

**IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE**

IN RE:

**PETITION OF TENNESSEE AMERICAN
WATER COMPANY REGARDING THE
2016 INVESTMENT AND RELATED
EXPENSES UNDER THE QUALIFIED
INFRASTRUCTURE INVESTMENT
PROGRAM RIDER, THE ECONOMIC
DEVELOPMENT INVESTMENT RIDER,
AND THE SAFETY AND ENVIRONMENTAL
COMPLIANCE RIDER**

Docket No. 17-00124

AFFIDAVIT

I, David N. Dittemore, Financial Analyst, on behalf of the Consumer Advocate Division of the Office of the Tennessee Attorney General Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Protection and Advocate Division.




DAVID N. DITTEMORE

Sworn to and subscribed before me this 21st day of Feb., 2018.


NOTARY PUBLIC

My commission expires: May 6, 2019

1 **Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION**
2 **FOR THE RECORD.**

3 **A1.** My name is David N. Dittmore. My business address is Office of the Tennessee
4 Attorney General, UBS Tower, 315 Deaderick Street, Nashville, TN 37243. I am a
5 Financial Analyst employed by the Consumer Protection and Advocate Division of the
6 Office of the Tennessee Attorney General (Consumer Advocate).

7 **Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND**
8 **PROFESSIONAL EXPERIENCE.**

9 **A2.** I received a Bachelor of Science Degree in Business Administration from the University
10 of Central Missouri in 1982. I am a Certified Public Accountant licensed in the state of
11 Oklahoma (#7562). I was previously employed by the Kansas Corporation Commission
12 (KCC) in various capacities, including Managing Auditor, Chief Auditor, and Director
13 of the Utilities Division. For approximately four years, I was self-employed as a Utility
14 Regulatory Consultant representing primarily the KCC Staff in regulatory issues. I also
15 participated in proceedings in Georgia and Vermont, evaluating issues involving
16 electricity and telecommunications regulatory issues. Additionally, I performed a
17 consulting engagement for Kansas Gas Service (KGS), my subsequent employer during
18 this time frame. For eleven years I served as Manager and subsequently Director of
19 Regulatory Affairs for KGS, the largest natural gas utility in Kansas serving
20 approximately 625,000 customers. KGS is a division of ONE Gas, a natural gas utility
21 serving approximately two million customers in Kansas, Oklahoma and Texas. I joined
22 the Office of the Tennessee Attorney General in September, 2017 as a Financial

Analyst. Overall, I have thirty years' experience in the field of public utility regulation. I have presented testimony as an expert witness on numerous occasions. Attached as Exhibit 1 is a detailed vitae of my background.

Q3. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION?

A3. Yes, I have filed testimony in TPUC Docket Nos. 17-00014 and 17-00108.

Q4. ON WHOSE BEHALF ARE YOU TESTIFYING?

A4. I am testifying on behalf of the Consumer Advocate.

Q5. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A5. The purpose of my testimony is to:

a) Identify a deficiency and recommend a modification to the manner in which Tennessee American Water Company (TAWC) calculates its Accumulated Deferred Income Tax (ADIT) balances within its Capital Recover Riders (CRR); and

b) Recommend TPUC indicate that tax savings related to the Capital Rider accruing from the recent tax legislation, be included in the next TAWC true-up filing effective as of January 1, 2018 rather than the effective date of the CRR tariff in this Docket (Rider Filing).

Q6. PLEASE BEGIN BY PROVIDING A BASIC DEFINITION OF ADIT.

A6. ADIT liabilities are recorded to reflect the timing differences between the recognition of book and tax income. Financial books are based upon Generally Accepted Accounting Principles (GAAP). Income tax expense included in the ratemaking formula is recorded in a similar manner to that required for GAAP. However, federal income

1 tax payments are based upon the determination of taxable income. The ADIT account
2 captures these differences. The liability balance of the account reflects taxes that have
3 been recognized for financial reporting purposes, but which have yet to be paid. For a
4 regulated utility, this liability represents customer contributed funds and is reflected as
5 zero cost capital in the ratemaking calculation¹.

6 **ADIT BALANCE**

7 **Q7. PLEASE DISCUSS YOUR CONCERN WITH THE TAWC ADIT**
8 **CALCULATION.**

9 **A7.** I noted that the ADIT balances used to reduce Rate Base within the Rider Filing were
10 surprisingly low, raising concerns that Rate Base may be overstated. In response to
11 CPAD Discovery Request #1-16, TAWC confirmed that the tax depreciation calculated
12 within the Rider Filing differed from the tax depreciation actually reflected within the
13 Company's tax return. TAWC acknowledged that it incorporated Bonus Depreciation
14 within its tax returns. A review of its tax calculations within the Rider indicates the use
15 of standard tax depreciation rates, which may range from less than two percent to thirty-
16 two percent depending upon the life of the asset. In other words, TAWC did not reflect
17 Bonus Depreciation in calculating its ADIT balance.

18 **Q8. SHOULD THE TAX DEPRECIATION REFLECTED WITHIN THE RIDER**
19 **FILINGS BE IDENTICAL TO THE CORRESPONDING TAX DEPRECIATION**
20 **INCLUDED IN THE TAX RETURN FOR THE ASSETS IN QUESTION?**

¹ Most state regulatory agencies, including the TPUC, recognize the ADIT liability as a reduction to Rate Base. It also may be reflected as zero cost capital within the capital structure, but this regulatory option may be problematic.

1 **A8.** Yes. It is important that the tax depreciation amounts in the CRR filing match the tax
2 depreciation rates used within the tax return. Otherwise, the CRR ADIT and Rate Base
3 balances will be misstated.

4 **Q9. WHAT IS THE RATE OF BONUS DEPRECIATION THAT IS AVAILABLE**
5 **DURING THE 2013 – 2017 TIME FRAME?**

6 **A9.** Bonus depreciation equal to fifty percent of the cost of the asset was available for those
7 assets placed in service during the 2013 – 2017 time period. As a result of the new tax
8 act, bonus depreciation is no longer available for utility assets placed in service
9 subsequent to January 1, 2018.

10 **Q10. DID TAWC PROVIDE AN EXPLANATION WHY IT DID NOT REFLECT**
11 **BONUS DEPRECIATION WITHIN THE RIDER CALCULATION?**

12 **A10.** Yes. The Company's response included the following:

13 However, the company has been in a Net Operating Loss (NOL)
14 position dating back to 2008. Pursuant to the tax normalization rule
15 the ADIT liability for claiming bonus would need to be offset by the
16 ADIT asset for the incremental impact in the NOL resulting from
17 claiming bonus (depreciation)².

18 **Q11. DO YOU HAVE A RESPONSE TO THIS STATEMENT?**

² See CPAD Discovery Response #1-16.

1 **A11.** Yes. I agree with the Company's statement that the NOL³ is a factor that would need
2 to be considered as it would likely increasing Rate Base. However, this issue should
3 not simply be dismissed because some portion of the NOL would need to be considered.
4 Instead, consistent with standard NARUC utility accounting principles, TAWC should
5 be required to calculate the ADIT incorporating bonus depreciation, and assign an
6 appropriate NOL asset to the Riders based upon the amount and composition of the
7 TAWC taxable income for the periods in question. The blanket statement that the NOL
8 would come into play does not provide the necessary information to identify the
9 appropriate amount of NOL that would be offset against a correct ADIT balance. While
10 I found the TAWC model used to calculate the CRR revenue requirement to be quite
11 sophisticated, the calculation of ADIT is an area of concern. I cannot state whether the
12 net ADIT (net of any appropriate NOL balance) included in the Riders is overstated or
13 understated, but I do know it is not accurate and should be corrected.

14 **Q12. DO YOU HAVE A HYPOTHETICAL EXAMPLE OF WHAT THE ADIT**
15 **BALANCE WOULD BE FOR AN ASSET SUBJECT TO BONUS**
16 **DEPRECIATION VERSUS THE ADIT BALANCE BASED UPON THE**
17 **METHODOLOGY OF TAWC?**

18 **A12.** Yes. I reviewed the Structures and General Improvements Account, one of the larger
19 accounts within the CRR proposal. The table below provides an example of the impact
20 on the gross ADIT balance from the TAWC practice of ignoring bonus depreciation.

³ An NOL represents a tax loss; *i.e.* tax deductions are greater than taxable income. From a ratemaking standpoint qualifying NOL is an offset to the ADIT in arriving at the net Rate Base, therefore to the extent the increases Rate Base, while the ADIT reduces Rate Base. Qualifying or protected NOL is that portion of the tax loss attributed to property.

This example is somewhat simplistic in that I have assumed all of the investment occurred within one year, which likely was not the case⁴. However, this assumption in my view does not materially change the point made that by ignoring bonus depreciation, the gross ADIT balance will be materially misstated.

Table 1

Impact of Bonus Depreciation on ADIT year 1			
Asset Cost: \$9,103,923			
	Structures and Improvements General		
	Bonus Depreciation	TAWC Tax Depreciation	
Depreciation Rates	50%	2.5640%	A/
Tax Depreciation	4,551,962	233,425	
Less: Book Depreciation @1.13%	(102,874)	(102,874)	
Book/Tax Differences	4,449,087	130,550	
Effective Tax Rate - historic	39.225%	39.225%	
ADIT Balance	1,745,154	51,208	
ADIT Difference	1,693,946		
A/ - Tax Depreciation in Year 2; Year 1 tax depreciation @ 1.282%			

The Rate Base offset of nearly \$1.7 million is what I would expect to see in the ADIT account, if such expenditures were made all in one year. To the extent TAWC (not the parent, American Water Company) had a net operating loss that was partially, or totally,

⁴ This assumption does not have a material effect on the conclusion that an incorrect assignment of the tax rate may have a material impact on the CRR Rate Base.

the result of tax depreciation on CRR property, there would be a reduction⁵ in this gross ADIT in arriving at the net Rate Base impact. The analysis of the NOL and the corresponding impact of property tax depreciation on the loss needs to be analyzed by year, in order to identify the appropriate level of NOL to include in the Rider Rate Base.

Q13. WHAT IS YOUR RECOMMENDATION REGARDING THE TAX DEPRECIATION RATE ISSUE?

A13. I recommend the true-up calculations for the Riders include the calculation of tax depreciation rates consistent with what was actually utilized on the TAWC tax return, attributed to its Tennessee operations. This issue should be addressed in the subsequent Rider true-up filing.

TAX SAVINGS ACCRUING FROM JANUARY 1, 2018

Q14. TURN TO THE ISSUE OF INCOME TAXES AND PROVIDE A BRIEF OVERVIEW OF THE RECENTLY PASSED TAX LEGISLATION.

A14. The Tax Cut and Jobs Act (TCJA) was signed into law on December 22, 2017. The legislation impacts utilities costs in several ways, including:

- a. Reducing the federal income tax rate from a maximum graduated rate of 35% to a flat rate of 21%.
- b. Accumulated Federal Tax Liabilities and Deferred Tax assets previously measured using the 35% rate will be re-measured to reflect the 21% rate. The result of this re-measurement process is that a significant balance of liabilities representing funds provided by ratepayers to utilities for taxes to be paid in the future, are cancelled. The net liabilities eliminated as a result of the reduction

⁵ Depending upon the amount of NOL, the amount of NOL that corresponds to property related losses, and the amount of that property loss attributed to the Riders in question, it is possible that the NOL asset may be equal to the ADIT liability.

1 in the tax rate (Excess Accumulated Deferred Income Taxes, or ADIT) represent
2 ratepayer provided capital and should be returned to ratepayers.

3 c. The TCJA requires that the portion of such excess ADIT attributed to book and
4 tax timing differences on property shall be flowed back to ratepayers using the
5 Average Rate Adjustment Method (ARAM). This method essentially flows
6 back the tax over-payments over the lives of the assets giving rise to the deferred
7 liability.

8 d. Excess ADIT attributed to accounting (book) and tax timing differences on items
9 other than property may be flowed back to ratepayers over a period that is
10 determined at the discretion of state regulators⁶.

11 **Q15. HAS TAWC PROPERLY REFLECTED THE REDUCTION IN THE TAX**
12 **RATE FROM 35% TO 21% WITHIN THIS FILING?**

13 **A15.** Yes, TAWC has properly reflected the change in the tax rate on a prospective basis.

14 **Q16. HAS TAWC RE-MEASURED ITS ADIT TO DETERMINE THE EXCESS AND**
15 **REFLECTED ANY PORTION OF THIS BALANCE AS AN AMORTIZATION**
16 **TO CREDIT BACK TO THE RIDER REVENUE REQUIREMENT?**

17 **A16.** No. However, my review of Ms. Linda Bridwell's Direct Testimony (Bridwell Direct
18 Testimony) indicates TAWC agrees conceptually that excess ADIT associated with the
19 Capital Recovery Riders should accrue to the benefit of ratepayers⁷. The calculation
20 necessary to comply with Internal Revenue Service requirements on how the excess
21 may be amortized into utility revenue requirements is complex. I do not question her
22 statement that such calculations were not available to incorporate into this Rider Filing,

⁶ There are other provisions that of the TCJA that impact utilities, but I will not go into those details as they are not as significant and do not impact the current CRR Filing.

⁷ One area of concern is with Ms. Bridwell's statement that TAWC may not be able to comply with the TPUC Order in Docket No. 18-0001 for a number of months. Bridwell Direct Testimony, P. 3, lines 15-18.

1 however such information should be filed within Docket No. 18-0001 by the deadline
2 established by TPUC.

3 **Q17. WHAT IS YOUR RECOMMENDATION IN THIS DOCKET REGARDING**
4 **THE IMPLICATIONS OF THE TCJA ON THE CRR FILING?**

5 **A17.** I recommend the following two points be identified in the TPUC order within this
6 Docket:

- 7 a. The reduced federal corporate tax rate of 21% shall be incorporated in the CRR
8 true-up filing effective as of January 1, 2018, rather than the effective date of
9 the new CRR rates in this Docket.
- 10 b. TAWC shall be required to preserve excess ADIT on its books associated with
11 the CRR. This would clarify that all excess ADIT should be preserved for future
12 ratemaking proceedings, not simply that excess ADIT associated with base rates.
13

14 I believe these recommendations are not controversial, but nonetheless out of caution, I
15 recommend these statements be included within the TPUC order. Confirming these
16 points in the TPUC order should reduce confusion and controversy in future CRR
17 filings.

18 **Q18. HAVE YOU READ THE TPUC ORDER IN DOCKET NO. 18-00001?**

19 **A18.** Yes.

20 **Q19. DO YOU BELIEVE YOUR RECOMMENDATIONS ARE CONSISTENT WITH**
21 **THE INTENT OF THE COMMISSION'S ORDER IN DOCKET NO. 18-00001?**

22 **A19.** Yes, I believe they are.

1 **Q20. WHAT IS THE BASIS FOR YOUR RECOMMENDATIONS?**

2 **A20.** The reduction in the tax rate is a material change in the utility's revenue requirement. If
3 corporate tax rates were increasing I would expect utilities to promptly seek to either
4 change rates or request an accounting order, effective with the date of the tax change,
5 to prevent such unavoidable cost increases from reducing operating margins. Ratepayers
6 reimburse utilities for their prudently incurred costs through the ratemaking process.
7 Since the costs in question are very material, ratepayers should receive the benefits of
8 the cost reductions, accruing as of the date the new tax rates became effective.

9 **Q21. DOES THIS CONCLUDE YOUR TESTIMONY?**

10 **A21.** Yes.

David Dittimore

Experience

Areas of Specialization

Approximately thirty-year experience in evaluating and preparing regulatory analysis, including revenue requirements, mergers and acquisitions, utility accounting and finance issues and public policy aspects of utility regulation. Presented testimony on behalf of my employers and clients in natural gas, electric, telecommunication and transportation matters covering a variety of issues.

Tennessee Attorney General's Office; **Financial Analyst September, 2017 – Current**

Responsible for evaluation of utility proposals on behalf of the Attorney General's office including water, wastewater and natural gas utility filings. Prepare analysis and expert witness testimony documenting findings and recommendations.

Kansas Gas Service; **Director Regulatory Affairs 2014 – 2017; Manager Regulatory Affairs, 2007 - 2014**

Responsible for directing the regulatory activity of Kansas Gas Service (KGS), a division of ONE Gas, serving approximately 625,000 customers throughout central and eastern Kansas. In this capacity I have formulated strategic regulatory objectives for KGS, formulated strategic legislative options for KGS and led a Kansas inter-utility task force to discuss those options, participated in ONE Gas financial planning meetings, hired and trained new employees and provided recommendations on operational procedures designed to reduce regulatory risk. Responsible for the overall management and processing of base rate cases (2012 and 2016). I also played an active role, including leading negotiations on behalf of ONE Gas in its Separation application from its former parent, ONEOK, before the Kansas Corporation Commission. I have monitored regulatory earnings, and continually determine potential ratemaking outcomes in the event of a rate case filing. I ensure that all required regulatory filings, including surcharges are submitted on a timely and accurate basis. I also am responsible for monitoring all electric utility rate filings to evaluate competitive impacts from rate design proposals.

Strategic Regulatory Solutions; 2003 -2007

Principal; Serving clients regarding revenue requirement and regulatory policy issues in the natural gas, electric and telecommunication sectors

Williams Energy Marketing and Trading; 2000-2003

Manager Regulatory Affairs; Monitored and researched a variety of state and federal electric regulatory issues. Participated in due diligence efforts in targeting investor owned electric utilities for full requirement power contracts. Researched key state and federal rules to identify potential advantages/disadvantages of entering a given market.

MCI WorldCom; 1999 - 2000

Manager, Wholesale Billing Resolution; Manage a group of professionals responsible for resolving Wholesale Billing Disputes greater than \$50K. During my tenure, completed disputes increased by over 100%, rising to \$150M per year.

Kansas Corporation Commission; 1984- 1999

Utilities Division Director - 1997 - 1999; Responsible for managing employees with the goal of providing timely, quality recommendations to the Commission covering all aspects of natural gas, telecommunications and electric utility regulation; respond to legislative inquiries as requested; sponsor expert witness testimony before the Commission on selected key regulatory issues; provide testimony before the Kansas legislature on behalf of the KCC regarding proposed utility legislation; manage a budget in excess of \$2 Million; recruit professional staff; monitor trends, current issues and new legislation in all three major industries; address personnel issues as necessary to ensure that the goals of the agency are being met; negotiate and reach agreement where possible with utility personnel on major issues pending before the Commission including mergers and acquisitions; consult with attorneys on a daily basis to ensure that Utilities Division objectives are being met.

Asst. Division Director - 1996 - 1997; Perform duties as assigned by Division Director.

Chief of Accounting 1990 - 1995; Responsible for the direct supervision of 9 employees within the accounting section; areas of responsibility included providing expert witness testimony on a variety of revenue requirement topics; hired and provided hands-on training for new employees; coordinated and managed consulting contracts on major staff projects such as merger requests and rate increase proposals;

Managing Regulatory Auditor, Senior Auditor, Regulatory Auditor 1984 - 1990; Performed audits and analysis as directed; provided expert witness testimony on numerous occasions before the KCC; trained and directed less experienced auditors on-site during regulatory reviews.

Amoco Production Company 1982 - 1984

Accountant Responsible for revenue reporting and royalty payments for natural gas liquids at several large processing plants.

Education

- B.S.B.A. (Accounting) Central Missouri State University
- Passed CPA exam; (Oklahoma certificate # 7562) – Not a license to practice

Board Member, Financial Research Institute – 2007 - 2017