

*Exhibit No.:*  
*Issue(s):* *Accumulated  
Deferred Income Tax  
(ADIT); Current  
Income Tax; Pensions  
& OPEBS*  
*Witness:* *Keith D. Foster*  
*Sponsoring Party:* *MoPSC Staff*  
*Type of Exhibit:* *Rebuttal Testimony*  
*Case No.:* *WR-2020-0344*  
*Date Testimony Prepared:* *January 15, 2021*

**MISSOURI PUBLIC SERVICE COMMISSION**

**FINANCIAL & BUSINESS ANALYSIS DIVISION**

**AUDITING DEPARTMENT**

**REBUTTAL TESTIMONY**

**OF**

**KEITH D. FOSTER**

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2020-0344**

*Jefferson City, Missouri  
January 2021*

1 **REBUTTAL TESTIMONY**

2 **OF**

3 **KEITH D. FOSTER**

4 **MISSOURI-AMERICAN WATER COMPANY**

5 **CASE NO.WR-2020-0344**

6 Q. Please state your name and business address.

7 A. Keith D. Foster, 200 Madison Street, Suite 440, Jefferson City, Missouri 65101.

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

9 A. I am a Utility Regulatory Supervisor for the Missouri Public Service  
10 Commission (“Commission”).

11 Q. Are you the same Keith D. Foster who contributed to Staff’s Cost of Service  
12 Report filed on November 24, 2020, in this case?

13 A. Yes, I am.

14 **EXECUTIVE SUMMARY**

15 Q. Please summarize your rebuttal testimony in this proceeding.

16 A. In this testimony, I will address corrections to my adjustments for  
17 Accumulated Deferred Income Tax (ADIT) for rate base and briefly address Staff’s position on  
18 the inclusion of Net Operating Loss (NOL) in ADIT in response to OPC witness John R. Riley’s  
19 direct testimony. In addition, I will address corrections to my adjustments for the  
20 Current Income Tax calculation and Pensions and Other Post-Employment Benefits (OPEBs).

21 **ACCUMULATED DEFERRED INCOME TAX (ADIT)**

22 Q. What corrections are you sponsoring for ADIT?

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1           A.     I am making two corrections based on technical discussions with  
2 Missouri-American Water Company (MAWC). For the first, I have removed the separately  
3 reported amount I included as Tax Cuts and Jobs Act (TCJA) Excess ADIT in rate base because  
4 that amount is already included in the total ADIT.

5           Q.     What is your second correction for ADIT?

6           A.     I am using a revised June 30, 2020, total ADIT amount that was supplied by  
7 MAWC prior to our direct filing. At that time I did not notice a comment by MAWC that the  
8 actual ADIT amount had changed. The revised total I am including in rate base for ADIT is  
9 \$453,671,105 which is \$2,526,221 higher than the total from Staff's direct filing.

10          Q.     Have you reviewed the direct testimony of the Office of the Public Counsel  
11 Witness John Riley concerning the reflection of Net Operating Losses (NOLs) in ADIT?

12          A.     Yes.

13          Q.     Do you agree with his conclusion that it is wrong for MAWC to recognize NOL  
14 "due to the Company's inability to utilize the interest free money created by the ADIT?"

15          A.     No.

16          Q.     Would you briefly describe what ADIT represents?

17          A.     MAWC's ADIT represents, in effect, a net prepayment of income taxes by  
18 customers prior to tax payment by MAWC. For example, because MAWC is allowed to deduct  
19 depreciation expense on an accelerated basis for income tax purposes, the amount of  
20 depreciation expense used as a deduction for income tax purposes by MAWC is considerably  
21 higher than the amount of depreciation expense used for ratemaking purposes. This results in  
22 what is referred to as a "book-tax timing difference," and creates a deferral of income tax  
23 reserves to the future. The net credit balance in the ADIT accounts reserve represents a source

1 of cost-free funds to MAWC. Therefore, MAWC's rate base is reduced by the ADIT balance  
2 to avoid having customers pay a return on funds that are provided cost-free to MAWC.  
3 Generally, deferred income taxes associated with all book-tax timing differences created  
4 through the ratemaking process should be reflected in rate base.

5 Q. Would you briefly explain what an NOL represents?

6 A. In the Commission's Report and Order issued June 17, 2020, for MAWC's most  
7 recent Infrastructure System Replacement Surcharge (ISRS) case (Case No. WO-2020-0190),  
8 the following Findings of Fact provides a succinct definition for this purpose:

9 "18. The term 'net operating loss' is defined as "the excess of operating expenses  
10 over revenues." An NOL results when a utility does not have enough taxable income to  
11 utilize all of the tax deductions to which it would otherwise be entitled. When this  
12 situation occurs, the amount of the unused deductions is referred to as an NOL and is  
13 booked to a deferred tax asset account."<sup>1</sup>

14 Q. Is it Staff's position that the NOL should be included in MAWC's booked  
15 ADIT balance for rate base?

16 A. Yes. Staff also recently presented this position in its initial brief for the Liberty  
17 Utilities' Empire District Electric (Empire) rate case, Case No. ER-2019-0374.

18 Q. Would you summarize Staff's position in that case?

19 A. As described above, an ADIT is mean to offset tax liability and generate "cost-  
20 free funds." But, to the extent a utility's taxable income becomes negative due to eligibility of  
21 large tax deductions, including bonus depreciation, there is no amount of income tax liability  
22 available for the excess deductions to offset and, therefore, no "cost-free funds" for the utility

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<sup>1</sup> WO-2020-0190, Report and Order, P. 6

1 are generated associated with that excess amount. In this situation, the utility must record an  
2 offsetting deferred tax asset for NOL. As mentioned above “[g]enerally, deferred income taxes  
3 associated with all book-tax timing differences created through the ratemaking process should  
4 be reflected in rate base.” This includes recognition of a deferred tax asset for NOLs when an  
5 NOL situation arises for a regulated utility.

6 Q. Did the Commission rule in favor of Staff’s position on this issue in Case  
7 No. ER-2019-0374?

8 A. Yes. The Commission’s Amended Report and Order issued on July 23, 2020,  
9 in its decision on this issue states “The Commission finds that Empire’s booked accumulated  
10 deferred federal income tax should include a reduction for the NOL.”<sup>2</sup>

11 Q. Is there any reason the Commission should treat MAWC’s NOL any different  
12 than Empire’s NOL?

13 A. No. The rationale for MAWC’s NOL situation is the same as Empire’s,  
14 primarily due to the impact of past excess accelerated depreciation book-tax timing deduction  
15 amounts on MAWC’s taxable income calculations in prior years.

16 Q. Do you expect MAWC’s NOL to reduce into the future?

17 A. Yes. Although the Tax Cut and Jobs Act (TCJA) eliminated the bonus  
18 depreciation that contributed to the NOL amounts effective January 1, 2018, MAWC can and  
19 has offset its taxable income for the tax years 2018 forward by the amount of previously  
20 recorded NOLs, and thereby can continue to calculate a zero amount of taxable income for as  
21 long as its NOL balance remains. However, it should be noted that the balance of the  
22 NOL deferred tax balance is reduced each tax year by the amount that was applied to offset that

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<sup>2</sup> ER-2019-0374, Amended Report and Order, P. 101.

1 year's utility taxable income, until such time that the balance is reduced to zero. As MAWC  
2 still has a remaining amount of NOL on its books recorded as a deferred tax asset during the  
3 pendency of this rate case, it remains appropriate to include the NOL deferred tax asset in rate  
4 base  
5 at this time.

6 Q. Does the total ADIT amount you are including for rate base in this rate case  
7 include an amount for NOLs?

8 A. Yes. The total ADIT is inclusive of a \$25,119,559 reduction for the NOL.

9 **CURRENT INCOME TAX**

10 Q. What correction are you sponsoring for Current Income Tax?

11 A. The Internal Revenue Service (IRS) tax code allows businesses under certain  
12 conditions to treat as repair expense for tax purposes qualifying outlays that are capitalized to  
13 plant-in-service for book purposes. On this basis, MAWC has chosen to take an immediate  
14 deduction for repairs expense on its tax returns in lieu of later reflection of those amounts on  
15 its returns through tax depreciation deductions. I did not include a deduction for repairs expense  
16 in the income tax calculation for Staff's direct filing, but I am adding it to our rebuttal filing.  
17 I am including it as an additional item under Subtractions from Operating Income Before Taxes  
18 on Accounting Schedule 11, Income Taxes.

19 **PENSIONS AND OPEBS**

20 Q. What corrections are you sponsoring for Pensions and OPEBs?

21 A. I am making corrections based on ongoing discussions with MAWC.  
22 For pension and OPEBs trackers, I updated the start of the stipulated expense and amortization  
23 calculations from May 2018 to June 2018, because the effective date of the order in Case No.

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1 | WR-2017-0285 was May 28, 2018, and starting in May calculated a full month of expense for  
2 | a month in which the order was in effect for only four (4) days. As a result, I also updated the  
3 | pension and OPEBs expenses because the monthly expense amortization changed as a result in  
4 | the updates to the trackers.

5 | Q. Does this conclude your rebuttal testimony in this case?

6 | A. Yes it does.

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

In the Matter of Missouri-American Water )  
Company's Request for Authority to )  
Implement General Rate Increase for Water )      Case No. WR-2020-0344  
and Sewer Service Provided in Missouri )  
Service Areas )

**AFFIDAVIT OF KEITH D. FOSTER**

STATE OF MISSOURI      )  
  )  
COUNTY OF COLE      )      ss.

**COME NOW KEITH D. FOSTER** and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Rebuttal Testimony of Keith D. Foster*; and that the same is true and correct according to his best knowledge and belief, under penalty of perjury.

Further the Affiants sayeth not.

*/s/ Keith D. Foster*  
\_\_\_\_\_ )  
**KEITH D. FOSTER**