Accumulated Deferred Income Taxes, including the NOL Deferred Tax Asset in Rate Base, treatment of the Hawaii Capital Goods Excise Tax Credit) and including the prepaid pension asset in rate base.

Participated on accounting panels before the Maine Public Utilities Commission supporting 1) a market study of Central Maine Power Company's shared service costs and 2) the treatment of Excess Accumulated Deferred Income Taxes (2019).

Submitted rebuttal testimony before the Utah Public Service Commission on pension accounting symmetry in connection with the rate case of Dominion Energy Utah (2019).

Submitted direct testimony to the New Jersey Board of Public Utilities on behalf of South Jersey Gas Company (2020) discussing consolidated income tax adjustments and Excess Accumulated Deferred Income Taxes being passed on to customers using the Average Rate Assumption method for protected book-tax differences to comply with the Tax Cuts and Jobs Act.

Participated on a panel before the Connecticut Public Regulatory Authority supporting GenConn Energy LLC's Accumulated Deferred Income Taxes in their Revenue Requirement proceeding (2020).

Submitted direct testimony before the Public Service Commission of West Virginia for Dominion Energy West Virginia (Hope Gas) supporting 1) the treatment of excess Accumulated Deferred Income Taxes and 2) why it is inappropriate to include Accumulated Deferred Income Tax and Excess Accumulated Deferred Income Tax balances as a rate base offset when the book-tax difference relates to costs not being recovered in revenue requirements. (2020)

REGULATORY CONSULTING EXPERIENCE

Synopsis—Throughout the late 1970's, the 1980's, 1990's, 2000's and 2010's assisted Andersen and PwC partners in the preparation of regulatory testimony covering a variety of accounting issues. Much of this testimony involved income tax accounting issues related to flow-through versus normalization or investment tax credit and the appropriate accounting and ratemaking treatment of excess

accumulated deferred income taxes when statutory tax rates change. Also developed testimony on CWIP in rate base and working capital (lead-lag technique), appropriateness of allocation of service company costs to regulated entities, recovery of pre-operating cost regulatory assets and capital structure issues.

In 2015, assisted with the preparation of an Expert Report for EverSource Energy subsidiary Connecticut Light & Power which was submitted to the Connecticut regulator. The issue concerned reopening a rate order to address the treatment of accumulated deferred income taxes which was incorrectly decided in the rate order.

In 2018, assisted with the preparation of a private letter ruling by American Transmission Company as to whether an internal transfer between a regulated and non-regulated partner would trigger the elimination of accumulated deferred income taxes that would need to be reflected on the books and records of the partnership.

In 2018 and 2019, assisted with the preparation of Expert testimony and a private letter ruling discussing the appropriate income tax treatment of a like-kind exchange between Oncor and Sharyland. The issue concerned whether the accumulated deferred income taxes relating to the exchanged assets could carry over or would need to be eliminated.

Provided assistance on rate case testimony for the following companies:

- Ameritech Corporation
- Central Illinois Light Company
- Central Illinois Public Service Company
- Central Telephone Company of Florida
- Central Telephone Company of Nevada
- Central Telephone Company of Texas
- Connecticut Light and Power Company
- Dayton Power & Light Company
- Dominion Energy Utah

- Elizabethtown Gas Company
- El Paso Electric Company
- GridLiance Corporation
- Hawaiian Electric Companies
- Indiana Bell Telephone Company
- Indianapolis Power & Light Company
- Integrys Energy Group, Inc.
- Iowa-Illinois Gas and Electric Company
- Iowa Power Company
- New Mexico Gas Company
- Northern Indiana Public Service Company
- Pacific Gas & Electric Company
- Peoples Gas Systems (Tampa)
- PPL Montana (contract dispute)
- The Peoples Gas Light and Coke Company
- Public Service Company of New Mexico
- San Gabriel Valley Water Company
- Southern Bell Telephone Company
- South Jersey Gas Company
- Tampa Electric Company/Peoples Gas Company
- Transco Pipeline
- Young Brothers, Limited

Provided regulatory consulting for the Panama Canal Company. Tariffs charged to transit the Panama Canal were based on a cost of service approach. Assisted the Panama Canal Company in determining test year costs. Tariffs were established based on these costs.

2012-2020. Led several projects to evaluate a rate case filing prior to filing validating the completeness, accuracy, consistency and support of the filing. As a result, adjustments and edits were made to the filing to increase the credibility of the utility's filing. Provided a similar role with respect to date request responses and rebuttal testimony.

FINANCIAL CONSULTING EXPERIENCE

Assisted two Chinese utility companies in registration filings to have their shares traded on the New York Stock Exchange. Huaneng Power International and Shandong Huaneng Power Company were the first two Chinese utilities to list on

the NYSE. Process involved working with attorneys, company personnel and the Securities and Exchange Commission to file the equivalent of a Form S-1.

Assisted a number of companies in the preparation, review and filing of Registration Statements with the SEC to raise debt and equity capital.

Consulted with an electric transmission company on whether costs charged to generation companies based on specific costs are in accordance with the costs permitted by the Federal Energy Regulatory Commission.

Consulted with Ameritech Corporation on a number of projects involving cost allocations and compliance with the Federal Communications Commission separations rules.

Consulted with several entities in the preparation of a private letter ruling request to determine whether certain regulatory/ratemaking approaches would violate the Internal Revenue Service (“IRS”) normalization rules. Provided the ratemaking aspect of the request when, combined with income tax consulting assistance formed the basis for a complete request, accepted by the IRS.

FINANCIAL AUDIT EXPERIENCE

- Allegheny Energy
- Ameritech Cellular
- Ameritech Corporation
- Ameritech New Media
- Centel Corporation
- Chicago Skyway
- Constellation Energy
- Focal Communications
- Iowa-Illinois Gas and Electric Company
- Louisville Gas and Electric Company
- Nicor, Inc.
- Nisource
- Peoples Energy
- United Airlines
- Utilities, Inc.

LECTURES AND SEMINARS

Speaker at Edison Electric Institute/American Gas Association Introductory, Intermediate and Advanced Accounting Seminar 1996-2019.

Speaker at SNL (Regulatory Research Associates) Utility Foundations Seminar 2013-2017

Speaker at Power Plan Associates annual conference (2012, 2010, 2008, 2006, 2004, 2002) on recent accounting, regulatory and SEC matters affecting utilities.

Developed and conducted Utilities Industry Basic Accounting and Ratemaking Seminar. This two-day seminar is conducted each year for Andersen, Huron and PwC personnel assigned to utility audits or projects. In addition, the seminar is periodically offered on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Developed and conducted Utility Income Taxes-Accounting and Ratemaking Issues. This two-day or two-and-a-half day seminar has been conducted each year for Andersen, PwC and Huron personnel assigned to utility audits or income tax projects. The seminar focus is the accounting, tax return/compliance and financial statement aspects of utility income taxes taking into consideration the consequences of ratemaking/revenue requirements. In addition, the seminar is conducted annually on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Developed and conducted Rate Case Experience Seminar, a week-long seminar taking participants through the process of filing a rate case, including preparing direct testimony based on a mock case study and sitting for cross-examination. At the conclusion of the seminar, an Order is presented. The course is conducted each year on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Specific examples of special training conducts for utility companies/regulators are as follows:

- Alaska Regulatory Commission
- American Electric Power
- American Water Works
- Ameritech Corporation
- Arizona Public Service Company
- Arkansas Public Service Commission
- Centerpoint Energy
- Cleco Corporation
- Consolidated Edison
- Consumers Power Company
- Dominion Resources
- Duke Energy
- Entergy Corporation
- Exelon Corporation
- Federal Energy Regulatory Commission
- Georgia Power Company
- Illinois Commerce Commission
- Louisville Gas and Electric Company
- National Grid
- Natural Gas Pipeline Company of America
- Nicor, Inc.
- Nisource, Inc.
- Northwest Pipeline
- Oklahoma Corporation Commission
- One Gas Corporation
- Peoples Energy
- Pepco Holdings, Inc.
- PG&E Corporation
- Portland General Electric Company
- PPL Corporation
- Qwest Corporation
- Sempra Energy
- Southern California Edison Company
- Sprint Corporation
- Tampa Electric Company
- The Southern Company
- Transco Pipeline
- Tucson Electric Power
- Williams Pipeline
- Xcel Energy

PROFESSIONAL ASSOCIATIONS

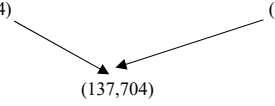
American Institute of Certified Public Accountants

Illinois CPA Society

ARAM ILLUSTRATION

Line No.	Year	(A) Asset Cost	(B) 5-year MACRS Tax Rate	(A x B = C) Tax Depreciation	(A / 10 = D) Book Depreciation 10 yrs. S/L	(C - D = E) Tax over Book		(G) Tax Rate	(E x G = H) Originating Deferred	(E x G = I) ADIT		(F x G = J) Cumulative ADIT Balance	(K) Average Rate	(E x K = L) Excess ADIT Reversing under ARAM	(M) Excess ADIT Cumulative Balance
						Tax over Book	Cumulative Tax Over Book Difference			Reversing Deferred	ADIT				
1	2016	1,000,000	20.000%	200,000.00	100,000.00	100,000.00	100,000.00	35%	35,000.00			35,000			
2	2017		32.000%	320,000.00	100,000.00	220,000.00	320,000.00	35%	77,000.00			112,000			
2a	Remeasurement at December 31, 2017		-	-	-	-	320,000.00	21%	-			67,200			44,800
3	2018		19.200%	192,000.00	100,000.00	92,000.00	412,000.00	21%	19,320.00			86,520			44,800
4	2019		11.520%	115,200.00	100,000.00	15,200.00	427,200.00	21%	3,192.00			89,712			44,800
5	2020		11.520%	115,200.00	100,000.00	15,200.00	442,400.00	21%	3,192.00			92,904			44,800
6	2021		5.760%	57,600.00	100,000.00	(42,400.00)	400,000.00	21%	-	(8,904)		84,000	10.1266%	(4,294)	40,506
7	2022		0.000%	-	100,000.00	(100,000.00)	300,000.00	21%	-	(21,000)		63,000	10.1266%	(10,127)	30,380
8	2023		0.000%	-	100,000.00	(100,000.00)	200,000.00	21%	-	(21,000)		42,000	10.1266%	(10,127)	20,253
9	2024		0.000%	-	100,000.00	(100,000.00)	100,000.00	21%	-	(21,000)		21,000	10.1266%	(10,127)	10,127
10	2025		0.000%	-	100,000.00	(100,000.00)	-	21%	-	(21,000)		0	10.1266%	(10,127)	0
Total				1,000,000.00	1,000,000.00	-			137,704.00	(92,904)					(44,800)

\$1,000,000 fixed asset placed in service on January 1, 2016
 Book Depreciation using straight-line method, 10-year life, no half-year convention
 Tax Depreciation using MACRS, five-year life



At the end of 2017, when the tax rate changes, the ADIT is remeasured at 21%. The remeasurement reclassifies a portion of the ADIT as Excess ADIT. (line 2a)
 The remeasured ADIT reverses normally (i.e. the book tax difference times the current statutory rate) while the Excess ADIT reverses following ARAM

Average Rate (Column K) computed when the book-tax difference reverses (Column E-Year 2021). Computation is based on dividing the Excess ADIT balance at the time of reversal (44,800 in Column M) by the cumulative book-tax differences at the beginning of the year (\$442,400 - the total originating differences in Column F). The average rate is 31.166 per cent, broken into 1) the statutory tax rate to apply to reversing book-tax differences (21 percent) to clear the ADIT balance (Column I) and 2) the rate to apply to reversing book-tax differences to clear the Excess ADIT balance (Column L).

Ratemaking tax expense includes both the deferred tax expense (i.e. originatind deferred or reversing defered) and rate base is reduced for both the Cumulative ADIT and Excess ADIT balances.