

Exhibit No. 11

Exhibit No:	_____
Issue:	Ratemaking treatment of excess ADIT, NOL Deferred Tax Asset in Rate Based
Witness:	Alan D. Felsenthal
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	Spire Missouri Inc.
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SPIRE MISSOURI INC.

CASE NO. GR-2021-0108

REBUTTAL TESTIMONY

OF

ALAN D. FELSENTHAL

JUNE 17, 2021

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1 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

2 A. My rebuttal testimony will address Staff witness Matthew Young and OPC witness John
3 Riley on the following issues:

- 4 • Excess Accumulated Deferred Income Tax Issues (“EADIT”) in connection with the
5 remeasurement of ADIT upon enactment of the Tax Cuts and Jobs Act of 2017
6 (“TCJA”), specifically Mr. Young’s recommendation to correct the return of protected
7 EADIT over a 10 year period which may violate the normalization provisions of the
8 Internal Revenue Code (“IRC”) (Young Direct, page 111);
- 9 • Witness Riley’s recommendation to exclude from rate base and the EADIT calculation
10 the NOL ADIT Asset, which ignores the rate base reducing ADIT Liability and excess
11 ADIT regulatory liability which is the cause of the NOL (John Riley Direct, page 11)

12 **II. EXCESS ADIT TRUE-UP**

13 **Q. CAN YOU SUMMARIZE THE ISSUE INVOLVING EXCESS ADIT CAUSED BY**
14 **THE REMEASUREMENT OF TAX RATES UPON ENACTMENT OF THE TCJA?**

15 A. Yes. The TCJA reduced the federal corporate income tax rate from 35% to 21%. As a
16 result, at year end 2017, entities (regulated utilities and others) remeasured their ADIT
17 balances that had been accumulated at a 35% income tax rate using the new 21% income
18 tax rate. Journal entries were recorded to adjust the existing ADIT balances to the
19 remeasured ADIT balance. Regulated utilities categorized the difference as excess ADIT
20 (or deficient ADIT for ADIT assets) and recorded an income tax related regulatory liability
21 or regulatory asset as an adjustment to the change in ADIT. The TCJA contains language
22 governing how the excess ADIT relating to “protected” book-tax differences (mainly
23 related to accelerated depreciation) are to be treated in the ratemaking process. The

1 guidance requires regulated utilities to use the Average Rate Assumption Method
2 (“ARAM”) to return the excess ADIT to customers and, importantly, states that if the
3 excess ADIT is returned to customers more quickly than provided by using ARAM, a
4 normalization violation will result. Unprotected book-tax differences can be amortized
5 using any basis agreed to by the Commission and Company.

6 **Q. HOW WAS THIS TREATED IN THE COMPANY’S PRIOR RATE CASE?**

7 A. At the time of the prior rate case, Spire had not yet determined the amount of protected
8 versus unprotected excess ADIT and had not calculated the amount that should be returned
9 each year under ARAM. In order to not delay the return to customers of excess ADIT, an
10 estimate of the protected and unprotected excess ADIT “split” was made (50% to protected,
11 50% to unprotected), with the protected estimate amortized over 20-years and the
12 unprotected excess ADIT estimate amortized over 10-years. All parties acknowledged that
13 this was an estimate to be trued up in the next rate case (*i.e.*, this pending rate case).

14 **Q. ARE THE ACTUAL AMOUNTS OF PROTECTED AND UNPROTECTED**
15 **EXCESS ADIT NOW KNOWN?**

16 A. Yes.

17 **Q. HAS THE COMPANY CALCULATED HOW THE AMORTIZATION OF**
18 **EXCESS ADIT USING THE ESTIMATES IN THE 2017 RATE CASE COMPARE**
19 **WITH WHAT SHOULD HAVE BEEN AMORTIZED USING ARAM FOR**
20 **PROTECTED EXCESS ADIT AND 10-YEAR AMORTIZATION FOR**
21 **UNPROTECTED EXCESS ADIT?**

22 A. Yes. Applying the actual ARAM calculation for 2018 through September 30, 2020 to the
23 actual protected excess ADIT amounts results in an actual cumulative ARAM reversal of

1 protected excess ADIT for Spire East of \$4,688,387 compared to \$6,295,231 that has
2 reduced customer billings based on the estimates established in the last rate case. For Spire
3 West, the actual ARAM reversal calculation for the protected excess ADIT from 2018 to
4 September 30, 2020 is a reduction of \$73,087 compared to a reduction of \$471,464 based
5 on the estimate determined in the last rate case. The total difference between what has
6 been refunded to customers based on the last rate case versus what should have been
7 refunded under ARAM (customer billings were reduced too quickly) is \$1,606,844 for
8 Spire East and \$398,377 for Spire West.

9 In addition, when the amount of unprotected excess ADIT refunded to customers from the
10 last rate case through September 30, 2020 (based on estimates) are compared to what the
11 reversals in this period should have been if the actual unprotected balances would have
12 been available at that time, a difference (customer billings were not reduced enough) of
13 \$1,150,520 for Spire East and \$1,168,178 for Spire West results.

14 When looked at in total, the over and under refunded amounts (\$2,005,221 over-refunding
15 of protected excess ADIT, \$2,318,698 under-refunding of unprotected excess ADIT)
16 produce a net under-refund of \$313,447. Spire East and Spire West propose to true-up both
17 the protected over-refund and the unprotected under-refund over three-years. Under the
18 approach I recommended, the annual impact of the net over and under recovery true up for
19 both companies is an approximate \$105K reduction in income tax expense.

20 **Q. DOES STAFF WITNESS YOUNG TAKE ISSUE WITH THE EXCESS**
21 **PROTECTED AND UNPROTECTED AMOUNTS?**

22 A. No. The issue is how to true-up the over-refunding of protected excess ADIT and the
23 under-refunding of unprotected excess ADIT.

1 **Q. YOU STATED THAT THE COMPANY PROPOSES TO TRUE UP THESE**
2 **AMOUNTS OVER THREE YEARS. HOW DOES MR. YOUNG PROPOSE TO**
3 **TRUE-UP THESE AMOUNTS?**

4 A. Mr. Young proposes the following:

5 “Staff recommends that the Commission order a transfer of the amounts
6 refunded to customers from the protected balance to the unprotected balance
7 of Excess ADIT for return to customers. This transfer will immediately
8 restore the balance of protected ADIT to the amount required by the IRS-
9 sponsored ARAM methodology, which should be sufficient to address any
10 concerns about potential normalization violations. Additionally, Staff
11 recommends that the amortization of the unprotected Excess ADIT should
12 be offset to capture the reclassification of the over-refunded amounts to flow
13 back to customers as well as allowing Spire to recover the shortfall in
14 collection of unprotected EADIT from customers. The adjusted
15 amortization of unprotected Excess ADIT should be reset to expire 10 years
16 from the effective date of rates from the 2017 cases.” (Young Direct, page
17 111.)

18 **Q. DO YOU AGREE?**

19 A. No, I first disagree with Mr. Young’s statement that “this transfer will immediately restore
20 the balance of protected ADIT to the amount required by the IRS-sponsored ARAM
21 methodology, which should be sufficient to address any concerns about potential
22 normalization violations.” (Young Direct, page 111.) I also disagree with his

1 recommendation to cure an over refund of protected ADIT over the remaining 7 years of
2 the initially ordered 10-year amortization period. (Young Direct , page 111.)

3 **Q. WHAT ISSUES DO YOU HAVE WITH MR. YOUNG’S RECOMMENDATION TO**
4 **SIMPLY TRANSFER THE OVER REFUNDED PROTECTED EXCESS ADIT**
5 **BALANCE TO UNPROTECTED AS A MEANS TO AVOID A POTENTIAL**
6 **NORMALIZATION ISSUE?**²

7 A. I do not believe it is appropriate to claim that the protected and unprotected split ordered
8 in the prior rate case did not exist. The prior order clearly divided the excess ADIT balance
9 into protected and unprotected buckets assigning a different amortization period (20-year
10 for protected, 10-year for unprotected) to each bucket. The “what if” argument (what if
11 Spire recharacterized the protected excess ADIT amortization as unprotected) does not
12 make sense—either from an accounting, ratemaking or IRS standpoint. If you could cure
13 potential IRS normalization by re-designating the methodology causing the potential
14 violation, there would never be a concern with violating normalization. As I said, if in the
15 prior rate case the intention was to amortize only unprotected ADIT, there would not have
16 been a reason to order different amortization periods.

17 **Q. WHAT IS YOUR CONCERN WITH MR. YOUNG’S PROPOSAL TO CURE THE**
18 **ESTIMATED VERSUS ACTUAL EXCESS ADIT AMORTIZATION OVER THE**
19 **REMAINING YEARS OF THE INITIAL 10-YEAR AMORTIZATION PERIOD?**³

² Witness Young’s Direct Testimony, page 111, lines 17-21.

³ Witness Young’s Direct Testimony, page 111, lines 24-26.

1 A. While the IRS does not provide guidance for unprotected excess ADIT, I am concerned
2 that an extended period of time to true-up the protected excess ADIT over refunded amount
3 (the Staff has effectively proposed a 7 year period) would not be in the spirit of the IRS
4 guidance and could result in a normalization violation.

5 **Q. ON WHAT IS YOUR CONCERN BASED?**

6 A. My concern is based on 1) prior guidance as provided in Private Letter Rulings (PLR) to
7 correct for inadvertent normalization violations as well as 2) the guidance provided by the
8 IRS in Revenue Procedure 2020-39 specifically addressing regulated utilities
9 implementation of the TCJA. Revenue Procedure 2020-39 provides relief in situations
10 where customer rates have been adjusted prior to the guidance contained in the Revenue
11 Procedure 2020-39 if “corrective action will require the utility to consult with its regulator
12 and obtain its regulator’s consent. Utilities are not in conflict with section 13001(d) of the
13 TCJA if the utilities follow such a path to correct potential normalization violations
14 prospectively”.

15 While Mr. Young’s recommendation will fix the over refunded amount prospectively, a
16 lengthy period in which to correct the situation is problematic.

17 In many PLR’s a shorter period (most often immediately) has been ordered.

18 **Q. CAN YOU CITE SEVERAL OF THE PLR’S WHERE THE IRS REQUIRED**
19 **INADVERTENT NORMALIZATION VIOLATIONS TO BE CORRECTED IN**
20 **THE NEXT RATE CASE?**

21 A. Yes. In the following PLR’s the IRS required the inadvertent normalization violation to
22 be corrected immediately. Although none of these rulings relate to over refunding ARAM

1 reversals, they demonstrate that a shorter, rather than longer period to correct the
2 inadvertent violation is preferred, if not, required. The PLR's are:

- 3 • PLR 201230021
- 4 • PLR 8326081
- 5 • PLR 9309013
- 6 • PLR 8831012

7 There are more, but the PLR guidance is generally to correct ASAP.

8 **Q. WHAT CONCLUSION HAVE YOU REACHED ON MR. YOUNG'S**
9 **RECOMMENDATION?**

10 A. I do not believe that the Staff's proposed period to correct for the over refunding of
11 protected excess ADIT should be accepted without seeking approval from the Internal
12 Revenue Service through the Private Letter Ruling process. The consequences of a
13 normalization violation (not permitting the use of accelerated depreciation for income tax
14 purposes) are too great a risk.

15 I am comfortable that the three-year period to correct this matter as suggested by Spire is
16 both reasonable and will comply with the guidance provided in the aforementioned
17 Revenue Procedure 2020-39.

18 **Q. DO YOU HAVE ANY OTHER COMMENTS ON THIS MATTER?**

19 A. Yes. As stated above and in my Direct Testimony, the over-refunded protected excess
20 ADIT and the under-refunded unprotected excess ADIT net to a fairly small amount with
21 amortization over three-years reducing rates by approximately \$105K a year. Once these
22 amounts are corrected, Spire's protected excess ADIT will follow ARAM and no longer
23 include over-refunded amounts, and the unprotected balance will reflect the true
24 unprotected balances to be refunded to customers over what is left of the initial 10-year
25 refunding period established in the last rate case.

1 **III. RATE BASE TREATMENT OF NOL ADIT ASSET**

2 **Q. TURNING TO THE ISSUE INVOLVING INCLUDING AN NOL ADIT ASSET IN**
3 **RATE BASE, WHAT RATIONALE DOES OPC WITNESS RILEY PROVIDE FOR**
4 **EXCLUSION?**

5 A. Mr. Riley states this:

6 “An NOL is a tax return creation that does not have a true cost attributable
7 to it. Also, since the tax code allows NOLs to be carried forward
8 indefinitely; ratepayers will continue to pay income tax expense that does
9 not associate with an actual income tax liability until the NOL is expended.”

10 (Riley Direct, page 11.)

11 He goes on to say:

12 “A taxable loss is a product of legislation and has no basis in a utility
13 company’s checkbook. IRS rules and regulations allow for generous
14 deductions and timing differences that allow companies to create and utilize
15 higher current expenses so taxable income is less. These timing differences
16 are the basis of deferred tax liabilities. These differences can also create the
17 taxable loss that companies carry forward and record on its books as a
18 deferred tax asset. These losses were not generated because a company
19 spent more money, but rather, because it could expense money quicker on
20 its tax returns.” (Riley Direct, page 12.)

21 **Q. WHAT IS INCORRECT WITH MR. RILEY’S REASONING?**

22 A. Mr. Riley’s reasoning displays a misunderstanding of the interplay between book-tax
23 differences and NOL’s - in particular, the impact on ratemaking.

1 As I explained in my direct testimony, ADIT liabilities are recorded for book-tax
2 differences caused by claiming accelerated depreciation for tax return purposes and
3 straight-line depreciation for books. As I explained, for every dollar reduction in current
4 income taxes due to claiming accelerated depreciation on the income tax return, there is an
5 equal and offsetting increase in deferred income tax expense. When computing income
6 tax expense, if the “currently payable” income tax expense is negative (because there is
7 negative taxable income, typically due to accelerating tax deductions), Spire must record a
8 NOL ADIT asset if it is probable that the NOL will be realized by being able to offset
9 future taxable income. Spire believes it is probable that the NOL will be realized. The
10 entry for this is a debit to NOL ADIT asset and credit to current income tax expense.

11 **Q. WHILE IT IS APPROPRIATE TO RECORD THE NOL ADIT ASSET, WHY**
12 **SHOULD THE NOL ADIT ASSET BE INCLUDED IN RATE BASE?**

13 A. ADIT represents an interest-free loan from the federal and state treasuries. The ADIT
14 liabilities for accelerated deductions, such as the ADIT resulting from using MACRS
15 depreciation for tax return purposes and straight-line depreciation for books and
16 ratemaking purposes, reduce rate base, providing the customers the benefit of the interest-
17 free capital. Spire has followed this approach and has an ADIT liability for the accelerated
18 tax versus book depreciation; that ADIT liability reduces rate base, thereby reducing the
19 revenue requirement. However, the existence of a NOL ADIT asset means that some of
20 those accelerated tax deductions have not yet been realized (*i.e.*, did not result in a current
21 year benefit). It is not equitable to reduce rate base for an “interest free loan” that has not
22 yet been realized. In other words, because Spire is using the most favorable method to

1 depreciate assets for income tax purposes and that accelerated depreciation results in an
2 ADIT liability and NOL ADIT asset, then either the ADIT liability should not reduce rate
3 base, or the NOL ADIT asset should be added to rate base to offset such ADIT liability for
4 the portion of the benefit that has not yet been realized.

5 Said another way, including the NOL ADIT asset in rate base counters (offsets) the ADIT
6 liability on the portion of the ADIT liability representing accelerated depreciation that has
7 not been actually realized by Spire. In short, Mr. Riley wants to inappropriately provide
8 customers the benefit of an interest-free loan that does not exist.

9 **Q. HAS FERC TAKEN A POSITION ON INCLUDING THE NOL ADIT ASSET IN**
10 **RATE BASE?**

11 A. Yes. In the rates section of the Code of Federal Regulations discussing ADIT, there is this
12 requirement: “any amounts properly includable in Account 190, Accumulated deferred
13 income taxes, must be treated as an addition to rate base” (18 CFR § 154.305 for gas
14 pipelines, 18 CFR § 35.24 for electric). The NOL ADIT asset is recorded to Account 190.

15 **Q. HAS THE IRS TAKEN A POSITION ON INCLUDING THE NOL ADIT ASSET**
16 **IN A PUBLIC UTILITIES RATE BASE?**

17 A. Yes. The Internal Revenue Code (through a number of private letter rulings) contains the
18 requirement that regulated public utilities include the NOL ADIT asset in rate base. See
19 for example, PLR’s 201421739, 201436037, 201519021, 201842001. To avoid a
20 normalization violation, Spire’s NOL ADIT assets must be included in rate base.

21 **Q. HOW DID THE REMEASUREMENT OF ADIT IMPACT THE NOL ADIT**
22 **ASSET?**

23 A. Spire has calculated the reduction in the NOL ADIT asset due to the tax rate change

1 included in the TCJA and netted the result against the excess ADIT regulatory liability
2 when determining excess ADIT amounts to amortize. Mr. Riley states:

3 “This seems to be an arbitrary exercise since an NOL cannot be amortized.
4 The results lowers the protected balance of ADIT to amortize through the
5 Average Rate Assumption Method (ARAM). This NOL balance should be
6 excluded for the same reasons that I explained previously.” (Riley Direct,
7 page 12.)

8 **Q. IS WHAT SPIRE HAS DONE WITH THE EXCESS NOL ADIT APPROPRIATE?**

9 A. Yes, I have seen a number of different approaches used for the excess NOL ADIT, but in
10 all cases, amounts identified will be recovered from customers. One such approach is that
11 used by Spire, offsetting the excess ADIT liabilities producing a “net” amount to be
12 included in customer rates.

13 **Q. HAS THE IRS PROVIDED GUIDANCE ON THIS ISSUE?**

14 A. Yes, as I stated previously, the NOL ADIT asset is a protected difference under the IRC.
15 In Revenue Procedure 2020-39, the IRS said:

16 “Compliance with normalization requires a determination of the source of an
17 NOLC so that rate base is not overstated in jurisdictions in which net deferred
18 tax liabilities reduce rate base. While § 1.167(l)-1(h)(1)(iii) is the relevant
19 general authority, there is not one single methodology provided for
20 determination of the portion of an NOLC that is attributable to depreciation.
21 Section 1.167(l)-1(h)(1)(iii) instead informs taxpayers that the amount and time
22 of the deferral of tax attributable to depreciation when there is an NOLC should
23 be taken into account in such “appropriate time and manner as is satisfactory

1 to the district director.” Regulating commissions have expertise in this area,
2 and any reasonable method for determining the portion of the NOLC
3 attributable to depreciation should generally be respected provided such
4 method does not clearly violate normalization requirements.”

5 As a protected difference, to comply with the IRC, Spire’s NOL ADIT asset should follow
6 ARAM, which is what the Company is proposing. Spire’s approach is reasonable and
7 should be accepted.

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

9 A. Yes.

