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IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
TENNESSEE AMERICAN WATER COMPANY'S RESPONSE TO COMMISSION'S INVESTIGATION OF IMPACTS OF FEDERAL TAX REFORM ON THE PUBLIC UTILITY REVENUE REQUIREMENTS	)	**DOCKET NO. 18-00039**
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DIRECT TESTIMONY

OF

DAVID N. DITTEMORE

November 21, 2019

IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE

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TENNESSEE AMERICAN WATER COMPANY'S RESPONSE TO COMMISSION'S INVESTIGATION OF IMPACTS OF FEDERL TAX REFORM ON THE PUBLIC UTILITY REVENUE REQUIREMENTS	)	**DOCKET NO. 18-00039**
	)	
	)	

AFFIDAVIT

I, __David N. Dittemore__, on behalf of the Consumer Advocate Unit of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Unit.

David N. Dittemore
DAVID N. DITTEMORE

Sworn to and subscribed before me
this 21st day of November, 2019.

Tiffany M Blackman
NOTARY PUBLIC

My commission expires: March 22, 2023

TIFFANY H. BLACKMAN STATE OF TENNESSEE NOTARY PUBLIC WILSON COUNTY My Commission Expires MAR. 22, 2023

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

A1. My name is David N. Dittemore. My business address is Office of the Tennessee Attorney General, War Memorial Building, 301 6th Ave. North, Nashville, TN 37243. I am a Financial Analyst employed by the Consumer Advocate Unit in the Financial Division of the Tennessee Attorney General's Office (Consumer Advocate).

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

A2. I received a Bachelor of Science Degree in Business Administration from the University of Central Missouri in 1982. I am a Certified Public Accountant licensed in the state of Oklahoma (#7562). I was previously employed by the Kansas Corporation Commission (KCC) in various capacities, including Managing Auditor, Chief Auditor, and Director of the Utilities Division. For approximately four years, I was self-employed as a Utility Regulatory Consultant representing primarily the KCC Staff in regulatory issues. I also participated in proceedings in Georgia and Vermont, evaluating issues involving electricity and telecommunications regulatory matters. Additionally, I performed a consulting engagement for Kansas Gas Service (KGS), my subsequent employer during this time frame. For eleven years I served as Manager and subsequently Director of Regulatory Affairs for KGS, the largest natural gas utility in Kansas serving approximately 625,000 customers. KGS is a division of ONE Gas, a natural gas utility serving approximately two million customers in Kansas, Oklahoma and Texas. I joined the Tennessee Attorney General's Office 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 many occasions. Attached as Exhibit DND-1 is a detailed overview of my background.

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

A3. Yes. I have submitted testimony in a number of dockets before TPUC, including several Capital Riders dockets.

Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A4. The purpose of my testimony is to present the Consumer Advocate's position on Phase 2 issues within Docket No. 18-00039 related to addressing impacts of the Tax Cut and Jobs Act (TCJA) on utility revenue requirements. Phase 1 of this docket was resolved by the Commission within an Order issued October 25, 2019, adopting a Settlement Agreement among the parties. The entire set of TCJA issues could not be addressed simultaneously (on a timely basis) due to the Company's assertion that necessary information was not available until mid-2019.[1]

Q5. IDENTIFY THE ISSUES RESOLVED IN PHASE 1

A5. Phase 1 addressed the issue of how Income Tax Expense savings associated with base rates (Base Rate Tax Savings) should be addressed as well as the appropriate treatment of deferred tax savings accruing for the period January 1, 2018 through August 31, 2019. The amount of Income Tax Expense savings associated with the Company's Capital Recovery Riders has been passed through to ratepayers within the Rider calculations.[2]

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[1] *See Pre-Filed Testimony of John R. Wilde*, pp. 7-8, TPUC Docket No. 18-00039, (April 4, 2018).

[2] Stipulation and Settlement Agreement Regarding Phase One Issues, p.4, TPUC Docket No. 18-00039, (July 24, 2019).

Q6. WHAT ISSUES ARE BEFORE THE COMMISSION IN THIS PHASE 2 DOCKET?

A6. The issue before the Commission in this Docket relates to the appropriate treatment of Excess Accumulated Deferred Income Taxes (EADIT). The balance of Accumulated Deferred Income Taxes represents income taxes that have been funded by ratepayers but which the Company will, in theory, pay to the federal and state governments at some point in the future. These customer-provided funds partially finance rate base since they reduce the amount of funds necessarily provided by the Company. The reduction in the tax rate effectively cancels a portion of these future tax payments. The reduction in these future tax obligations is referred to as EADIT, since the funds are no longer required to pay future taxes.

Q7. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS DOCKET.

A7. My recommendations in this docket are as follows:

- I agree with the Company's determination of its EADIT (Net $16,843,171). Of this balance, $5,045,921 is represented by the Repairs Deductions.
- Notwithstanding the caveats below, I agree with the application of the Average Rate Assumption Method (ARAM) resulting in 2018 and 2019 EADIT amortizations of $660,206 and $692,017 (both gross of tax) respectively. These balances, plus the gross-of-tax 2020 ARAM amortization of EADIT, should be reflected as EADIT to the next TAWC Capital Riders filing.
- At this time, I am not contesting the Company's position that the language in the Consent Agreement[3] requires that TAWC's Repairs Deduction should be normalized.

[3] *See* Supplemental Testimony of John Wilde, pgs. 6-9, TPUC Docket No. 18-00039 (September 16, 2019).

However, I also believe that as a general proposition, the Repairs Deduction is considered Unprotected EADIT for utilities. I believe the IRS may provide some clarity on this issue through its response to Notice 2019-33 or through the issuance of a Private Letter Ruling (PLR).[4]

- If the IRS issues guidance in Notice 2019-33 or concludes that the Repairs Deduction for American Water Company is Unprotected in a PLR, the Commission should initiate a subsequent proceeding to determine the appropriate amortization of the remaining portion of EADIT associated with the Repairs Deduction.
- The Commission should order the Company to update this Docket upon receipt of 1) a response to a PLR submitted on behalf of Indiana-American Water Company or any notification from the IRS that it will not respond to the PLR submitted by Indiana-American Water Company and 2) guidance issued by the IRS in Notice 2019-33.
- The recommendations above are consistent with the provisions of the Settlement Agreement entered between the Consumer Advocate and Atmos in Docket No. 18-00034.

Q8. BEGIN WITH A SUMMARY OF YOUR REVIEW OF THE COMPANY'S DETERMINATION OF ITS EADIT.

A8. I issued discovery to evaluate the balance of EADIT identified in Mr. Wilde's testimony. Based upon this review, I believe the total EADIT identified by the Company is appropriate. Notwithstanding the classification of the Repairs Deduction, I found the

[4] IRS 2019-33 is attached as DND-3.

classification[5] of the book/tax timing differences comprising the EADIT balance between Protected and Unprotected to be reasonable.[6]

Q9. WHAT IS THE RESULTING AMORTIZATION OF 2018 AND 2019 EXCESS ADIT?

A9. Based upon the total net EADIT of $16,843,171, the resulting amortization using the ARAM methodology for 2018 and 2019 is $660,206 and $692,017 (both gross of tax), respectively.

Q10. HOW SHOULD THESE AMORTIZATIONS BE FLOWED BACK TO RATEPAYERS?

A10. The two amounts referenced above, plus the 2020 amortization, should be credited to customers within the Company's Docket No.19-00105 Capital Riders filing.

CLASSIFICATION OF THE REPAIR DEDUCTION AS PROTECTED

Q11. WHAT IS THE REPAIRS DEDUCTION?

A11. The Repairs Deduction is permitted under IRC Section 162 and allows utilities to deduct one hundred percent of certain costs as incurred in computing taxable income. These costs are capitalized as plant in service for financial reporting purposes and included in Rate Base for ratemaking purposes.

Q12. HOW DOES THE REPAIR DEDUCTION IMPACT THIS DOCKET?

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[5] The Company has acknowledged uncertainty regarding the Protected/Unprotected classification of the book/tax timing differences associated with Cost of Removal; however, I have not taken issue with this classification to be consistent with the classification adopted in TPUC Docket No. 18-00034 concerning Atmos. This should not bar a further review of this classification in future dockets.

[6] For more discussion concerning the distinction between Protected and Unprotected ADIT, refer to page 12 of John Wilde's Pre-filed Supplemental Testimony (TPUC Docket No. 18-00039).

A12. There are two types of EADIT: Protected and Unprotected. "Protected" excess ADIT relates to book and tax timing differences associated with Depreciation Expense. The tax code requires that for ratemaking purposes the lower depreciation expense, relying upon lower regulatory-determined depreciation rates, be used within the calculation of Income Tax Expense[7] included in the determination of rates. With respect to ratemaking, the use of a lower book expense within the income tax calculation yields a higher taxable income for ratemaking purposes, resulting in a higher level of Income Tax Expense included in base rates. This calculation contrasts with the calculation of taxable income for federal income tax payment purposes, which permits much higher depreciation rates and historically permitted Bonus Depreciation.[8]

The "Unprotected" aspect of EADIT refers to that ADIT whose treatment is not specified within the TCJA. "Unprotected" EADIT is comprised of all other book tax timing differences other than Depreciation, notwithstanding the unique language of the Company's consent decree referenced in Mr. Wilde's testimony.

Q13. WHAT IS THE SIGNIFICANCE OF THE PROTECTED AND UNPROTECTED CATEGORIES OF EADIT FOR OUR PURPOSES TODAY?

A13. The language of the TCJA describes how the excess Protected EADIT may be treated in the ratemaking process.[9] The TCJA requires that the balance of the Protected EADIT must be amortized as a reduction to the revenue requirement using the Average Rate Assumption Method (ARAM). If the utility's records are insufficient to use the ARAM method, it must rely upon the Reverse South Georgia Method (RSGM).[10] Both methods result in an amortization of the excess over the life of the assets giving rise to the liability, although the amortization amount will vary year to year with the ARAM methodology, while the annual amortization is constant under the RSGM method.

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[7] IRC § 168 (i)(9).

[8] Bonus Depreciation is no longer available under the TCJA; however, it is still relevant due to its historic impact on balances of ADIT, including excess ADIT, the subject of this docket. https://www.irs.gov/newsroom/new-rules-and-limitations-for-depreciation-and-expensing-under-the-tax-cuts-and-jobs-act

[9] *Tax Cuts and Jobs Act*, Pub. L. No. 115-97,§ 1561(d)(1) (2017).

[10] *Tax Cuts and Jobs Act*, Pub. L. No. 115-97, § 1561 (d)(2)(2017).

The Unprotected EADIT, comprised of all book/tax timing differences other than Depreciation, may be amortized over a period determined at the discretion of the state utility regulatory body.

Q14. DO YOU AGREE WITH THE COMPANY'S CONCLUSION THAT ITS CONSENT AGREEMENT REQUIRES THAT THE REPAIRS DEDUCTION BE TREATED AS PROTECTED?

A14. I believe there is some uncertainty regarding this point. I agree that the 2010 Consent Agreement required the Company's Repairs Deduction to be normalized, translating to a Protected designation. However, there is some question as to whether the provisions of the TCJA (enacted in December 2017) have rendered the provisions of the Consent Agreement moot. The provisions of the TCJA indicate that only plant related book/tax depreciation differences are designated as Protected. As such, Repairs are not depreciation and ,notwithstanding the Consent Agreement, there should be little controversy that the Repairs Deduction is Unprotected and thus available for return to ratepayers over a much shorter period (compared to the results from the implementation of the ARAM).

Q15. HAS THIS ISSUE BEEN ADDRESSED IN OTHER CASES INVOLVING AFFILIATES OF TAWC?

A15. Yes. The appropriate designation of the Repairs Deduction was an issue in a case involving Indiana-American Water Company in Cause 45032 S4 before the Indiana Utility Regulatory Commission (IURC). I have attached a copy of the *Order*, which includes the *Stipulation and Settlement Agreement* of the parties, identified as Exhibit DND-2. In pertinent part, the *Stipulation and Settlement Agreement* contains the following language:

> *The Settling parties further agree that the Company will seek a Private Letter Ruling (PLR) from the Internal Revenue Service (IRS) requesting a determination whether the Commission has the discretion to order an amortization for EADIT related to the Company's repairs deduction that is faster than ARAM. The Settling Parties agree the PLR request is not an opportunity for advocacy for one outcome or another and that the PLR request will be drafted using neutral and unbiased language. The Settling*

Parties will confer on the working of the draft PLR request to objectively frame the issue while adhering to IRS guidelines and requirements (Rev. Proc. 017-1, Part III, Section 7) before the PLR request is submitted to the IRS for resolution. If the IRS requires additional information, the Company shall use reasonable efforts to coordinate any response with the non-Company Settling parties prior to responding to any such request within the confines of the IRS requirements and deadlines. The Company will file notice of the results of the ruling with the Commission and all parties to the tax subdocket within 10 business days of the receipt of the Private Letter Ruling. No Settling Party shall be deemed to have waited any position in any subsequent case as to whether Indiana American may recover the costs it incurs associated with the PLR request. For purposes of permitting the Commission to make the necessary finding consistent with the terms of this Stipulation the Company will waive confidential treatment of (1) the fact of its request for a Private Letter Ruling and (2) the overall results of the ruling. If the IRS issues a Private Letter Ruling that amortization of repairs related EADIT cannot be faster than ARAM without causing a normalization violation, the Settling parties have agreed Indiana American will continue to use the estimate producing annual amortization of $1.7 million for purposes of Step 1 and Step 2 rates in Cause No. 45152 until the Company's next general rate case, at which point the EADIT amortization will be trued up using the actual ARAM calculation. In that event, the Commission shall issue an order to dismiss the tax subdocket proceeding. If the IRS issues a Private Letter Ruling determining that the Commission has discretion to order amortization for EADIT related to the Company's repairs deduction that is faster than ARAM, or otherwise determining that amortization using non-normalized accounting would be appropriate, the Settling Parties agree and hereby request that the Commission establish, by order in the tax subdocket, the appropriate amortization period for such non-normalized EADIT and order the Company to file revised rates to reflect the revised amortization for the non-normalized EADIT along with *the true-up for the actual ARAM calculation for all EADIT required to be normalized.*

On page 7 of its *Order*, the IURC found:

Within 10 business days of receipt of the Private letter Ruling from the IRS, Indiana American shall file the PLR under this Cause. If the IRS determines that this Commission has discretion to determine the amortization period for the EADIT associated with the repairs deduction, Indiana American shall make a request to reopen the record in this proceeding and make any required changes to Indiana American rates consistent with Paragraph No. 5. If the Private Letter Ruling determines that this Commission does not have discretion, all of Indiana American's EADIT shall be normalized pursuant to ARAM, as described herein, and reflect in Paragraph 3(a) of the Settlement.

Q16. WHAT IS THE BALANCE OF THE REPAIRS DEDUCTION AS A PORTION OF THE EADIT?

A16. The balance of EADIT comprised of the Repair Deduction is $5,045,921 as of 2018. In addition, there is an additional ($393,074) in EADIT that the Company has identified as Unprotected.[11] The Company has proposed to net these EADIT assets against liabilities and amortize the net liability using the ARAM methodology. Absent the designation of the Repairs Deduction as Unprotected, I do not suggest amortizing the remaining Unprotected balances over a period other than that computed using the ARAM methodology. However, if the Repair Deduction is eventually determined to be Unprotected, these unamortized debits should be used to offset the EADIT liability balance associated with the Repairs Deduction. This net balance at December 31, 2018 was $4,652,847.

[11] *See* Company's Response to Consumer Advocate Request No. 1-5, Summary Workpaper tab.

Q17. ARE THE ISSUES IDENTIFIED IN THE IURC ORDER AS WELL AS THE STIPULATION AND AGREEMENT IDENTICAL TO THE ISSUE YOU HAVE RAISED REGARDING THE CLASSIFICATION OF THE REPAIR DEDUCTION?

A17. Yes.

Q18. WHAT IS YOUR RECOMMENDATION REGARDING THE CLASSIFICATION OF THE REPAIRS DEDUCTION AND THE RESULTING AMORTIZATION OF EADIT AS PROPOSED BY THE COMPANY?

A18. I recommend the Commission adopt the EADIT balances referenced above as well as the amortization balances for 2018 – 2020 as identified above. These amortizations should be credited to the next TAWC Capital Riders filing. Subsequent years' amortizations should be flowed through to ratepayers either through the Capital Riders or through base rates if such a filing is before the Commission. However, if the IRS addresses the classification of the Repairs Deduction with a finding that it is Unprotected, the Commission should then take up the question of the appropriate regulatory treatment of the unamortized Unprotected EADIT balance, net of the miscellaneous other Unprotected items referenced above.[12] This Docket should remain open until such time as the IRS responds to the Indiana PLR or issues guidance in Notice 2019-33 (discussed below). If the IRS makes a determination that the Repairs Deduction of Indiana-American Water Company is Protected, I recommend that this Docket be closed at that time and the issue of the amortization adopted in this proceeding be considered final. As part of the Final Order in this Docket, the Commission should require the Company to submit in this Docket any pronouncements issued by the IRS either in the form of a response to the Indiana-American Water PLR and/or guidance issued in response to IRS Notice 2019-33.

Q19. YOU ARE RECOMMENDING THE COMMISSION RELY UPON THE RESPONSE TO THE INDIANA PLR. WHY ARE YOU NOT RECOMMENDING THE COMPANY SUBMIT A SPECIFIC PLR ON BEHALF OF TAWC?

[12] The Commission found that the Unprotected EADIT balance of Chattanooga Gas Company should be amortized over a five-year period in Docket No. 18-00017.

A19. The *Order* in the Indiana case and the *Settlement and Stipulation Agreement* reference the identical issue set forth in my testimony. I do not believe there is any incremental value to be obtained by requiring the submission of a duplicative PLR that would result in additional costs to the Company and potentially the IRS. Instead, I recommend that the Commission await the response of either the Indiana PLR, or in the absence of a response, the guidance issued in Notice 2019-33.

Q20. YOU HAVE REFERENCED IRS NOTICE 2019-33. WHAT IS THE SCOPE AND INTENT OF THE NOTICE?

A20. Attached as Exhibit DND-3 is Notice 2019-33 issued by the IRS. As is referenced in the preamble, the purpose is to notify interested parties that the IRS intends to issue guidance under Section 168 of the Code to clarify the normalization requirements for excess tax reserves arising from the TCJA. The Notice also requests comments about ratemaking issues that have arisen or are expected to arise due to the tax rate decrease. I believe an underlying goal of the Notice is to greatly reduce the anticipated number of PLR requests submitted by utilities. I would expect the Notice to address the issue of whether the Repairs Deduction is Protected or Unprotected. I expect that the Company will not necessarily agree that the guidance issued by the Notice will supersede the Company's 2010 Consent Agreement. However, I think the possibility exists that the IRS will not issue a response to the Indiana PLR and will instead simply refer the Company to its eventual response to Notice 2019-33. In the event it is confirmed that a response to the Indiana PLR will not be forthcoming, the Company should submit such a notification to the Commission in this Docket, and the parties should then rely upon any findings by the IRS in the 2019-33 Notice to address the categorization of the Repairs Deduction.

Q21. DID AMERICAN WATER COMPANY (AWC), THE PARENT OF TAWC, SUBMIT COMMENTS IN RESPONSE TO IRS NOTICE 2019-33?

A21. Yes. Attached as Exhibit DND-4 is the response of AWC to the Notice.[13] Likewise, the Tennessee Attorney General's Office provided comments, which are attached as Exhibit DND-5.

Q22. WERE THERE COMMENTS SUBMITTED BY OTHER PARTIES THAT ARE PERTINENT TO THE CLASSIFICATION OF THE REPAIRS DEDUCTION?

A22. Yes. On page 15 of the Joint Comments of the Edison Electric Institute[14] and the American Gas Association[15], the following statement is made:

> ***The difference in the treatment of repairs is a good example of basis differences that do not produce protected deferred taxes.***

This statement is clear that neither of these industry associations believes the Repairs Deduction is Protected under the TCJA.

Q23. HAS THE COMMISSION DEALT WITH THE UNCERTAINTY REGARDING THE CLASSIFICATION OF THE REPAIRS DEDUCTION IN OTHER DOCKETS?

A23. Yes. Atmos argued in Docket No. 18-00034 that due to its inability to use the ARAM methodology, it is required to use the Reverse South Georgia Method (RSGM) to amortize its EADIT. Atmos further argued that an exclusive provision associated with RSGM qualifying utilities is that the Repairs Deduction must be considered Protected EADIT. In an *Order* dated June 24, 2019, the Commission adopted the provisions of a Settlement Agreement[16] finding that "…the docket shall remain open in order to address the outstanding issues which may be addressed subsequent to the IRS's response to Atmos Energy's Private Letter Ruling Request as proposed by the Settlement Agreement."

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[13] Entities submitting comments include: Natural Gas Association of America, Tennessee Attorney General's Office, Virginia State Corporation Commission Staff, Dominion Energy, Northwestern Energy, American Water Works, Utilities Division Staff of the Kansas Corporation Commission, Washington Utilities and Transportation Commission, Master Limited Partnership Association, Joint Comments of Edison Electric Institute of America and American Gas Association.

[14] The Edison Electric Institute is a trade organization representing the interests of investor owned utilities.

[15] The American Gas Association is a trade organization representing U.S. based natural gas distribution companies.

[16] *Order Approving Joint Petition to Approve Stipulation and Settlement Agreement*, p. 9, TPUC Docket No. 18-00034, (June 24, 2019).

In addition, the transcript from Docket No. 18-00034 contains the following comments from Chair Morrison:

> *"Further, I move that the parties are directed to file the Internal Revenue Service's response to Atmos Energy's Private Letter ruling Request in this docket file once it is received and this docket remain open in order to address the outstanding issues which will be addressed subsequent to the IRS response."*[17]

Q24. IS YOUR RECOMMENDATION CONCERNING THE PROCESS FOR DETERMINING THE PROPER CLASSIFICATION OF THE REPAIR DEDUCTION CONSISTENT WITH THE TERMS OF THE SETTLEMENT AGREEMENT ADOPTED BY THE COMMISSION IN DOCKET NO. 18-00034?

A24. Yes.

Q25. DOES THIS CONCLUDE YOUR TESTIMONY?

A25. Yes.

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[17] *Transcript of Commission Conference*, p. 55, TPUC Docket No. 18-00034, (April 15, 2019).

Exhibit DND-1

David Dittemore

Experience

Areas of Specialization
Approximately thirty-years 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.

<u>Education</u>

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

Exhibit DND - 2

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE INDIANA UTILITY REGULATORY COMMISSION'S INVESTIGATION INTO THE IMPACTS OF THE TAX CUTS AND JOBS ACT OF 2017 AND POSSIBLE RATE IMPLICATIONS UNDER PHASE 1 AND PHASE 2 FOR INDIANA AMERICAN WATER COMPANY, INC.	**CAUSE NO. 45032 S4** **APPROVED: JUN 26 2019**

PHASE 2 ORDER OF THE COMMISSION

Presiding Officers:
James F. Huston, Chairman
David E. Veleta, Senior Administrative Law Judge

This Subdocket ("Tax Subdocket") was created by Docket Entry on May 7, 2018, which granted the Petition filed on April 12, 2018, by Indiana American Water Company, Inc. ("Indiana American" or "Company") to create a subdocket. Indiana American filed the Petition when it withdrew its 30-day submission to reduce its rates to reflect the reduction in federal income tax expense from 35% to 21% produced by the Tax Cuts and Jobs Act of 2017 ("TCJA"). Our February 16, 2018 Order in the main docket in this Cause divided the investigation into two phases. Phase 1 of the investigation is complete and we issued an Order in that Phase on July 31, 2018. The purpose of Phase 2 of the investigation was to address all remaining issues not addressed in Phase 1, including: (1) the amount and amortization of normalized and non-normalized excess accumulated deferred income taxes ("EADIT") and regulatory accounting being used by Respondents as required by our January 3, 2018 Order in this Cause for estimated impacts resulting from the TCJA; and (2) the timing and method for how these benefits will be realized by customers, whether directly or indirectly.

The Presiding Officers issued questions to the parties by Docket Entries issued November 28, 2018, and December 6, 2018. The parties respectively filed their answers on November 30, 2018 and December 10, 2018. A public evidentiary hearing in this Cause was held at 9:30 a.m. on December 3, 2018, in Hearing Room 222 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. Indiana American, the Office of Utility Consumer Counselor ("OUCC"), and Intervenors Indiana Industrial Group ("Industrial Group"), United States Steel Corporation ("US Steel"), Town of Schererville, Indiana ("Schererville"), and City of Crown Point, Indiana ("Crown Point"), appeared and participated in the hearing. After the hearing, the parties submitted post-hearing briefings. However, the parties later arrived at a settlement resolving all remaining issues in this Tax Subdocket.

On February 27, 2019, Indiana American, by counsel and on behalf of itself, the OUCC, and Intervenors Industrial Group, US Steel, Schererville, and Crown Point (collectively the "Settling Parties" in this Tax Subdocket), filed a joint motion requesting the Commission to temporarily stay the issuance of a Phase 2 Order and for leave to submit a Stipulation and Settlement Agreement (the "Settlement") and supporting settlement testimony.

On March 18, 2019, Indiana American filed the Settlement, which was reached in connection with this proceeding as well as Indiana American's pending general rate case in Cause No. 45142 ("Rate Case"). A copy of the Settlement is attached hereto as Attachment A. The Settlement, specifically Paragraph 3, addresses all issues remaining in dispute in this Tax Subdocket, including EADIT and the deferred regulatory liability recorded on the Company's books and records as a result of the Commission's January 3, 2018 Order in Cause No. 45032.

The Presiding Officers issued a Docket Entry on March 27, 2019, requesting the parties to provide the date by which the parties believe the request for a Private Letter Ruling ("PLR") will be filed with the Internal Revenue Service ("IRS"). Indiana American filed its response on March 27, 2019.

On March 28, 2019, a settlement hearing was held and the Settlement and supporting testimony were admitted into the record in this Cause.

Based upon applicable law and the evidence presented, the Commission finds:

1. **Notice and Jurisdiction.** Notice of the hearing in this subdocket was given and published by the Commission as required by law. Indiana American is a public utility as defined by Ind. Code§ 8-1-2-1(a). Under Ind. Code § 8-1-2-42, the Commission has jurisdiction over Indiana American's rates and charges for water and wastewater service. The Commission also has jurisdiction to initiate investigations into all matters relating to public utilities under Ind. Code §§ 8-1-2-58, 8-1-2-59, and 8-1-2-68. Accordingly, the Commission has jurisdiction over Indiana American and the subject matter of this subdocket.

2. **Indiana American's Characteristics and Business.** Indiana American is a public utility corporation organized under the laws of the State of Indiana and is engaged in the provision of water utility service to the public in and around numerous communities throughout the State of Indiana. The Company also provides sewer utility service in Wabash, Delaware, and Hamilton Counties. Indiana American has charter power and authority to engage in the business of providing such water and sewer utility service. Indiana American renders such water and sewer utility service by means of utility plant, property, equipment, and related facilities owned, leased, operated, managed, and controlled by it, which are used and useful for the convenience of the public in the production, treatment, transmission, distribution, and sale of water for residential, commercial, industrial, public authority, and sale for resale purposes, for the provision of public and private fire service, and for the provision of sewer service.

3. **Background.** The Settling Parties submitted the Settlement following the evidentiary hearing in Phase 2 of this Subdocket. At that time, there were two remaining issues to be decided: (1) the amount and amortization of normalized and non-normalized EADIT; and (2) how should customers benefit from Indiana American's deferred regulatory liability resulting from the deferred accounting we required per our January 3, 2018 Order in the main docket in this Cause. The first category further divides into two issues – between EADIT that is required to be

normalized under the Internal Revenue Code (commonly referred to as "protected EADIT") and EADIT that need not be normalized ("unprotected EADIT"). Per the Internal Revenue Code, the former must not be returned to customers any more rapidly and to no greater extent than would result under the Average Rate Assumption Method ("ARAM"); for the latter, the ARAM requirement in the Internal Revenue Code does not apply, and we have discretion over the appropriate amortization period. Indiana American proposed that all EADIT be returned using ARAM, based on its EADIT amortization estimate set forth in Indiana American's pending general rate case. As to the "unprotected EADIT," Indiana American's evidentiary position is that the repairs deduction was authorized pursuant to a Consent Agreement American Water Works, Inc. executed with the IRS in 2010 and that the Consent Agreement requires as a precondition that the repairs deduction EADIT be normalized in the same fashion as "protected EADIT." This would mean that EADIT associated with it can be amortized no more quickly and to no greater extent than ARAM. The OUCC and certain Intervenors testified that the Consent Agreement did not contemplate the federal tax rate change in the TCJA and that repairs-related EADIT can be returned to customers over a period determined under this Commission's discretion. The OUCC testified that the repairs deduction is a basis difference and not a method/life difference; therefore, no tax depreciation deductions were claimed on the amounts that were deducted for federal income tax purposes as repairs. As to the second issue, Indiana American's evidentiary position is that the deferred regulatory liability should be used to "accelerate" its lead service line replacement program. The OUCC and certain Intervenors took issue with this proposal and seek to have the deferred regulatory liability refunded to customers, from whom it was originally collected.

4. **Settlement and Supporting Evidence of the Parties.** Gregory D. Shimansky, Director Rates & Regulatory for American Water Works Service Company, provided settlement testimony on behalf of Indiana American. The Settlement resolves all issues in this Tax Subdocket and in Indiana American's pending general rate case. The Settlement is conditioned upon, and the Settling Parties request, Commission approval of Paragraph 3 of the Settlement in this Subdocket, and approval of the remaining provisions of the Settlement in the Rate Case. Mr. Shimansky testified that the parties to the Tax Subdocket have joined in and agreed to be bound by Paragraph 3 of the Settlement, which addresses pending issues in the Tax Subdocket, including: (a) EADIT and (b) deferral of the regulatory liability created as a result of the Commission's January 3, 2018 Order in Cause No. 45032. Mr. Shimansky stated that, for purposes of settlement, the Settling Parties agree the terms and conditions set forth in Paragraph 3 of the Settlement represent a fair and reasonable resolution of the remaining issues in the Tax Subdocket based on the current record. Mr. Shimansky testified that the Settlement is in the public interest and reasonably resolves all issues in the Tax Subdocket. Mr. Shimansky further testified that the Settlement represents the result of arm's-length negotiations by a diverse group of stakeholders with differing views on the issues raised in both cases.

Margaret Stull, Chief Technical Advisor in the Water/Wastewater Division of the OUCC, also provided testimony in support of the Settlement. Ms. Stull testified that the Settlement is in the public interest and generates a number of overall customer benefits, including a substantive reduction to the overall rate increase sought by Indiana American in the Rate Case. She further testified that the Settlement strikes an appropriate balance between the interest of the ratepayer and Indiana American, while also producing numerous customer benefits, which leads the OUCC to conclude the Settlement is an equitable resolution, supported by the evidence, and should be approved.

Mr. Shimansky discussed Paragraph 3(a) of the Settlement, which sets forth the Settling Parties' agreement with respect to the amortization of EADIT. Mr. Shimansky testified that the Settling Parties have agreed that for purposes of Step 1 rates in the Rate Case, the Company will use the EADIT amortization estimate provided in the Company's rebuttal case in the Rate Case, which produces a result that is approximately the same as an estimate using ARAM, for the entirety of Indiana American's EADIT.

Mr. Shimansky further testified that, under Paragraph 3(a), the Settling Parties agree that Indiana American will seek a PLR from the IRS requesting a determination as to whether the Commission has the discretion to order an amortization for EADIT related to Indiana American's repairs deduction that is faster than ARAM. He noted that prior to submission of the PLR, the Settling Parties will confer on the PLR's wording to objectively frame the issue for resolution while adhering to IRS guidelines and requirements. If the IRS requests additional information, the Company has agreed to use reasonable efforts to coordinate any response with the non-Company Settling Parties prior to responding to any such request within the confines of IRS requirements and deadlines. Mr. Shimansky stated that if the IRS issues a PLR that amortization of repairs-related EADIT cannot be faster than ARAM without causing a normalization violation, the Settling Parties have agreed Indiana American will continue to use the estimate producing annual amortization of $1,719,961 for purposes of Step 1 and Step 2 rates in the Rate Case until the Company's next general rate case, at which point the EADIT amortization will be trued up using the actual ARAM calculation.

Mr. Shimansky further stated that if the IRS issues a PLR determining that the Commission has discretion to order amortization for EADIT related to Indiana American's repairs deduction that is faster than ARAM, then the Commission shall establish, by order in the Tax Subdocket, the appropriate amortization period for such non-normalized EADIT and order Indiana American to file revised rates to reflect the revised amortization for the non-normalized EADIT along with the true-up for the actual ARAM calculation for all EADIT required to be normalized. The Company has committed to filing notice of the results of the PLR within 10 business days of receiving it. The Company agreed to waive confidentiality of the results as explained in the Settlement. Mr. Shimansky testified that he believes the agreement in Paragraph 3(a) is a fair and reasonable resolution of the amortization of EADIT issue. Mr. Shimansky further testified that the Settling Parties agree the Commission should not, in either the Rate Case or this Tax Subdocket, come to a decision that could potentially result in the loss of the repairs deduction for federal income tax purposes. The PLR approach allows the Commission to obtain the IRS's interpretation of the Consent Agreement as to whether it has discretion to order an amortization period faster than ARAM.

Ms. Stull also testified regarding the agreement reached by the Settling Parties with respect to the amortization of EADIT. She explained that the Settling Parties agree the PLR request is not an opportunity for advocacy for one outcome or another and that the PLR request will be drafted using neutral and unbiased language. Ms. Stull testified that the Settlement terms reached on the PLR provide a path forward to providing customers with a full EADIT refund that complies with

IRS guidance, while also initiating an EADIT refund based on ARAM so there is no further delay of the customer refund while the PLR is pending.

Mr. Shimansky also described Paragraph 3(b) of the Settlement, which sets forth the Settling Parties' agreement with respect to the balance of Indiana American's deferred regulatory liability created as a result of the Commission's January 3, 2018 Order in Cause No. 45032. For purposes of settlement, the Settling Parties stipulate and agree that the balance shall be flowed to customers as a bill credit commencing with implementation of Step 2 rates in the Rate Case. This bill credit will be credited ratably over a 12-month period, allocated among customer classes in accordance with the allocation methodology used at the time the current rates were approved. Mr. Shimansky testified that he believes the agreement reached in Paragraph 3(b) is a fair and reasonable resolution of the issue. He noted that the agreed upon 12-month period reflects a compromise between the OUCC's proposal to refund the money immediately, and the Industrial Group's proposal to flow it back over a two-year period. Mr. Shimansky further testified that the agreement represents Indiana American's concession in favor of refunding the deferred dollars, as opposed to using them to fund the Company's lead line replacement program as Indiana American originally proposed. In addition, Mr. Shimansky testified that, by starting the bill credit commensurate with the effective date of Step 2 rates, the Step 2 rate increase is mitigated, which was a desire of the other parties.

Ms. Stull further testified regarding the Settling Parties' agreement with respect to the deferred regulatory liability. Ms. Stull testified the Settling Parties' agreement set forth in Paragraph 3(b) generates a customer benefit, as the Settlement provides for a refund of the deferred dollars to customers, as opposed to using the dollars for lead line replacements as Indiana American initially proposed.

Ms. Stull ultimately testified that the tax terms in the Settlement serve the public interest. She testified that the issues at play in Indiana American's Tax Subdocket are interconnected with setting Indiana American's ongoing revenue requirement in Cause No. 45142. She testified that reaching a consolidated resolution, as the Settlement does, is efficient and promotes administrative economy.

5. <u>Commission Discussion and Findings</u>. Settlements presented to the Commission are not ordinary contracts between private parties. *United States Gypsum, Inc. v. Indiana Gas Co.*, 735 N.E.2d 790, 803 (Ind. 2000). When the Commission approves a settlement, that settlement "loses its status as a strictly private contract and takes on a public interest gloss." *Id.* (quoting *Citizens Action Coalition v. PSI Energy*, 664 N.E.2d 401, 406 (Ind. Ct. App. 1996)). Thus, the Commission "may not accept a settlement merely because the private parties are satisfied; rather [the Commission] must consider whether the public interest will be served by accepting the settlement." *Citizens Action Coalition*, 664 N.E.2d at 406.

Furthermore, any Commission decision, ruling, or order, including the approval of a settlement, must be supported by specific findings of fact and sufficient evidence. *United States Gypsum*, 735 N.E.2d at 795 (citing *Citizens Action Coalition v. Public Service Co.*, 582 N.E.2d 330, 331 (Ind. 1991)). The Commission's own procedural rules require that settlements be supported by probative evidence. 170 IAC 1-1.1-17(d). Therefore, before the Commission can approve the Settlement, we must determine whether the evidence in this cause sufficiently supports the conclusions that the Settlement is reasonable, just, and consistent with the purpose of Ind. Code § 8-1-2-1 et seq., and that such agreement serves the public interest.

In this case, the Commission has before it evidence with which to judge the reasonableness of the terms of the Settlement. Both the OUCC and Indiana American presented testimony explaining the Settlement. No party presented testimony challenging the reasonableness of the Settlement.

A. Deferred Regulatory Liability. The deferred regulatory liability of $5,821,888 is comprised of rates and charges collected from Indiana American customers between January 1, 2018, and July 31, 2018, based upon a federal corporate income tax rate of 35% instead of the TCJA's 21% rate. Our January 3, 2018 Order in the main docket in this Cause required Indiana American to record the difference between the 35% and revised 21% federal income tax rates as a regulatory liability. We also established in that Order that the TCJA investigation was initiated "to review and consider the impacts from the Act and how any resulting benefits should be realized by customers."

The deferred regulatory liability, under the terms of the Settlement, will be held static by Indiana American until Step 2 rates are implemented. Specifically, the Parties have agreed to flow back the deferred dollars over a twelve-month period, allocated among customer classes in accordance with the allocation methodology used at the time that the current rates were approved, commencing with the implementation of Step 2 rates. By starting the bill credit with the effective date of Step 2 rates, the Step 2 rate increase will be mitigated, resulting in a more gradual rate increase. The flow-back to customers of the regulatory liability is markedly delayed compared to the vast majority of our orders effecting the realization of this near term related TCJA benefit pursuant to our investigation. Significantly, this term is only a single term in the comprehensive Settlement impacting Indiana American customer's rates and charges and the timing of the related overall changes. Accordingly, while the delay in the realization of the TCJA benefit reflected by the regulatory liability could reasonably call for additional considerations, we find the approach of the Settling Parties is reasonable because Indiana American's customers will benefit from mitigation of the Step 2 rate increase in a more gradual manner through application of the deferred dollars as a bill credit.

We encourage Indiana American to communicate to its customers the return of the deferred regulatory liability as a way to mitigate the Phase 2 rate increase through customer bills or whatever means practicable.

B. EADIT. In the Settlement Agreement, the Parties agreed that Indiana American can use its estimated EADIT that was provided in Indiana American's rebuttal in Cause No. 45142 for purposes of Step 1 rates. The Parties further agreed that Indiana American would seek a PLR from the IRS regarding the proper amortization associated with Indiana American's repairs deductions. Depending on the IRS's determination, Indiana American will either continue to use its estimated EADIT amortization of $1.7 million until its next rate case at which point the EADIT amortization will be trued up using the actual ARAM calculation, or request that the Commission determine the appropriate amortization period for its non-normalized EADIT. Consistent with the Commission's Order in Cause No. 45142, and for the purpose of trying to resolve this long outstanding issue in the most expeditious manner possible, Indiana American shall confer with the other Settling Parties upon the PLR request language, and submit the request for a PLR to the IRS within 30 days of the date of this Order unless otherwise authorized by the Presiding Officers in Cause No. 45142 for good cause.

C. **Conclusion.** Based on the evidence of record, we find that the Settlement represents a reasonable resolution to the issues raised in this proceeding and is in the public interest. The Settlement provides a fair and reasonable approach for ultimately returning the benefits that result from the TCJA to Indiana American's customers.

Finally, the Parties agree that the Settlement should not be used as precedent in any other proceeding or for any other purpose, except to the extent necessary to implement or enforce its terms. Consequently, with regard to future citation of the Settlement, we find that our approval herein should be construed in a manner consistent with our finding in *Richmond Power & Light*, Cause No. 40434, 1997 WL 34880849 at *7-8 (IURC March 19, 1997).

6. Confidentiality. Indiana American filed a motion for protective order showing documents to be filed by the OUCC containing information of Indiana American that the Company deems confidential, proprietary, competitively sensitive and/or trade secret to the Commission pursuant to 170 IAC 1-1.1-4 were to be treated as confidential and protected from disclosure to the public under Ind. Code § 5-14-3-4 and Ind. Code § 8-1-2-29. The Presiding Officers granted Indiana American's Motion in its Docket Entry dated September 4, 2018, finding such information to be preliminarily confidential after which such information was submitted under seal. We find all such information is confidential and is exempt from public access and disclosure by the Commission under Ind. Code § 5-14-3-4 and Ind. Code § 8-1-2-29.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. Paragraph 3 of the Settlement is approved in its entirety.

2. Indiana American shall make its request for a Private Letter Ruling to the Internal Revenue Service within 30 days of the date of this Order unless otherwise authorized by the Presiding Officers in Cause No. 45142 for good cause. Within 10 business days of receipt of the Private Letter Ruling from the IRS, Indiana American shall file the PLR under this Cause. If the IRS determines that this Commission has discretion to determine the amortization period for the EADIT associated with the repairs deduction, Indiana American shall make a request to reopen the record in this proceeding and make any required changes to Indiana American rates consistent with Paragraph No. 5. If the Private Letter Ruling determines that this Commission does not have discretion, all of Indiana American's EADIT shall be normalized pursuant to ARAM, as described herein, and reflected in Paragraph 3(a) of the Settlement.

3. Indiana American is ordered to refund the deferred regulatory liability recorded as a result of our January 3, 2018 Order as a bill credit to customers commencing with implementation of Step 2 rates in the Rate Case ratably over a 12-month period allocated among customer classes in accordance with the allocation methodology used at the time the current rates were approved.

4. The information filed by the OUCC containing confidential, proprietary, competitively sensitive and/or trade secret information of Indiana American in this Cause pursuant to Indiana American's Motion for Protective Order is deemed confidential pursuant to Ind. Code § 5-14-3-4, is exempt from public access and disclosure by Indiana law, and shall be held confidential and protected from public access and disclosure by the Commission.

5. This Order shall be effective on and after the date of its approval.

HUSTON, FREEMAN, OBER, AND ZIEGNER CONCUR; KREVDA ABSENT:

APPROVED: JUN 26 2019

I hereby certify that the above is a true and correct copy of the Order as approved.

Mary M. Becerra

Mary M. Becerra
Secretary of the Commission

Exhibit DND - 2

FILED
March 18, 2019
INDIANA UTILITY
REGULATORY COMMISSION

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA-AMERICAN WATER COMPANY, INC. FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER UTILITY SERVICE, (2) REVIEW OF ITS RATES AND CHARGES FOR WASTEWATER UTILITY SERVICE, (3) APPROVAL OF NEW SCHEDULES OF RATES AND CHARGES APPLICABLE TO WATER AND WASTEWATER UTILITY SERVICE, AND (4) AUTHORITY TO IMPLEMENT A LOW INCOME PILOT PROGRAM.	)	**CAUSE NO. 45142**

STIPULATION AND SETTLEMENT AGREEMENT

Indiana-American Water Company, Inc. ("Indiana American" or "Petitioner"), the Indiana Office of Utility Consumer Counselor ("OUCC"), the Indiana American Industrial Group ("Industrial Group"), City of Crown Point, Town of Schererville, Town of Whiteland, Sullivan-Vigo Rural Water Corporation, Citizens Action Coalition, and Indiana Community Action Association, Inc. (collectively, the "Settling Parties")[1], by their respective counsel, respectfully request that the Indiana Utility Regulatory Commission ("Commission") approve this Stipulation and Settlement Agreement ("Stipulation"). The Settling Parties agree that the terms and conditions set forth below represent a fair and reasonable resolution of the issues described herein, subject to incorporation into a final order of the Commission which approves this Stipulation – both in Cause No. 45032 S4 in the case of the terms set forth in Paragraph 3 below and in Cause 45142 in the case of the remainder of the terms of this Stipulation -- without any modification or condition that is not

[1] The Settling Parties listed are all of the parties to this general rate case proceeding. The Indiana Industrial Group and U.S. Steel are separate parties to the tax subdocket proceeding (Cause No. 45032 S4) and join in and agree to be bound by Paragraph 3 of this Stipulation for purposes of that proceeding.

acceptable to the Settling Parties. The Settling Parties will cooperate to jointly submit to the Commission a form of a proposed order that would approve this Stipulation.

This Stipulation has been reached subsequent to the filing of Indiana American's case-in-chief, the OUCC and other intervenors' respective cases-in-chief, Indiana American's rebuttal evidence, and OUCC and other intervenors' respective cross-answering testimony and evidence in this proceeding. Those filings have framed the discussions among the Settling Parties, and formed the basis for the Settling Parties to reach agreement on the terms reflected in this Stipulation. A basic component of each party's willingness to enter this agreement is the overall result that is achieved hereby. The Settling Parties have agreed to concessions on individual issues to which the Settling Parties would not be willing to agree but for the overall result produced by this Stipulation and Settlement Agreement. In other words, each party is agreeing to forego or compromise on positions on individual issues in exchange for the overall settlement result produced collectively by all of the concessions. As set forth in Appendices A (Pro Forma Income Statement) , B (Revenue Requirement and supporting schedules), and C (Revenue Allocation and Rate Design), the parties have negotiated terms that resolve all issues in this proceeding. The agreed upon adjustments to pro forma results of operations, rate base, and cost of capital are founded upon documented prefiled positions that are in the record in this proceeding. The Settling Parties have agreed that the Company and the OUCC will, and the other Settling Parties may, file Settlement Testimony in support of this Stipulation.

All issues not specifically addressed in the enumerated paragraphs below are as reflected in Appendices A through C attached hereto and incorporated herein by reference.

The Settling Parties stipulate and agree as follows:

1. Rate Increase.

Petitioner shall be authorized to increase its basic rates and charges (collectively "rates") for water service in two steps as described in this Stipulation. Subject to and as adjusted for the Step 1 and Step 2 rate certification set forth in Paragraph 2(d) below, the rates shall be designed to produce, after completion of both steps of implementation, additional annual revenues of $17,500,000. The increase produces total annual operating revenues after Step 2 (total company) of $240,249,127. The stipulated increase produces total net operating income after Step 2 of $74,268,732, which the Parties stipulate is a fair return on the fair value of Petitioner's rate base for purposes of this case. The calculation is set forth in Appendix B. Based on projected additional revenues of $17,500,000, the overall increase over total operating revenues is approximately 7.86%.

The agreed upon rate increase reflects the following forecasted original cost rate base, cost of capital, operating expenses, and revenues (See Appendices A & B), which the Parties agree are reasonable for purposes of compromise and settlement:

Table 1. Rate Base as of April 30, 2019 and 2020

Components of Original Cost Rate Base	Per Books as of December 31, 2017	Adjustments (as of April 30, 2019)	Step 1 (as of April 30, 2019)	Adjustments (as of April 30, 2020)	Step 2 (as of April 30, 2020)
Utility Plant:	$1,664,347,710	$124,674,531	$1,789,022,241	$151,301,687	$1,940,323,928
Accumulated Depreciation:	$494,134,121	$21,734,090	$515,868,211	$21,715,025	$537,583,236
Net Utility Plant:	$1,170,213,589	$102,940,441	$1,273,154,030	$129,586,662	$1,402,740,692
Deduct:					
Contributions in aid of construction	$161,238,063	$6,361,977	$167,600,040	$3,905,896	$171,505,936
Customer advances for construction	40,281,702	5,779,981	46,061,683	4,169,604	50,231,287
Northwest Billing Change - Bi-Monthly to Monthly	295,547	0	295,547	(98,516)	197,031
Capacity Adjustment - Somerset	217,962	62,224	280,186	(7,671)	272,515
Total Deductions:	$202,033,274	$12,204,182	$214,237,456	$7,969,313	$222,206,769
Add:					
Acquisition Adjustment (net)	$14,234	($1,364)	$12,870	($1,023)	$11,847
Wabash Billing Change - Area Two to Area One	293,861	0	293,861	(97,954)	195,907
Materials and supplies	1,409,855	18,620	1,428,475	0	1,428,475
Total Additions:	$1,717,950	$17,256	$1,735,206	($98,977)	$1,636,229
Original Cost Rate Base - Total Company:	$969,898,265	$90,753,515	$1,060,651,780	$121,518,372	$1,182,170,152

Note: Adjusted Rate Base reflects the elimination of Southern Indiana High Service Pumps as per Cause No. 43680 and the elimination of Northwest Tunnel's outstanding easement payments as per Cause No. 44450

Table 2. Pro Forma Proposed Rates –Step 1 and Step 2

Description	Base Year Ended 12/31/2017	Adjustments	Present Rates Step 1	Proposed Rate Adjustments	Proposed Rates Step 1	Adjustments	Present Rates Step 2	Proposed Rate Adjustments	Proposed Rates Step 2
Operating Revenues:	$222,515,256	$233,871	$222,749,127	$3,836,226	$226,585,353	$0	$226,585,353	$13,663,774	$240,249,127
Total Operation & Maintenance Expense:	73,076,551	7,244,103	80,320,654	39,007	80,359,661	(2,354,422)	78,005,239	138,920	78,144,159
Depreciation	48,054,562	67,805	48,122,367	0	48,122,367	4,406,608	52,528,975	0	52,528,975
Amortization	535,287	(260,588)	274,699	0	274,699	0	274,699	0	274,699
General Taxes	15,684,056	1,579,538	17,263,594	55,038	17,318,632	0	17,318,632	207,717	17,526,349
Income Taxes	25,812,897	(12,142,257)	13,670,640	951,894	14,622,534	(495,084)	14,127,450	3,378,763	17,506,213
Total Operating Expenses:	$163,163,353	($3,511,399)	$159,651,954	$1,045,939	$160,697,893	$1,557,102	$162,254,995	$3,725,400	$165,980,395
Net Utility Operating Income:	$59,351,903	$3,745,270	$63,097,173	$2,790,287	$65,887,460	($1,557,102)	$64,330,358	$9,938,374	$74,268,732

Table 3. Capital Structure – Step 1 and Step 2

Settlement Figures

		Step 1 %	Cost	Wt Cost	CapStr.		Step 2 %	Cost	Wt Cost	CapStr.
Long Term Debt	$ 413,259,859	37.41%	5.26%	1.97%	46.6%	$ 463,799,134	38.03%	5.19%	1.97%	46.6%
ADIT	$ 217,647,012	19.70%	0.00%	0.00%		$ 223,526,407	18.33%	0.00%	0.00%	
Other Zero	$ (299,202)	-0.03%	0.00%	0.00%		$ 80,657	0.01%	0.00%	0.00%	
JDIT	$ 381,500	0.03%	8.39%	0.00%		$ 344,492	0.03%	8.35%	0.00%	
Common Equity	$ 473,706,090	42.88%	9.80%	4.20%	53.41%	$ 531,771,238	43.60%	9.80%	4.27%	53.41%
	$ 1,104,695,259	100.00%		6.17%		$ 1,219,521,928	100.00%		6.25%	

2. Resolution of Issues Impacting Rate Increase.

All agreed upon revenue requirement components are detailed in Appendices A and B. As a result of settlement negotiations, the Company agrees to decrease its overall rate request by $21.25 million. The attached Appendices show the resolution and comparison of positions for Operating Income (Appendix A) and Rate Base (Appendix B), as well as explanations of the settlement positions for cost of capital and overall rate increase (Appendices A and B respectively).

The material pro forma reductions as a result of settlement discussions are described specifically below. While an explanation of these individual adjustments is provided, the negotiated amounts represent agreements reached by the Parties as part of the overall settlement package of terms.

(a) Revenues

Total company pro forma revenues at present rates for the test year for purposes of settlement will be $222,749,127. That figure represents the amount the Settling Parties agree is reasonable for purposes of compromise and settlement, and is not based on a particular calculation methodology or percentage of declining usage. Total pro forma revenues at present rates are detailed in the attached schedules.

(b) Capital Structure and Cost of Equity

For purposes of settlement, the Company has agreed to change its forecasted capital structure that will be used to set rates for the future test period as shown in Table 3 above, reflecting a level of equity as a percentage of total investor-supplied capital of 53.41%. The Settling Parties have agreed to a cost of common equity of 9.8%, producing a weighted cost of capital of 6.17% in Step 1 and 6.25% in Step 2 based on the above-described capital structure, which the Settling Parties stipulate and agree is both reasonable and within the range of the evidence that has been submitted.

(c) Rate Base

As discussed in more detail below, the Settling Parties agree that Indiana American's actual net original cost rate base at Step 2, upon which it is authorized to earn a reasonable return, will not exceed $1,182,170,152, representing a $40 million reduction from Indiana American's forecasted Step 2 rate base in its testimony in this

Cause. The $40 million reduction to the forecast is composed of non-DSIC eligible assets.

(d) Rate Base Certification

For purposes of this section, Petitioner shall certify it has completed the amount of net plant indicated in its certification and the corresponding net plant additions have been placed in service and are used and useful in providing utility service as of the date of certification. Petitioner will serve all Settling Parties with its certification.

(i) Certification – Step 1 Rates

The Company will certify its net utility plant in service as of April 30, 2019 and calculate the resulting Step 1 rates using the capital structure reflected in Table 3 above. Step 1 rates will become effective upon the later of the date of the Commission's order in this case or July 1, 2019.. Indiana American will serve all Settling Parties with its Step 1 certification as soon as possible after the closing of its books following April 30, 2019.

(ii) Certification – Step 2 Rates

The Company will certify its net utility plant in service as of the end of the test year (April 30, 2020) and calculate the resulting Step 2 rates using the capital structure reflected in Table 3 above. Step 2 rates will be based upon actual net original cost rate base that does not exceed $1,182,170,152 (the "Rate Base Cap") and actual depreciation expense associated with the Rate Base Cap; however, the total increase shall not exceed $17,500,000 over pro forma revenues at present rates.

Step 2 rates will become effective upon the later of the date the Company certifies its end of test year net plant in service or May 1, 2020.

The OUCC and intervening parties will have 60 days from the date of certification to state any objections to the Company's certified test-year-end net plant in service.

If objections cannot be resolved informally, a hearing will be held to determine the Company's actual test-year-end net plant in service, and rates will be trued-up (with carrying charges) retroactive to the date that the Company's Step 2 rates became effective as stated above in this Paragraph 2(d)(ii).

To the extent the Company's actual net original cost rate base as of April 30, 2020 exceeds the Rate Base Cap, the Company is not foreclosed from including those additional investments in rate base in a future general rate case. In forecasting its rate base, the Company has forecasted investment from the end of the period covered by the Company's most recent DSIC filing (November 30, 2017) through the end of the test year (April 30, 2020) totaling $ 114,004,218 (excluding costs of removals and retirements) in improvements that might qualify for a distribution system improvement charge (DSIC) pursuant to IC 8-1-31 but for their inclusion in rate base in this Cause. Accordingly, Petitioner may not apply for a DSIC for improvements placed in service before April 30, 2020, unless the Company shall have invested more than $114,004,218 (excluding costs of removals and retirements) in distribution system improvements during the period between November 30, 2017 and April 30, 2020. An application under IC § 8-1-31-1 et seq. that includes in-service distribution system improvements shall only include distribution system improvement costs that exceed the $114,004,218 (excluding costs of removals and retirements) projected to be made during the period between November 30, 2017 and April 30, 2020. In any application for DSIC including improvements placed in service before April 30, 2020, Petitioner shall identify the plant additions composing the $114,004,218 (excluding costs of removals and retirements) of distribution system additions as well as those plant additions that qualify for and for which DSIC recovery is sought.

The Settling Parties agree there will be no deferred asset reflecting post-in-service allowance for funds used during construction and deferred depreciation associated with the major projects included in this Cause within the Company's certified rate base in either Step 1 or Step 2. This Stipulation does not affect the Company's ability to file a petition seeking such accounting treatment and to include the resulting regulatory asset in rate base in future general rate cases or the rights of the parties to oppose such relief.

(e) Operating Expenses, Depreciation and Amortization

For purposes of settlement, the Settling Parties agree to a forecasted level of Operating Expenses at Step 2 of $165,980,395 including forecasted Depreciation Expense at Step 2 of $52,528,975, forecasted Amortization Expense at Step 2 of $274,699, and forecasted Taxes Other than Income Tax Expense at Step 2 of $17,526,349. The detailed stipulations underlying these forecast adjustments are set forth in Appendix A, which is incorporated herein by reference.

With respect to the reduction to deferred Federal income tax expense, the Settling Parties agree that for purposes of Step 1 rates in the pending rate case (Cause

No. 45142), the Company will use the estimate provided in the Company's rebuttal in Cause No. 45142. Subject to the provisions of Paragraph 3 below, which are to be submitted for Commission approval in Cause No. 45032 S4, if the Internal Revenue Service issues a Private Letter Ruling that determines amortization of repairs-related excess accumulated deferred income taxes ("EADIT") cannot be faster than under the Average Rate Assumption Method ("ARAM") without causing a normalization violation, then the Settling Parties agree for purposes of Cause 45142, the estimate producing annual amortization of $1.7 million will continue to be used for purposes of Step 2 rates until the Company's next general rate case at which point the EADIT amortization will be trued up using the actual ARAM calculation.

3. Tax Cuts and Jobs Act of 2017 ("TCJA") - Cause No. 45032 S4

The following terms of this Stipulation address pending issues in the Company's subdocket proceeding in the Commission's investigation into the impact of the TCJA (Cause No. 45032 S4, referred to herein as the "tax subdocket"). The Settling Parties agree the terms and conditions set forth herein represent a fair and reasonable resolution of the remaining issues in the tax subdocket based on the record as it currently exists in that proceeding, subject to incorporation into a final order of the Commission in the tax subdocket which approves Paragraphs 3(a) and 3(b) of this Stipulation without any modification or condition that is not acceptable to the Settling Parties. The Settling Parties will cooperate to submit jointly to the Commission a form of a proposed order that would approve Paragraphs 3(a) and 3(b) of this Stipulation in Cause No. 45032 S4.

(a) Excess Accumulated Deferred Income Taxes

The Settling Parties have agreed in the pending rate case (Cause No. 45142) that, for purposes of Step 1 rates, the Company will use the estimate of excess accumulated deferred income taxes ("EADIT") provided in the Company's rebuttal in Cause No. 45142, which produces a result that is approximately the same as an estimate using the average rate assumption method ("ARAM") to the entirety of Indiana American's EADIT.

The Settling Parties further agree that the Company will seek a Private Letter Ruling ("PLR") from the Internal Revenue Service ("IRS") requesting a determination whether the Commission has the discretion to order an amortization for EADIT related to the Company's repairs deduction that is faster than ARAM. The Settling Parties agree the PLR request is not an opportunity for advocacy for one outcome or another and that the PLR request will be drafted using neutral and unbiased language. The Settling Parties will confer on the wording of the draft PLR request to objectively frame the issue while adhering to IRS guidelines and requirements (Rev. Proc. 2017-1, Part III, Section 7) before the PLR request is submitted to the IRS for resolution. If the IRS requires additional information, the Company shall use reasonable efforts to coordinate any response with the non-Company Settling Parties prior to responding to any such request within the confines of IRS requirements and deadlines. The Company will file notice of the results of the ruling with the Commission and all parties to the tax subdocket within ten (10) business days of receipt of the Private Letter Ruling. No Settling Party shall be deemed to have waived any position in any subsequent case as to whether Indiana American may recover the costs it incurs associated with the PLR request. For purposes of permitting the Commission to make the necessary findings consistent with the terms of this Stipulation, the Company will waive confidential treatment of

(1) the fact of its request for a Private Letter Ruling and (2) the overall results of the ruling.

If the IRS issues a Private Letter Ruling that amortization of repairs related EADIT cannot be faster than ARAM without causing a normalization violation, the Settling Parties have agreed Indiana American will continue to use the estimate producing annual amortization of $1.7 million for purposes of Step 1 and Step 2 rates in Cause No. 45142 until the Company's next general rate case, at which point the EADIT amortization will be trued up using the actual ARAM calculation. In that event, the Commission shall issue an order to dismiss the tax subdocket proceeding.

If the IRS issues a Private Letter Ruling determining that the Commission has discretion to order amortization for EADIT related to the Company's repairs deduction that is faster than ARAM, or otherwise determining that amortization using non-normalized accounting would be appropriate, the Settling Parties agree and hereby request that the Commission establish, by order in the tax subdocket, the appropriate amortization period for such non-normalized EADIT and order the Company to file revised rates to reflect the revised amortization for the non-normalized EADIT along with the true-up for the actual ARAM calculation for all EADIT required to be normalized.

(b) Regulatory Liability – Deferral

The $5,821,888.14 balance of Indiana American's regulatory liability created as a result of the Commission's January 3, 2018 order in Cause No. 45032 shall be flowed to customers as a bill credit commencing with implementation of Step 2 rates ratably over a twelve-month period allocated among customer classes in accordance with the allocation methodology associated with the underlying rates that generated the regulatory liability.

4. Low Income Pilot Program

The Company agrees to add the Gary, Indiana service territory as a third location for inclusion in the Low Income Pilot Program ("LIPP"). The Settling Parties agree that the total program cost for the LIPP will be borne evenly (50/50) between the deferred asset and non-deferred contribution established herein.

For every year of the LIPP except for Year One and Two, the Settling Parties agree that the Company will contribute up to $300,000 per year to the LIPP, allocated equally among the three pilot locations (ie, up to $100,000 per location). The actual amount contributed will depend on participation with the requirement that the total contribution not to exceed $300,000 annually, except for Year Two when the total contribution will not exceed $450,000, and will continue until the earlier of the next general rate case filing, or termination of the LIPP. Of the maximum annual contribution amount, an amount not to exceed $150,000 per year will be accrued in a deferred asset, without carrying charges, for recovery in the Company's next general rate case.

The Company's contribution obligation will commence with the commencement of the LIPP; however, in Year One of the LIPP, only the $150,000 deferred asset will be contributed, with the remaining non-deferred portion of the first year's contribution to be made at the time of the second year's contribution. Accordingly, for Year Two of the LIPP, the maximum contribution to be made by the Company could be as high as $450,000, with $300,000 from the Company's non-deferred contribution and $150,000 in the deferred asset. All subsequent annual contributions under this provision will not exceed $300,000.

The Settling Parties have agreed to a reservation of rights with respect to the allocation among customer classes of the deferral, and the Settling Parties may raise any and all arguments concerning the allocation among customer classes of the deferral in the Company's next base rate case.

5. Conservation

Indiana American will conduct a good faith review of market potential and customer impact of a utility-sponsored water conservation program in its service territory. Indiana American agrees such a utility-sponsored water conservation program proposal could include non-behavioral, measure-based conservation efforts, such as device distribution programs, direct installation programs, manufacturer buy down programs, and rebate and voucher programs for water conservation measures and services. Indiana American agrees to meet and discuss preliminary and final findings of its efforts under this Paragraph 5 with interested Settling Parties at mutually agreeable times.

6. Effect of Stipulation In Future Proceedings

As a part of this Stipulation and Settlement Agreement and for purposes of Petitioner's next general rate case and thereafter, the parties stipulate and agree to the following terms and conditions. Other than as stated in this Paragraph 6, the Settling Parties reserve the right to take positions in future cases, including but not limited to, positions that may be inconsistent with the revenue requirements, cost of capital, rate base, cost of service, revenue allocation, rate design, and other matters set forth in this Stipulation and Settlement Agreement:

(a) Information Regarding Capital Projects

The parties have resolved their dispute regarding the support for Petitioner's forecasted capital projects for purposes of the current case and stipulate that an agreement among the parties regarding information to be included in future cases will mitigate the risk of future similar disputes. Accordingly, for purposes of future general rate cases involving a forward looking test period, Indiana American will, to the extent such information exists, include the following information in its workpapers supporting its case-in-chief; *provided, however*, that if the Commission promulgates rules amending or adapting the minimum standard filing requirements for a rate case utilizing a forward-looking test period, then those promulgated rules shall supersede the parties' agreement in this Paragraph 6(a). To the extent the following information does not exist, Indiana American will explain in testimony or exhibits how it determined the forecasted capital additions by subaccount and how it calculated the cost of the capital additions it forecasted by subaccount. If any of the Settling Parties believes Indiana American has failed to provide the required information, that party must file a deficiency notice within the timeframe as set forth in 170 IAC 1-5-4; otherwise, Indiana American is deemed to have filed a complete case-in-chief for purposes of a motion to dismiss based on a failure to meet the Minimum Standard Filing Requirements ("MSFRs"). Nothing herein shall be construed to establish, alter, or amend any party's burden of proof in any subsequent rate case. No Settling Party shall be deemed to have waived the ability to request additional information nor shall Petitioner be deemed to have waived any objection to discovery in excess of the information promised below. The foregoing promises shall not constitute a basis for objecting to a data request or other method of discovery in any subsequent proceeding.

(i) ***Projects Greater than $500,000.***

a. Project name

b. Project number, including Comprehensive Planning Study project number (if applicable)

c. Project cost or cost estimate, including contingency allowance and non-construction costs (with identification of the amounts and percentages allocated for (or other basis for determining) non-construction costs)

d. Actual or projected project construction start and in-service date

e. Location

f. Dollar amount of additions

g. Amount and derivation of cost of removals

h. Total dollar amount of additions and cost of removals

i. Project description and purpose (including, if applicable, a list of major components of new construction, treatment and pumping capacities, and storage volumes)

j. Project benefits

k. Project background (including identification of any studies, reports, or analyses which provided background, input, or which were considered in developing the project scope, including any alternatives that were considered.)

(ii) ***Recurring Capital Investments That Are Individually Less Than $500,000***

a. Categories of recurring projects

b. Cost projections by category

c. Identification in testimony, attachment(s), or workpaper(s) of the historic operating experience and assumptions, including applicable unit costs, quantities and contingency and non-construction costs used to build the cost projections for known and anticipated recurring investments

(iii) Access to Studies Including Comprehensive Planning Studies

Subject to the terms of this Paragraph 6(a)(iii), contemporaneous with the filing of its case in chief in a general rate case, Indiana American will provide the OUCC with copies of the studies, reports, or analyses -- including Comprehensive Planning Studies if applicable – for operations that are projected to include an individual project that would qualify as a "major project" pursuant to the MSFRs. The Parties will work cooperatively to find reasonable solutions to afford timely access to the materials related to the case. Nothing herein shall be construed as prohibiting the OUCC or any other intervenor from specifically identifying and asking for more detail, documents, or information other than what Indiana American has agreed to provide in this section, including other or historical reports previously conducted and nothing shall be construed as estopping the Company from interposing any objection to such requests.

(b) Deferral and Amortization of Comprehensive Planning Studies

Following issuance of an Order approving this Stipulation, all costs of conducting comprehensive planning studies shall be deferred and amortized over a 15-year period.

(c) Acquisition Journal Entries

Based upon the evidence and filings in the respective causes, Indiana American will revise the journal entry to record the acquisitions for Yankeetown and Merom to reflect the journal entry submitted in Petitioner's Exhibit JCH-6 (Cause No. 44400) and Petitioner's Exhibit JCH-5 (Cause No. 44399), respectively. The journal entry to record the Russiaville acquisition matches the journal entry ordered in Cause No. 44584 and thus will not be changed.

7. Next General Rate Increase

It is anticipated that this settlement will allow Indiana American to operate without seeking a general increase in base water rates and charges before January 2022. While not anticipated, circumstances, short of emergency rate relief under IC § 8-1-2-113, could justify an earlier filing. Nothing in this Stipulation affects the Company's ability to file a petition seeking an increase in its base rates and charges for sewer service or the timing thereof. Should Indiana American deem it necessary to seek a base rate increase before January 2022, it agrees to provide the Settling Parties and the Commission with 60 days notice in advance of such filing, including a statement as to why the rates set by this Settlement are no longer just and reasonable.

8. Revenue Allocation and Rate Design

The agreed allocation of the stipulated increase is set forth in Appendix C. The Settling Parties agree that the Commission should proceed to approve the rate design set forth in Appendix C, which resets the DSIC to zero and accomplishes the agreed allocation. Given the efforts to gradualize impacts on the various customer classes, the Settling Parties agree that in light of the proposed and agreed upon rate design and allocation among customer classes, the various cost of service study and allocation disputes raised in this case are moot, and do not need to be resolved at this time, and request that the Commission not issue any finding approving any particular cost of service study. The Parties retain all rights to advocate for alternative cost of service studies and rate designs different from those in this Settlement in future proceedings. The rates set forth in the attached Appendix C are the rates that would be in effect after the filing of the April 30, 2020 certification described in Paragraph 2(d)(ii) of this Stipulation.

9. Stipulation Effect, Scope and Approval.

The Stipulation is conditioned upon and subject to its acceptance and approval by the Commission in its entirety without any change or condition that is unacceptable to any Settling Party. Each term of the Stipulation is in consideration and support of each and every other term. If the Commission does not approve the Stipulation in its entirety – with Paragraph 3 to be approved in Cause No. 45032 S4 -- or if the Commission makes modifications that are unacceptable to any Settling Party, the Stipulation shall be null and void and shall be deemed withdrawn upon notice in writing by any party within 15 days after the date of the final order stating that a modification made by the Commission is unacceptable to the Settling Party.

The Stipulation is the result of compromise in the settlement process and neither the making of the Stipulation nor any of its provisions shall constitute an admission or waiver by any Settling Party in any other proceeding, now or in the future. The Stipulation shall not be used as precedent in any other current or future proceeding or for any other purpose except to the extent provided for herein or to the extent necessary to implement or enforce its terms.

The evidence to be submitted in support of the Stipulation, together with evidence already admitted, constitutes substantial evidence sufficient to support the Stipulation and provides an adequate evidentiary basis upon which the Commission can make any findings of fact and conclusions of law necessary for the approval of the Stipulation.

The communications and discussions and materials produced and exchanged during the negotiation of the Stipulation relate to offers of settlement and shall be privileged and confidential.

The undersigned represent and agree that they are fully authorized to execute the Stipulation on behalf of the designated party who will be bound thereby.

The Settling Parties will either support or not oppose on rehearing, reconsideration and/or appeal, an IURC Order accepting and approving this Stipulation in accordance with its terms.

(signature page follows)

ACCEPTED and AGREED this 18th day of March, 2019.

Indiana-American Water Company, Inc.

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Deborah Dewey, President
153 North Emerson Avenue
Greenwood, Indiana 46143

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By: ______________________
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By: ______________________
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ACCEPTED and AGREED as to paragraphs 3 and 9 this 18th day of March, 2019.

Indiana Industrial Group	United States Steel Corporation
By: ______________________	By: ______________________
Todd A. Richardson, Attorney No. 16620-49	Nikki G. Shoultz, Attorney No. 16509-41
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DMS 14189941v1

ACCEPTED and AGREED as to paragraphs 3 and 9 this 18th day of March, 2019.

Indiana Industrial Group

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Request for Comments on Necessary Clarifications to Normalization Requirements for Excess Tax Reserves Resulting from the Corporate Tax Rate Decrease

Notice 2019-33

SECTION 1. PURPOSE

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue guidance under § 168 of the Internal Revenue Code to clarify the normalization requirements for excess tax reserves resulting from the corporate tax rate decrease in the Tax Cuts and Jobs Act (TCJA), Pub. L. 115-97 (131 Stat 2054). This notice requests comments about ratemaking issues that have arisen or are anticipated due to the corporate tax rate decrease and the requirements of section 13001(d) of the TCJA.

SECTION 2. BACKGROUND

In general, normalization is a system of accounting used by regulated public utilities to reconcile the tax treatment of accelerated depreciation of public utility assets with their regulatory treatment. Under normalization, a utility receives the tax benefit of accelerated depreciation in the early years of an asset's regulatory useful life and passes that benefit through to ratepayers ratably over the regulatory useful life of the asset in the form of reduced rates.

Section 168 of the Code generally allows taxpayers to compute their depreciation deduction for federal income tax purposes under the accelerated cost recovery system. Section 168(f)(2) provides that § 168 does not apply to any public utility property, as defined in § 168(i)(10), if the taxpayer does not use a normalization method of accounting. Section 168(i)(9) describes what constitutes a "normalization method of accounting."

In order to use a normalization method of accounting, § 168(i)(9)(A)(i) requires a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account (regulated tax expense), to use a method of depreciation for property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for establishing its cost of service for ratemaking purposes. Under § 168(i)(9)(A)(ii), if the amount allowable as a deduction under § 168 differs from the amount that would be allowable as a deduction under § 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under § 168(i)(9)(A)(i), then the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Former § 167(l) generally contained the requirements discussed above regarding permitting public utilities to use accelerated methods for calculating depreciation only if they used a "normalization method of accounting." The requirements for establishing and adjusting the reserve required by § 168(i)(9)(A)(ii) are contained in § 1.167(l)-1of the Income Tax Regulations.

Section 1.168(i)–3, finalized in 2008 (2008 regulations), provides rules on the treatment of excess deferred income tax reserve upon disposition of deregulated public utility property.

Section 1.168(i)-3(a)(1) generally provides rules for the application of section

203(e) of the Tax Reform Act of 1986 (1986 Act), Public Law 99–514 (100 Stat. 2146), to a taxpayer with respect to public utility property (within the meaning of § 168(i)(10)) that ceases, whether by disposition, deregulation, or otherwise, to be public utility property with respect to the taxpayer and that is not described in § 1.168(i)-3(a)(2) (deregulated public utility property).

Section 1.168(i)-3(b) provides that if a public utility property of a taxpayer becomes deregulated public utility property to which this section applies, the reduction in the taxpayer's excess tax reserve permitted under section 203(e) of the 1986 Act is equal to the amount by which the reserve could be reduced under that provision if all such property had remained public utility property of the taxpayer and the taxpayer had continued use of its normalization method of accounting with respect to such property.

SECTION 3: TAX CUTS AND JOBS ACT

The TCJA, enacted on December 22, 2017, generally reduced the corporate tax rate under § 11 of the Code from 35 percent to 21 percent for taxable years beginning after December 31, 2017. Section 13001(a).

Section 13001(d) of the TCJA includes accompanying but uncodified normalization requirements. Section 13001(d)(1) provides that a normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of §§ 167 or 168 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method (ARAM).

Section 13001(d)(2) provides an alternative method for certain taxpayers. If, as of the first day of the taxable year that includes the date of enactment of the TCJA, the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and the taxpayer's books and underlying records did not contain the vintage account data necessary to apply ARAM, the taxpayer will be treated as using a normalization method of accounting if, with respect to such jurisdiction, the taxpayer uses the alternative method for public utility property that is subject to the regulatory authority of that jurisdiction.

Section 13001(d)(3) provides definitions for purposes of section 13001(d). Section 13001(d)(3)(A) defines an "excess tax reserve" to mean the excess of the reserve for deferred taxes (as described in § 168(i)(9)(A)(ii)) as of the day before the corporate rate reductions provided in the amendments made by section 13001(a) take effect, over the amount which would be the balance in such reserve if the amount of such reserve were determined by assuming that the corporate tax rate reductions provided in the TCJA were in effect for all prior periods.

Section 13001(d)(3)(B) defines ARAM as the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in the taxpayer's regulated books of account which gave rise to the reserve for deferred taxes. Under such method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by the amount of the timing differences which reverse during such period.

Section 13001(d)(3)(C) defines the "alternative method" as the method in which the taxpayer computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and reduces the excess tax reserve ratably over the remaining regulatory life of the property.

Section 13001(d)(4) provides that, for any taxable year ending after the date of the enactment of the TCJA, if the taxpayer does not use a normalization method of accounting for the corporate rate reductions provided in the amendments made by section 13001, then the taxpayer's tax for the taxable year shall be increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting, and such taxpayer shall not be treated as using a normalization method of accounting for purposes of § 168(f)(2) and (i)(9)(C).

The Joint Explanatory Text of the Committee of Conference, H. Rept. 115-466 (Conference Report), adds more clarification about the normalization rules in section 13001(d) of the TCJA. The Conference Report states that the excess tax reserve is the reserve for deferred taxes as of the day before the corporate rate reduction takes effect over what the reserve for deferred taxes would be if the corporate rate reduction had been in effect for all prior periods. Conference Report, at 343. If an excess tax reserve is reduced more rapidly or to a greater extent than such reserve would be reduced under ARAM[1], the taxpayer will not be treated as using a normalization method with respect to the corporate rate reduction. If the taxpayer does not use a normalization method of accounting for the corporate rate reduction, the taxpayer's tax for the taxable year shall be increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting and the taxpayer will not be treated as using a normalization method of accounting for purposes of § 168(f)(2) and (i)(9)(C).

The Conference Report also explains in greater detail the application of ARAM. According to the Conference Report, ARAM reduces the excess tax reserve over the remaining regulatory lives of the property that gave rise to the reserve for deferred taxes during the years in which the deferred tax reserve related to such property is reversing. Id. Under this method, the excess tax reserve is reduced as the timing differences reverse over the remaining life of the asset. The reversal of timing differences generally occurs when the amount of the tax depreciation taken with respect to an asset is less than the amount of the regulatory depreciation taken with respect to the asset. To ensure that the deferred tax reserve, including the excess tax reserve, is reduced to zero at the end of the regulatory life of the asset that generated the reserve, the amount of the timing difference which reverses during a taxable year is multiplied by the ratio of (1) the aggregate deferred taxes as of the beginning of the period in question to (2) the aggregate timing differences for the property as of the beginning of the period in question.

[1] Section 13001(d)(2) provides that certain taxpayers may use the alternative method to calculate the reduction of their excess tax reserve and such taxpayers will be treated as using a normalization method of accounting.

SECTION 4: THE TAX REFORM ACT OF 1986 AND REV. PROC. 88-12

For taxable years beginning on or after July 1, 1987, section 601 of the 1986 Act reduced the maximum federal income tax applicable for corporations from 46 percent to 34 percent.

Similar to section 13001(d) of the TCJA, section 203(e) of the 1986 Act provided rules for reducing the excess tax reserve resulting both from that reduction and from the smaller reduction in rates for tax years starting before and ending after July 1, 1987. Section 203(e)(2)(B) of the 1986 Act defined ARAM as the method under which the excess tax reserve is reduced over the remaining lives of the property (as used in a public utility's regulated books of account) that gave rise to the reserve for deferred taxes. Some taxpayers, however, did not necessarily have adequate data to apply ARAM because they were required by regulatory agencies to depreciate property for regulatory purposes using a weighted average life or composite rate, and such a method focuses on the entire plan and does not account for property by vintage accounts. The 1986 Act, however, did not provide taxpayers an alternative method to ARAM.

Rev. Proc. 88-12, 1988-1 C.B. 637, provides an alternative method sometimes referred to as the Reverse South Georgia Method (RSGM). Under section 4.01 of Rev. Proc. 88-12, a taxpayer uses the RSGM if it computed the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and reduced the excess tax reserve ratably over the remaining regulatory life of the property. Section 5.01 of Rev. Proc. 88-12 provides generally that for eligible taxpayers the RSGM satisfied the requirements of section 203(e) of the 1986 Act.

In summary, section 13001(d)(1) of the TCJA provides ARAM as the regular method in the same manner as that provided in section 203(e)(2)(B) of the 1986 Act. Section 13001(d)(2) of the TCJA provides an alternative method that, while not specifically referred to as the RSGM, is nevertheless the same as the RSGM as originally provided in Rev. Proc. 88-12.

SECTION 5. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on issues that should be addressed in proposed guidance to clarify the normalization requirements for excess tax reserves resulting from the corporate tax rate decrease in the TCJA and the requirements of section 13001(d) of the TCJA as well as comments regarding what form of guidance would be most useful. Specifically, the Treasury Department and the IRS request comments that address the following:

(1) Situations where taxpayers may have vintage account data in their underlying books and records in some form but such data is not necessarily useful for ARAM without significant additional analysis and expense. More specifically, comments on whether some sort of "reasonable" test should be provided, under which the use of the alternative method by a taxpayer is permissible if the cost to the taxpayer of assembling the data contained in the underlying books and records in a way necessary to apply ARAM exceeds a reasonable amount, based on a percentage of rate base or some other factor.

(2) Other fact patterns where taxpayers may use the alternative method instead of ARAM including but not limited to comments on when the RSGM is a taxpayer's current normalization method of accounting for excess deferred taxes, regardless of the availability of vintage or class information for the accumulated deferred income taxes (ADIT) that had been accrued after the 1986 Act.

(3) Net operating loss (NOL) issues including but not limited to comments on the significance of a depreciation-related NOL carryforward in the context of excess deferred taxes, and comments on whether a depreciation-related NOL as of December 31, 2017, must be analyzed for normalization purposes based on the underlying loss year.

(4) By their terms, the 2008 regulations apply only to section 203(e) of the 1986 Act, but the Treasury Department and the IRS believe it may be appropriate to extend their application to section 13001(d) of the TCJA. Comments on the ongoing relevance of the 2008 regulations including but not limited to comments on the treatment of book-only retirements and tax dispositions in regard to significant transactions (such as sales of power plants) versus day-to-day (ordinary or not significant) transactions as well as comments on transactions not addressed in the 2008 regulations such as like-kind exchanges or other dispositions of public utility property.

(5) The implementation of interim rates to reflect the TCJA's decrease in the corporate tax rate including but not limited to comments about the meaning of the phrase "reduces the excess tax reserve more rapidly or to

a greater extent than such reserve would be reduced under ARAM."

(6) Whether the proration formula required by § 1.167(l)-1(h)(6)(ii) must be applied to excess deferred tax activity related to reversals (refunds) of excess deferred taxes if the company uses a future test period or a part-historical, part-future test period.

(7) Methodology of reversing protected (by the normalization rules) versus unprotected ADIT after the 2017 rate changes.

SECTION 6. ADDRESS TO SEND COMMENTS

Any comments must be received by July 29. 2019. Taxpayers may submit comments electronically via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and Notice 2019-33). Alternatively, taxpayers may submit hard copy submissions to:

CC:PA:LPD:PR (Notice 2019-33), Room 5203, Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C., 20044

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

CC:PA:LPD:PR (Notice 2019-33), Courier's Desk, Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
Attn: CC:PA:LPD:PR

All comments received will be available for public inspection on www.regulations.gov.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Martha M. Garcia of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Ms. Garcia at (202) 317-6853 (not a toll-free call).

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July 26, 2019

Internal Revenue Service
CC:PA:LPD:PR (Notice 2019-33)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Request for Comments on Necessary Clarifications to Normalization Requirements for Excess Tax Reserves Resulting from the Corporate Tax Rate Decrease [Notice 2019-33]

Dear Sir or Madam:

American Water Works Company, Inc ("AWK") commends the United States Department of Treasury ("Treasury") and the Internal Revenue Service (the "Service" or "IRS") for its efforts to carefully consider the ratemaking issues that have arisen and are expect to arise related to the normalization requirements for excess tax reserves resulting from the corporate tax rate decrease pursuant to section 13001(d) the Tax Cuts and Jobs Act ("TCJA"), Pub. L. 115-97 (131 Stat 2054). AWK appreciates the opportunity to participate in the process described in Notice 2019-3, to inform Treasury and the Service of what it considers to be the most significant of these ratemaking issues from the perspective of AWK's utility affiliates, their regulators and customers, and to provide recommendations regarding the forthcoming tax guidance.

AWK is the largest and most geographically diverse, publicly-traded water and wastewater utility company in the United States, as measured by both operating revenues and population served. AWK is a holding company originally incorporated in 1936 and employs approximately 6,900 professionals who provide drinking water, wastewater and other related services to an estimated 15 million people in 46 states, the District of Columbia and Ontario, Canada. The majority of AWK's business is conducted through its rate-regulated utility subsidiaries that provide water and wastewater services to residential, commercial, industrial, public authority, fire service and sale-for-resale customers. The utilities operate in approximately 1,600 communities in 16 states in the United States, with approximately 3.4 million active customer connections to water and wastewater networks of AWK's affiliates. Services provided by AWK's utilities are generally subject to economic regulation by applicable state utility commissions or other entities engaged in utility regulation. Certain federal, state and local governments also regulate environmental, health and safety, and water quality matters.

Overall Recommendations for the TCJA Excess Deferred Tax Normalization Guidance

In Notice 2019-33, Treasury and the Service request comments on issues that should be addressed in proposed guidance to clarify the normalization requirements for TCJA excess tax reserves, including seven particular issues, as well as comments regarding what form of guidance would be most useful. AWK is providing comments that directly address two of the specific issues and comments on another issue that is within the scope of one of the broader issues described in Notice 2019-33. AWK is hopeful that Treasury and the Service would issue guidance related to the TCJA excess tax reserve normalization issues that are least controversial, based on the comments received, as quickly as practical in a pronouncement that does not require another comment period rather than issuing a single pronouncement to comprehensively address all excess tax reserve issues that have been or will be raised. AWK is hopeful that the forthcoming guidance alleviates the need for utilities to need to seek their own private letter rulings on these topics and allows final resolution to the many ratemaking proceedings across the country that are addressing the treatment of these tax benefits, many on an interim basis subject to adjustment, as necessary, to conform with the forthcoming TCJA excess tax reserve normalization guidance. AWK recommends that the forthcoming guidance include effective date and transition rules that permit companies that have initiated regulatory reporting and ratemaking for TCJA excess tax reserves using computations not in accordance with aspects of the forthcoming guidance to comply with such guidance on a prospective basis and not be considered to have violated the TCJA excess tax reserve normalization rules by use of good faith interpretation of the statute prior to such time and until the taxpayer's "next available opportunity" (as defined in Revenue Procedure 2017-47) to become compliant with the TCJA excess deferred tax normalization rules.

Net Operating Losses

AWK's utility affiliates, like many utilities, incurred net operating losses ("NOLs") in numerous recent years due to the availability of bonus depreciation under Section 168(k) of the Internal Revenue Code ("Code") and due to changes in tax methods of accounting for costs to repair and maintain tangible property and for dispositions of certain tangible depreciable property in accordance with the tangible property regulations. AWK's consolidated group was in an NOL carryforward ("NOLC") position attributable to its utility affiliates as of December 31, 2017, and, thus, is particularly interested in the following excess tax reserve issue specifically identified in Notice 2019-33: NOL issues including but not limited to comments on the significance of a depreciation-related NOL carryforward in the context of excess deferred taxes, and comments on whether a depreciation-related NOL as of December 31, 2017, must be analyzed for normalization purposes based on the underlying loss year.

AWK believes that the ratemaking treatment of NOLs after the decrease in corporate tax rate in conjunction with the depreciation-related deferred tax normalization rules involves a multi-step analysis:

- Computation of the portion of a utility's NOLC that is attributable to depreciation method and life differences,
- Determination of when the excess NOLC-related deferred taxes should begin to be recovered through customer rates, and
- Determination of the time period during which such rate recovery should occur.

As an initial matter, AWK recommends that the excess deferred tax guidance expressly acknowledge that the current financial reporting for NOLCs under ASC 740, *Income Taxes*, and, thus, the regulatory reporting in many jurisdictions results in the tax benefits of an NOLC treated as a deferred tax asset not netted against any particular deferred tax liability resulting from a book/tax timing difference. Section 1.167(l)-1(h)(1)(iii) of the Regulations is the relevant general authority regarding application of the normalization rules to NOLCs. This provision is phrased in terms of the impact of an NOLC on the deferral of tax liability. The wording of the regulation broadly and appropriately addresses the economic aspect of deferral of taxes and determination of an allowable return in ratemaking and is not limited to any particular accounting convention for the tax attribute of an NOLC.

Despite the financial and regulatory reporting for NOLC tax benefits not requiring attribution of losses to tax benefits of particular timing differences not realized, compliance with the normalization rules for depreciation timing differences requires a determination of the source of the NOLC so that rate base is not overstated in jurisdictions in which net deferred tax liabilities reduce rate base (or so that the weighted-average cost of capital is not understated in jurisdictions in which net deferred tax liabilities are treated as zero-cost capital). The normalization rules of Section 1.167(l)-1(h)(1)(iii) of the Regulations, Section 168(i)(9)(A) of the Code and Section 13001(d) of the TCJA are limited to ratemaking for depreciation-related deferred taxes (and associated NOLCs), but the economic principles underlying the existing rules and the need for additional guidance with respect to TCJA excess tax reserves also sensibly apply to the remainder of a utility's NOLC. The need for TCJA normalization guidance for NOLCs results, in part, from some regulatory commissions proposing different ratemaking for the depreciation-related portion of an NOLC and remainder of an NOLC.

AWK has analyzed its utilities' NOLCs in regulatory jurisdictions proposing less favorable ratemaking treatment for the portion of the NOLCs not attributable to depreciation method and life differences by first computing of the portions of the NOLCs that are attributable to depreciation method and life differences. Section 1.167(l)-1(h)(1)(iii) of the Regulations does not prescribe a particular methodology for this computation and instead informs taxpayers that the amount and time of the deferral of tax liability attributable to depreciation differences when an NOLC exists shall be taken into account in such appropriate time and manner as is satisfactory to the district director. The Service has issued several private letter rulings in the context of determining the maximum amount of net deferred tax reserve to reduce rate base that held that the With-and-Without Method (sometimes referred to as the Last-Dollars-Deducted Method) is required to comply with this normalization requirements. Such rulings include PLR 201436037 (With-and-Without Method), PLR 201436038 (With-and-Without Method), PLR 201438003 (With-and-Without Method), PLR 201519021 (With-and-Without Method), PLR 201534001 (Last-Dollars-Deducted Method), PLR 201548017 (Last-Dollars-Deducted Method) and PLR 201709008 (With-and-Without Method).

AWK believes that the TCJA excess tax reserve normalization requirements are part of the overall pre-existing deferred tax normalization rules and that the forthcoming guidance regarding TCJA excess tax reserves should state this as a general principle, be consistent with such rules (including the rules applicable to NOLCs) and indicate, as appropriate, that the forthcoming TCJA excess tax reserve normalization rules are creating an exception to how the overall pre-existing deferred tax normalization rules would apply in order to avoid any inference as to the general rules. Given the approach in Section 1.167(l)-1(h)(1)(iii) of the Regulations, AWK would not expect that the TCJA excess tax reserve normalization rules would mandate a single methodology to determine the portion of an NOLC attributable to depreciation method and life differences. However, AWK recommends that the TCJA excess tax reserve normalization rules deem that certain methodologies be considered compliant with such rules, including:

- The With-and-Without Method (or the Last-Dollars-Deducted Method)
- Any method already employed by a utility in its ratemaking for NOLCs prior to the TCJA decrease in corporate tax rate

AWK recommends that the TCJA excess tax reserve normalization rules specify that the With-and-Without Method (or the Last-Dollars-Deducted Method) be computed with and without the depreciation method and life difference, not with and without the full amount of the tax depreciation deduction. Further, given the purpose of the excess tax reserve normalization rules, AWK believes that the NOLC attributable to depreciation method and life differences should be computed in the aggregate for all NOL years comprising the NOLC as of December 31, 2017 (for calendar year companies), not computed for each loss year or based on the underlying vintages of the property depreciated during the loss year(s).

The second computational step in applying the excess tax reserve normalization rules to NOLCs is the determination of when the excess NOLC-related deferred taxes should begin to be recovered through customer rates. This computational step also presents a policy decision for Treasury and the Service in drafting TCJA excess tax reserve normalization guidance. In making this policy decision, AWK believes that it is important to consider the following example. Assume that a utility had an NOLC of $500 as of December 31, 2017 and had depreciation method and life differences in the loss years of $900. Without the depreciation method and life differences, the utility would not have had an NOLC and, thus, the entire NOLC is related to depreciation method and life differences under the With-and-Without Method for normalization purposes. Further assume that $100 of depreciation method and life differences related to these years reverse in 2018 and that taxable income is $100 in 2018. Had the statutory tax rate not changed, the utility would not pay a current tax liability in 2018. With a lower tax rate in 2018, the utility would still not pay a current tax liability in 2018. At issue is whether an adverse cash flow should occur in 2018 for the refund of excess tax reserve to customers and, if so, the maximum amount pursuant to the TCJA excess tax reserve normalization rules. AWK does not believe that the TCJA excess tax reserve normalization rules were intended to result in a detrimental cash flow for utilities relative to what cash flows would have been if tax rates had not decreased. In the case of utilities without NOLCs, the average rate assumption method ("ARAM") achieves this result and the alternative method approximates this result. For an NOLC utility to have the same cash flows, the excess tax reserve normalization guidance should indicate that refunds of excess tax reserves attributable to depreciation method and life differences may not begin until the NOLC as of December 31, 2017, has been fully utilized. If the timing of NOLC utilization is not reflected in the

ARAM or alternative method computations, the utility in the example may need to refund \$14 to customers in 2018 (plus a tax gross-up to the revenue requirement) when there would have been no current tax payment had tax rates not decreased. This detrimental cash result is inconsistent with the reason that the TCJA excess tax reserve normalization rules were enacted.

The third computational aspect of applying ARAM or the alternative method when an NOLC related to depreciation method and life differences occurs is determination of the time period during which such rate recovery should occur. Under ASC 740, a deferred tax asset for an NOLC represents the sum of deferred tax benefits recognized on the accrual basis of accounting for tax benefits to be realized in the future. In the context of ratemaking, a normalized NOLC (whether normalized only to the extent of the deferred tax normalization requirements or fully normalized as a regulatory policy) represents a tax benefit that reduced recoverable income tax expense in a prior year. Under ARAM, a TCJA excess tax reserve related to depreciation method and life differences recovered from customers in a prior year under the accrual method of accounting is refunded to customers over the same time period and at the same rate as the difference reverses (i.e., over the same period and at the same rate as what was originally a deferred tax liability becomes a current tax liability). The equivalent result should occur with respect to a deferred tax asset for an NOLC that reduced recoverable tax expense in earlier years at an amount based on a higher corporate income tax rate when the attribute is realized on the tax return at the lower tax rate. For the utility to be made whole, the rate recovery for the reduction of regulatory tax expense in prior years at a tax rate that is higher than the applicable income tax rate when the tax attribute is utilized, should be recovered from customers no later than when the attribute is utilized. Rate recovery over a longer period or at a slower pace would put a utility in a worse economic position than its cash flows would be had the tax rate not changed. This analysis considers recovery of the excess deferred tax asset for an NOLC separately from the refund of the excess tax reserve for depreciation method and life differences. As such, this analysis is stated in terms of rate recovery of the excess deferred tax asset independently of the refund of excess tax reserves. The same result would occur by netting the rate recovery of the excess deferred tax asset for an NOLC against the refund of excess tax reserves such that no refund occurs until the NOLC is utilized (with appropriate adjustments to rate base and reduction of the total excess tax reserve to be refunded).

Removal Costs

Notice 2019-33 requests comments regarding the methodology of reversing protected (by the normalization rules) versus unprotected accumulated deferred income taxes ("ADIT") after the 2017 rate changes. AWK requests that the TCJA excess tax reserve normalization guidance includes examples of property-related timing differences that do not result in ADIT or TCJA excess tax reserves subject to the normalization rules. AWK provides the following analysis of why it believes that ADIT resulting from timing differences related to removal costs have not been subject to the normalization rules of Section 168(i)(9) of the Code and are not subject to the normalization rules of Section 13001(d) of the TCJA as well as why it is important for the TCJA excess tax reserve guidance to specify how depreciation method and life differences reverse.

First and simply, the scope of the normalization rules of Section 168(i)(9)(A) of the Code is limited to amounts deductible under Section 168 of the Code. Removal costs, unless capitalizable to replacement property, are deductible under Section 162 of the Code. The focus of these comments is the timing difference related to deductible removal costs, not removal costs for an asset that become depreciable as part of the tax basis of its replacement asset.

AWK's more detailed rationale is that Section 168(i)(9)(A)(ii) of the Code[1] defines ADIT subject to the normalization rules as resulting from the timing difference between two depreciation computations with respect to the tax basis of assets constituting public utility property: actual tax depreciation (i.e., tax basis

[1] Section 168(i)(9)(A)(ii) of the Code states: if the amount allowable as a deduction under this section with respect to such property (respecting all elections made by the taxpayer under this section) differs from the amount that would be allowable as a deduction under section 167 using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

depreciated using the tax method and life (recovery period) and what tax depreciation would be using the depreciation method and life used to compute recoverable depreciation expense (i.e., tax basis depreciated using book method and life)). As estimated removal costs are not included in the tax basis of public utility property, the deferred taxes resulting from this timing difference are not described in Section 168(i)(9)(A)(ii) of the Code. Section 13001(d)(3) of the TCJA[2] defines the "excess tax reserve" (subject to the normalization rules) with reference to ADIT described in Section 168(i)(9)(A)(ii) of the Code. Accordingly, the determination of whether a timing difference results in an excess tax reserve subject to Section 13001(d) of the TCJA is based on the determination of whether the associated ADIT is subject to the normalization rules of Section 168(i)(9) of the Code. Accordingly, AWK asserts that the difference between deferred taxes with respect to removal costs measured before and after the TCJA decrease in corporate tax rate are not excess tax reserves as defined in Section 13001(d) of the TCJA.

AWK notes that its utility subsidiaries accrue estimated removal costs for regulatory reporting and ratemaking purposes over the estimated book lives of the associated property. Removal costs are not incurred for federal income tax purposes until the end of an asset's usefulness and, thus, and the removal cost timing difference for AWK affiliates results in deferred tax assets. It is AWK's understanding that the regulatory reporting and ratemaking practices of its regulatory jurisdictions are similar to that of most regulatory jurisdictions, but AWK is aware that regulatory practices vary and that the removal cost timing differences for some utilities result in deferred tax liabilities.

The AWK utility affiliates maintain deferred tax accounting for its removal cost differences separately from their deferred tax accounting for depreciation method and life differences. As such, clarification of whether deferred taxes for removal costs are subject to the deferred tax normalization rules, including the TCJA excess tax reserve normalization rules, would resolve regulatory uncertainty regarding the scope of ARAM and the alternative method for accounting for excess tax reserves.

AWK utility affiliates have asserted in their rate proceedings that deferred taxes resulting from removal cost timing differences are not subject to the normalization rules. There are at least two computational ramifications of such classification of this deferred tax asset:

- Computations as of the end of 2017 of (a) the amount of the TCJA excess tax reserve subject to ARAM and (b) the amount of other excess deferred income tax assets and liabilities to be recovered or refunded at the discretion of a regulatory jurisdiction
- Computation of the amount of reversal of depreciation method and life timing differences after 2017

It is important that the TCJA excess tax reserve guidance clarify and provide examples of plant-related timing differences that are not subject to the deferred tax normalization rules because even though many regulatory jurisdictions have voluntarily normalized removal cost timing differences over the years in the context of computing recoverable income tax expense on a normalized (accrual) basis or a flow through (cash) basis, numerous regulatory jurisdictions are not voluntarily applying ARAM to all (or net) property-related excess deferred tax liabilities.

The second significant computational effect of the proper classification and accounting for removal cost deferred taxes is affects the reversal of excess tax reserves in 2018 and subsequent years. For financial and regulatory purposes, AWK utility subsidiaries accrue the estimated cost of removal for a given asset or asset class as part of the depreciation rate and record the entire amount of depreciation expense in accumulated

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[2] Section 13001(d)(3) of the TCJA states: (3) DEFINITIONS.—For purposes of this subsection—
(A) EXCESS TAX RESERVE.—The term ''excess tax reserve'' means the excess of—
(i) the reserve for deferred taxes (as described in section 168(i)(9)(A)(ii) of the Internal Revenue Code of 1986) as of the day before the corporate rate reductions provided in the amendments made by this section take effect, over
(ii) the amount which would be the balance in such reserve if the amount of such reserve were determined by assuming that the corporate rate reductions provided in this Act were in effect for all prior periods.

depreciation. For example, an asset with an estimated useful life of 25 years and an estimated removal cost of five percent would record annual depreciation for financial and regulatory reporting as 4.2 percent of the original cost of the asset (i.e., 100 percent divided by the 25-year life equals four percent related to the original cost of the asset PLUS five percent divided by the 25-year life equals 0.2 percent accrual of estimated removal costs). Though estimated removal costs are recorded as part of book depreciation, the AWK utility subsidiaries separately compute estimated annual removal costs (rates) and are able to easily and accurately compute the portion of regulatory depreciation expense related to the original cost of an asset.

Section 13001(d)(3)(B) of the TCJA, as supplemented by the Joint Explanatory Text of the Committee of Conference, H. Rept. 115-466, provides that ARAM reduces the excess tax reserve over the remaining regulatory lives of the property that gave rise to the reserve for deferred taxes during the years in which the deferred tax reserve related to such property is reversing. Under this method, the excess tax reserve is reduced as the timing differences reverse over the remaining life of the asset. The reversal of timing differences generally occurs when the amount of the tax depreciation taken with respect to an asset is less than the amount of the regulatory depreciation taken with respect to the asset. For ARAM to properly reverse depreciation method and life differences, the life-only portion of regulatory depreciation expense must be used for the computation. Use of a regulatory depreciation expense amount that also includes estimated removal costs could result in reversal of excess tax reserve for a given vintage of depreciation method and life differences too soon (i.e., improper identification of the first year that book depreciation exceeds tax depreciation) and, even in years in which the depreciation method and life difference is truly reversing, computation of the amount of the reversing depreciation method and life difference with reference to two timing differences (i.e., depreciation and removal costs) would result in a higher refund of excess tax reserves than permitted by ARAM.

AWK appreciates that some utilities may not have historically computed or recorded deferred taxes with respect removal cost differences separately from deferred taxes resulting from depreciation method and life differences. AWK would support administrative relief for the ARAM computation for these companies in the TCJA excess tax reserve normalization guidance so that their ARAM computations reflecting a combined (net) deferred tax amount are deemed to satisfy the TCJA excess tax reserve normalization rules. AWK believes that the approach in the TCJA excess tax reserve guidance that would best serve utilities would be to first provide a rule that adheres to the relevant statute (i.e., indicate whether deferred taxes for removal cost are subject to the normalization rules or not) and then create a practical approach only available to companies without separate deferred tax accounting records for depreciation method and life differences that is considered to satisfy ARAM. The availability of any such relief should be limited such that a regulatory jurisdiction does not have discretion to force a utility with separate deferred tax accounting records for depreciation method and life differences to use an alternative method set forth to assist companies without such records.

Dispositions

Notice 2019-33 requests comments with respect to the treatment of dispositions of public utility property on TCJA excess tax reserves, specifically: By their terms, the 2008 regulations apply only to section 203(e) of the 1986 Act, but the Treasury Department and the IRS believe it may be appropriate to extend their application to section 13001(d) of the TCJA. Comments on the ongoing relevance of the 2008 regulations including but not limited to comments on the treatment of book-only retirements and tax dispositions in regard to significant transactions (such as sales of power plants) versus day-to-day (ordinary or not significant) transactions as well as comments on transactions not addressed in the 2008 regulations such as like-kind exchanges or other dispositions of public utility property.

AWK considers the 2008 regulations to include principles regarding the effects of retirements and dispositions of public utility property on Tax Reform Act of 1986 excess tax reserves that should be extended to TCJA excess tax reserves but recommends that the forthcoming guidance address more types of transactions than were included in the prior guidance.

AWK recommends that the TCJA excess tax reserve normalization rules permit continued sharing of excess tax reserves with customers in most circumstances (via reduction in regulatory tax expense (i.e., refunds or price reductions) and reduction in rate base reduction for unamortized excess tax reserves) after a retirement or disposition. Following are examples of situations in which AWK recommends that continued rate reductions for TCJA excess tax reserves continue as well as parameters to determine when reductions of customer rates for TCJA excess tax reserves should cease.

Unlike the rules in the 2008 regulations, AWK recommends that the TCJA excess tax reserve normalization guidance clearly permit the continued sharing of excess tax reserves upon an ordinary retirement of public utility property within the meaning of Section 1.167(a)-11(d)(3)(ii) of the Regulations. Further, AWK does not believe that the TCJA excess tax reserve normalization guidance should generally distinguish between types of taxable dispositions of public utility property. Instead, AWK believes that the TCJA excess tax reserve normalization rules should permit continued sharing of excess tax reserves to the extent that the undepreciated net regulatory basis of the asset is reflected in ratemaking (i.e., included in rate base and recoverable through depreciation, stranded cost recovery or otherwise). Such a limitation on continued sharing of TCJA excess tax reserves is essentially application of the consistency requirement of Section 168(i)(9)(B) of the Code. AWK believes that this is required and recommends that the TCJA excess tax reserve normalization guidance clarify that the consistency requirement and other pre-existing normalization rules of the Code also apply to TCJA excess tax reserves.

The determination of whether and, if applicable, to the extent net regulatory basis of depreciable plant is reflected in ratemaking varies based on a company's regulatory reporting. First, as acknowledged in Notice 2019-33, a transaction that is recorded as a retirement for regulatory and financial reporting may not constitute a disposition for federal income tax purposes (depending on tax accounting methods adopted and tax elections made) by a taxpayer (i.e., a "book-only retirement"). Gain or loss recognition for regulatory reporting or income tax purposes may affect the timing difference used to compute an ARAM reversal but is not determinative of whether or not sharing of excess tax reserves with customers should continue.

To illustrate an example of regulatory reporting in which net regulatory basis of depreciable plant continues to be reflected in ratemaking after a retirement (whether a book-only retirement or also a disposition for tax purposes), following is a description of how a utility may record a retirement of depreciable plant for regulatory and financial reporting purposes and how a plant retirement affects ratemaking. Except in extraordinary circumstances (often as a result of a transaction-specific accounting order from its commission), a utility records a retirement of depreciable plant for regulatory and financial reporting purposes by reducing (crediting) plant in service by the original cost of the asset and reducing (debiting) accumulated depreciation by the same amount. In addition, as applicable, a cash expenditure is recorded (credit) for any net removal costs (i.e., excess of removal costs over salvage value) with a further debit to accumulated depreciation. Or, a cash receipt is recorded (debit) for any net salvage value (i.e., excess of salvage proceeds over removal costs) with a credit to accumulated depreciation. Gain or loss is not reported for regulatory or financial reporting purposes for day-to-day retirements of depreciable plant. The plant accounting described above as well as depreciation for regulatory and financial reporting purposes is recorded based on asset classes (or groups), not for specific individual assets. Rate base is not affected by a day-to-day retirement of depreciable plant. As such, allowed return and recoverable tax expense after a day-to-day retirement are also not affected. Depreciation expense for regulatory and financial reporting purposes is computed with reference to gross plant in service and, as such, depreciation expense is lower beginning in the month after a day-to-day retirement for regulatory or financial reporting purposes, but lifetime depreciation will not change for these reporting purposes for the asset group. AWK recommends that the forthcoming TCJA excess tax reserve normalization rules permit continued sharing of excess tax reserves with customers in this common circumstance.

AWK's view is consistent with the application of Section 1.167(l)-1(h)(2)(i) of the Regulations regarding when deferred tax reserves subject to the normalization requirements may be increased or decreased in accordance with such rules. Consistent with the basic statutory language of Section168(i)(9)(A) of the Code and its predecessor statutory provisions, deferred tax reserves must be credited (increased) for the deferral of taxes resulting from use of accelerated tax depreciation for federal income tax purposes (i.e., book/tax differences arising from faster tax methods and shorter tax recovery periods). Section 1.167(1)-1(h)(2)(i) of the Regulations prescribes limited circumstances when deferred tax reserves subject to the normalization requirements may be reduced. The rule provides that deferred tax reserves subject to the normalization requirements shall not be reduced except to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation (i.e., reversing depreciation differences) or to reflect asset retirements (and in limited circumstances not relevant to TCJA excess tax reserves). This rule does not specify whether the asset retirements causing a deferred tax reserve adjustment must be retirements for both regulatory accounting and tax reporting purposes, may be retirements for regulatory accounting purposes only or may be dispositions for tax purposes only. AWK believes that the deferred tax reserve adjustment (reversal) under Section 1.167(l)-1(h)(2)(i) of the Regulations applies to book retirements as well as tax dispositions, regardless of whether the transaction is considered a retirement or disposition in the other context. The rule simply provides that an adjustment is made to the deferred tax reserve balance and does not indicate that the adjusted deferred tax reserve balance ceases to be subject to the normalization requirements.

To be clear, AWK believes that the continued sharing of TCJA tax reserves should be permitted occur over a period at least as long as the remaining regulatory depreciation period for the applicable asset group (if in accordance with a company's regulatory depreciation method) or what would have been the remaining depreciable life for the asset had it not been retired (if in accordance with a company's regulatory depreciation method or if determinable from its fixed asset records) if the net regulatory basis of the retired depreciable plant continues to be reflected in ratemaking. Return of TCJA excess tax reserves faster than over the remaining regulatory lives of property in the same asset class used to compute regulatory depreciation or reversal of the depreciation timing difference for such asset class would violate the TCJA excess tax reserve normalization rules.

Like the 2008 regulations, AWK recommends that the TCJA excess tax reserve guidance include flexibility for sales of public utility property to another regulated utility. The 2008 regulations permit either utility (but not both) to continue to share the pre-transaction excess tax reserves with customers. AWK recommends that the TCJA excess tax reserve guidance permit sellers of public utility property and/or rate-regulated buyers of public utility property to continue to share pre-transaction excess tax reserves with customers, limited such that the total rate base reductions and rate refunds of the two companies do not exceed the amount of the pre-transaction excess tax reserve. Further, AWK recommends that the TCJA excess tax reserve guidance prescribe a minimum refund period for buyers (because the buyers normally will not know or have reason to maintain the reversal pattern of the seller's pre-transaction timing difference as if the transaction did not occur). The TCJA excess tax reserve guidance should permit ratable refunds by buyers in this situation even if the buyer otherwise employs ARAM.

Conclusion

We appreciate your time and consideration of these important issues. We believe that the TCJA excess tax reserve normalization guidance is an opportunity to resolve significant issues in many regulatory proceedings and to minimize the need for private letter rulings in the future. AWK would be pleased to explain its views by teleconference or in a meeting with Treasury and Service personnel working on the Notice 2019-33 guidance project. Please do not hesitate to call me at (856) 955-4513 or to email me at John.Wilde@amwater.com if additional information would be helpful.

Respectfully submitted,

John R. Wilde
Vice President – Tax Strategy and Compliance
American Water Works Company, Inc.

JRW/mmy

Edison Electric INSTITUTE

American Gas Association

July 26, 2019

Via Hand Delivery and Electronic Mail
CC:P:LPD:PR (Notice 2019-33), Couriers Desk,
Internal Revenue Service
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Washington, D.C. 20224
Attn: CC:PA:LPD:PR

The Honorable David Kautter
Assistant Secretary (Tax Policy)
United States Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington D.C. 20220

The Honorable Charles Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, N.W.
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Dear Messrs. Kautter, Rettig and Desmond:

The Edison Electric Institute and the American Gas Association want to express our gratitude for the careful thought and attention that went into the development of Notice 2019-33 requesting comments to clarify the normalization requirements included in section 13001(d) of the Tax Cuts and Jobs Act ("TCJA"), Pub. L. 115-97 (131 Stat 2054) for the excess tax reserves ("ETR") resulting from the corporate tax rate decrease provided by the TCJA. We agree that several issues have arisen or are anticipated to arise as regulated public utilities and regulators take the effects of the corporate rate reduction into account in the ratemaking process. We support the issuance of guidance to provide certainty to taxpayers and regulators on these issues. Your guidance on these matters is extremely important to regulated public utilities and regulators because of the significant tax costs imposed in the event a taxpayer is found not to have used a normalization method of accounting in regulatory reporting or ratemaking for its ETR.

You have requested comments on seven specific issues, which we will address in Section 1 of this letter. In Section 2, we will discuss comments on transition rules, which we consider important to allow the orderly implementation of your guidance. Finally, in Section 3, we will address the forms of the guidance, the need for your guidance as soon as practicable, and our suggestions for a process by which the timeliness of guidance may be accelerated.

Section 1. Specific Issues Raised and Comments

(1) Situations where taxpayers may have vintage account data in their underlying books and records in some form but such data is not necessarily useful for ARAM without significant additional analysis and expense. More specifically, comments on whether some sort of "reasonable" test should be provided, under which the use of the alternative method by a taxpayer is permissible if the cost to the taxpayer of assembling the data contained in the underlying books and records in a way necessary to apply ARAM exceeds a reasonable amount, based on a percentage of rate base or some other factor.

The general normalization rule of section 13001(d)(1) of the TCJA provides that a regulated public utility is not permitted to reduce its ETR "more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method" ("ARAM"). A limited exception is provided to this general rule by section 13001(d)(2) of the TCJA. Under section 13001(d)(2) of the TCJA, certain taxpayers are permitted to use an alternative method in lieu of the ARAM, if on the first day of their taxable year that includes December 22, 2017 (the date of enactment of the TCJA): (i) they are required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and (ii) their books and underlying records did not contain the vintage account data necessary to apply the ARAM.

It is important that taxpayers have clear guidance to determine if they do not have "books and underlying records" that "contain the vintage account data necessary to apply the average rate assumption method" in order to use the alternative method without the risk of a normalization violation. In response to one specific question raised in this Issue 1 of Notice 2019-33, we do not believe that consideration of the reasonableness of the cost of assembling the data contained in the underlying books and records in a way necessary to apply the ARAM resolves this issue, particularly if the costs were measured as a percentage of rate base. This is so because the rate base of a regulated public utility is a significant amount, and any material percentage would be a significant cost. In contrast, the use of an immaterial percentage of rate base could produce an arbitrary cost threshold that would be an unreliable measure of whether the cost exceeds a "reasonable amount." Furthermore, a taxpayer would be faced with the challenge of determining and proving the cost of assembling the needed data contained in the underlying books and records in a way necessary to apply the ARAM in the absence of actually having incurred such costs. This challenge could lead to serious uncertainty and controversy.

In our view, the issue is best addressed by focusing on the intent of the statute and not the cost of compliance, although we do not object to consideration of the cost of compliance as a general matter in the sound administration of our federal income tax system. The statute makes the required use of the ARAM dependent upon the taxpayer having books and underlying records that contain the vintage account data necessary to apply the ARAM. It does not require the taxpayer to create the books and underlying records that contain the vintage account data. In other words, unless the books, which contain the financial and tax accounts of the regulated utility, are already based upon the vintage account data that is required for the ARAM, use of the ARAM should not be required. A taxpayer should not be required to construct, restore or estimate vintage account data to determine the ARAM if such data is not already in use in the taxpayer's books. Such an expansive reading would change the second requirement of the statute to require a taxpayer to show that it could not produce or re-construct the vintage account data needed to apply the ARAM. In our view, that was not the intent of Congress. The statute does not require a taxpayer to show that it could not produce or construct the vintage account data needed to apply the ARAM. Rather the statute focuses on the data's existence. In our view, the intent of Congress, was to require the ARAM only when the taxpayer already has the books and underlying records that contain the vintage account data.

Thus, in the absence of a taxpayer reflecting sufficient vintage account data in regulatory filings, financial reports, or management reports, the taxpayer would not have the books and underlying records that contain the vintage account data necessary to apply the ARAM. We also believe a safe harbor based upon this distinction is appropriate. Thus, pursuant to such a safe harbor, a taxpayer not reflecting sufficient vintage account data in regulatory filings, financial reports, or management reports would not be required to apply the ARAM because the taxpayer's books lack vintage account data.

In the absence of the application of the safe harbor, the question whether the taxpayer has vintage account data in its books and records to use the ARAM would be based on all the facts and circumstances.

In determining whether the taxpayer qualifies for the alternative method either by applying the safe harbor or based on its facts and circumstances, the guidance should provide that the taxpayer is not required to cure deficiencies in its books and records by the creation, recreation, or restoration of books or records, including through the use of estimates, statistical sampling, or the accessing of data through the use of computer systems not currently in use for its financial processes. This would eliminate the arguments that sufficient data exists to use the ARAM simply because vintage account data can be determined by reconstruction from underlying primary records or the use of estimates and statistical sampling.

In the absence of guidance to date, some regulated public utilities have used estimates, statistical sampling, or accessed data from computer systems no longer in use to cure deficiencies in their books and records to timely provide benefits of the TCJA to customers under the ARAM. While we are asking that such creation, recreation or restoration of books and records not be required, we believe that taxpayers that have created, recreated or restored books or records to cure deficiencies in data, by the time your guidance is issued in order to use the ARAM, should be permitted to do so. The ARAM is favored by section 13001(d)(1) of the TCJA and its use should be encouraged. In support of the use of the ARAM, we ask that your guidance provide that a regulated utility that uses the ARAM is presumed to have sufficient vintage account data to use the ARAM.

Consistent with Rev. Proc. 88-12, 1988-1 C.B. 637, your guidance should provide that if a taxpayer is subject to the jurisdiction of more than one regulatory body, the determination of the adequacy of the vintage account data for each asset or group of assets is determined on a jurisdiction-by-jurisdiction basis.

Our final comment on this first issue is that vintage account data has improved over time for some regulated public utilities. In the case of a single regulated public utility business with the absence of vintage account data for some, but not all vintages, the taxpayer should not be required to use the ARAM or the alternative method on a vintage-by-vintage basis depending on the existence of the vintage account data for each vintage. Instead the alternative method should be available for all vintages unless a significant amount of the taxpayer's ETR is attributable to vintages for which the taxpayer has vintage account data. For purposes of this rule, we suggest you define the term "significant" to mean that the taxpayer has 50 percent or more of its ETR in vintages for which it has vintage account data. A taxpayer with 50 percent or more of its ETR in vintages for which it has vintage account data needed to use the ARAM should be required to use the ARAM for vintages for which it has the required data available, and the alternative method for the balance of its ETR for which it does not have the required vintage account data available. A regulated public utility with less than 50 percent of its ETR in vintages for which it has vintage account data to use ARAM, could either: (i) use the alternative method to account for all its ETR, or (ii) use ARAM for those vintages for which it has vintage account data and the alternative method for the balance of its ETR. Once adopted, a taxpayer should be required to use ARAM or the alternative method consistently from year to year with respect to ETR resulting from the TCJA. Again, we suggest that a regulated public utility is presumed to have sufficient vintage account data to use the ARAM, if it uses the ARAM.

(2) Other fact patterns where taxpayers may use the alternative method instead of ARAM including but not limited to comments on when the RSGM is a taxpayer's current normalization method of accounting for excess deferred taxes, regardless of the availability of vintage or class information for the accumulated deferred income taxes (ADIT) that had been accrued after the 1986 Act.

In our view, the ARAM and the alternative method are not tax methods of accounting under section 446 of the Internal Revenue Code of 1986, as amended ("Code"). While we recognize the need for consistency with respect to the application of the normalization rules from year to year as stated in our comments to Issue 1, above, section 203(e) of the Tax Reform Act of 1986, and section 13001(d) of the TCJA are separate statutory provisions, each of which identifies the ETR to which it relates separately. Furthermore, section 203(e) of the Tax Reform Act of 1986 did not contain an alternative to the ARAM, whereas section 13001(d) of the TCJA does contain an alternative method. More importantly, the alternative method provided under Rev. Proc. 88-12, supra, was based on the taxpayer's books and underlying records as of the first day of the taxable year that included July 1, 1987, and the alternative method provided under section 13001(d) of the TCJA is based on the taxpayer's books and underlying records as of the first day of the taxable year that included December 22, 2017. In the case of the same calendar year taxpayer these dates are three decades apart. The fact that a taxpayer did not have vintage account data in 1987 does not mean that the taxpayer did not have vintage account data in 2017, nor is there any indication that Congress intended the taxpayer's method of accounting for the ETR under the Tax Reform Act of 1986 to carry over to the ETR created by the TCJA.

We also recognize that Treasury Regulation section 1.167(l)-1(h)(5) requires taxpayers to notify the IRS upon a taxpayer's "change in method of regulated accounting." This provision however, does not bind the taxpayer to any specific method of accounting for the ETR resulting from the TCJA.

In our view, a regulated public utility that has the books and vintage account data needed to apply the ARAM, should be required to use the ARAM under section 13001(d) of the TCJA for the ETR resulting from the corporate rate reduction in the TCJA without regard to whether the taxpayer used the alternative method permitted by Rev. Proc. 88-12, supra, for the ETR resulting from the corporate rate reduction in the Tax Reform Act of 1986.

(3) Net operating loss (NOL) issues including but not limited to comments on the significance of a depreciation-related NOL carryforward in the context of excess deferred taxes, and comments on whether a depreciation-related NOL as of December 31, 2017, must be analyzed for normalization purposes based on the underlying loss year.

To the extent a regulated public utility has a depreciation-related net operating loss ("NOL"), the normalization rules require it to include a deferred tax asset ("DTA") in its rate base in an amount equal to the depreciation-related deferred tax liability ("DTL"). In the absence of a depreciation-related NOL, the DTL represents the cash tax benefit the regulated public utility received from accelerated depreciation, which was not realized as a reduction of its current tax expense included in its cost of service used in setting its rates. For regulatory accounting purposes, this tax benefit, which is a deferral of tax, is akin to a loan from the government that the regulated public utility will pay back to the government over the period when its book depreciation exceeds its tax depreciation. Since the government's "loan" to the regulated public utility is interest free, the regulated public utility treats the DTL as zero cost capital or reduces its rate base on which customers pay the regulated public utility a return. This reduction in rate base benefits customers. However, when the regulated public utility has a depreciation-related NOL, it receives no current cash tax benefit from the depreciation deductions and therefore it has no interest-free loan. The DTA recorded in the case of a depreciation-related NOL represents an amount that the regulated public utility will collect from the government in future years if the NOL is utilized, assuming there is no change in corporate tax rate. In the interim, the DTA offsets the DTL impact on rate base reflecting the fact that the utility is not receiving the benefit of zero-cost capital and thus has no such benefit to share with its customers as cost-free capital or a reduction in rate base.

When the corporate tax rate was reduced and the regulated public utility had a depreciation-related NOL carryover that was recorded at the pre-TCJA corporate tax rate, both the regulated public utility's DTL and DTA were overstated. The overstatement of the DTL is the ETR, the accounting for which is controlled by section 13001(d) of the TCJA. Under section 13001(d), the regulated public utility is not permitted to reduce the ETR more rapidly or to a greater extent than such reserve would be reduced under the ARAM, or in certain cases the alternative method. With respect to the DTA, the overstatement, or excess tax asset ("ETA"), will not be collected from the government because the corporate tax rate has been reduced, but it continues its purpose as an offset to the ETR, which will be reduced over time. The treatment of the ETA presents some issues that deserve clarification.

First, we believe that guidance should recognize that a regulated utility's reduction of the ETA by recovery in rates under the same method (the ARAM or the alternative method) as the ETR is a normalization method of accounting under the TCJA. Such treatment is consistent with the rationale for establishing and maintaining a DTL and DTA in the case of a depreciation-related NOL.

Second, the guidance should recognize that while the regulated public utility will not collect the ETA from the government, its reversal of the ETA more rapidly or to a greater extent than the reversal of the ETR under the ARAM, or for certain taxpayers the alternative method, should be considered a normalization method of accounting under the TCJA as long as the reversal of the ETA is taken into account in setting rates (e.g., the utility collects additional revenue). In the case of an ETA, which was established to recognize that the regulated public utility did not receive the cash benefit from the depreciation-related NOL, it is appropriate to allow the regulated public utility to reduce the ETA as it receives the benefit in rates. In other words, a normalization method of accounting is a limitation on the provision of tax benefits to the customers of a regulated public utility. The normalization rules of the TCJA are not a mechanism to limit a regulated public utility's ability to receive benefits in rates.

Issue 3 of Notice 2019-33 asks for comments on whether a depreciation-related NOL as of December 31, 2017, must be analyzed for normalization purposes based on the underlying loss year. We understand that most utilities do not track each year's depreciation-related NOL by accelerated depreciation vintages, and that such tracking would be impracticable and burdensome. We ask that guidance permit taxpayers to allocate the depreciation-related NOL to accelerated depreciation vintages using any reasonable method as long as the method is consistently applied. We ask that this include, but not be limited to, allowing a regulated public utility to increase customer revenue for the ETA attributable to the depreciation-related NOL carryover no less rapidly or to no lesser extent than such ETA would be reduced under the ARAM, or an alternative method for certain taxpayers, based upon the accelerated depreciation vintages of the property taken into account in the last depreciation-related NOL year before its first taxable year beginning after December 31, 2017.

(4) By their terms, the 2008 regulations apply only to section 203(e) of the 1986 Act, but the Treasury Department and the IRS believe it may be appropriate to extend their application to section 13001(d) of the TCJA. Comments on the ongoing relevance of the 2008 regulations including but not limited to comments on the treatment of book-only retirements and tax dispositions in regard to significant transactions (such as sales of power plants) versus day-to-day (ordinary or not significant) transactions as well as comments on transactions not addressed in the 2008 regulations such as like-kind exchanges or other dispositions of public utility property.

We believe that Treasury Regulation section 1.168(i)-3 should be extended to apply to section 13001(d) of the TCJA, with certain modifications to clarify subparagraph (b). Subparagraph (b) provides:

> (b) Amount of reduction. If public utility property of a taxpayer becomes deregulated public utility property to which this section applies, the reduction in the taxpayer's excess tax reserve permitted under section 203(e) of the Tax Reform Act of 1986 is equal to the amount by which the reserve could be reduced under that provision if all such property had remained public utility property of the taxpayer and the taxpayer had continued use of its normalization method of accounting with respect to such property.

In addition to referencing section 13001(d) of the TCJA, we ask that this provision be clarified to deal with two instances: (i) when the regulated public utility's regulator allows the regulated public utility to recover unrecovered costs of property that becomes deregulated, and (ii) when the regulated public utility's regulator does not allow the regulated public utility to recover the unrecovered cost of property that becomes deregulated. For this purpose, we understand property becomes deregulated when it ceases to be public utility property in the hands of the taxpayer by sale, disposition, casualty loss, or otherwise.

To the extent the regulated public utility's regulator allows the regulated public utility to recover the unrecovered cost of the property that becomes deregulated, the same proportionate amount of the ETR related to that property should be returned to customers over the same period and under the same pattern as the regulator has permitted the recovery of the costs. This rule does not change the principle that the customers are entitled to the benefits of the ETR on the property after its disposal, but synchronizes that enjoyment of benefits over the same period and under the same pattern as the recovery of the costs from customers. The deferred taxes are established to assure that the regulated public utility, and not the customer, receives the benefit of the tax deferral provided by accelerated depreciation over the life of the asset. Section 203(e) of the Tax Reform Act of 1986, and section 13001(d) of the TCJA are intended to provide the regulated public utility the same benefit over the life of the asset. To the extent that the regulated public utility has disposed of the asset, and the regulated public utility has recovered its costs, the regulated public utility no longer requires the ETR benefit to support the capital cost of the asset.

To the extent the regulated utility's regulator does not allow the regulated utility to recover the unrecovered cost of the property that becomes deregulated, the regulated utility should not be permitted to return that same proportion of the ETR to customers, and should flow-through that ETR to shareholders immediately. In this circumstance, the regulated public utility has not recovered all its costs and the ratepayers have not paid the full cost of the asset through ratemaking depreciation or otherwise. In considering this issue with respect to the accumulated deferred investment tax credit the IRS and the Treasury Department recognized that Congress did not intend for ratepayers to share in benefits attributable to costs that they do not bear. See Preamble to Treasury Regulation section 1.46-6 and Treasury Regulation section 1.168(i)-3, T.D. 9387 (Mar. 20, 2008), which rejects the suggestion of commenters that the regulations permit flow-through of accumulated deferred investment tax credit reserves even in cases in which ratepayers do not bear the cost of the asset giving rise to the credit.

Treasury Regulation section 1.168(i)-3 deals with the complex issue of accounting for retirements when applying the normalization rules to the return of the ETR to customers. We suggest you consider a major simplification of the rules by permitting a regulated public utility to elect to reduce its ETR under the ARAM based on a computation which schedules the amortization of its ETR without making any adjustments to that amortization schedule over the life of the assets, related to any tax disposition for which ETR is required to be returned to customers. Additionally, we believe such an election to be essential for taxpayers that use the alternative method, since vintage account data does not exist to determine the amount of the ETR associated with the retirement of an asset or group of assets. A taxpayer would make this election and computation based on the facts as they exist at a specified date within a reasonable period of time after you issue guidance. This election should also allow a taxpayer a separate election to reduce its ETA over any period as long as it is no longer or less rapid than the amortization of the ETR. This "set it and forget it" election is supported by a significant number of regulated public utilities and would represent a major simplification. This simplification is wholly consistent with the intent of the TCJA normalization principle of limiting the return of the ETR to customers at the rate that was anticipated immediately before the effective date of the corporate tax rate reduction.

(5) The implementation of interim rates to reflect the TCJA's decrease in the corporate tax rate including but not limited to comments about the meaning of the phrase "reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under ARAM."

The rates charged by regulated public utilities to their customers are based on their cost of providing service, including a return on their capital investment. Federal income taxes are one of a regulated public utility's costs. The corporate rate reduction provided by the TCJA provided a substantial reduction in the federal income taxes that will be provided by regulated public utilities to their customers. Regulators, understandably, have been anxious to pass these federal income tax cost reductions on to ratepayers in the form of lower rates as soon as practicable. There are two elements of this benefit to customers. The first is that regulated public utilities had been collecting deferred federal income tax expense from customers at the pre-rate reduction rate. These deferred tax collections are a consequence of the normalization method of accounting. Since the regulated public utilities now expect to pay these deferred taxes to the government in the future at the reduced rate, the ETR can be returned to customers subject to the limitations of section 13001(d) of the TCJA. The second federal tax cost reduction is with respect to the expected current federal income tax expense imbedded in current rates. Regulated public utilities estimate expenses, including federal income taxes, for purposes of determining rates, based on either a historic or a future test period. In either case, prior to the enactment of the TCJA, regulated public utilities did not anticipate the rate reduction and therefore their rates include current federal income tax expense at the higher pre-rate reduction amount. Most regulators have either encouraged or required regulated public utilities to adjust their rates quickly as interim rate adjustments to account solely for the reduction in the corporate tax rate. These interim rate adjustments differ from rate adjustments made through general rate case proceedings, which consider all costs of service, including capital returns. These interim rate reductions, which have occurred in many ways, raise two principal areas of concern. The first relates to the application of section 13001(d) of the TCJA to the return of the ETR. The second relates to the consistency rules that are generally applicable to a normalization method of accounting.

As an initial matter, we believe it is important for your guidance to recognize that the consistency rules of section 168 of the Code apply to the ETR and that the interim rate adjustments to reflect the reduction in the corporate tax rate are consistent with a normalization method of accounting. Specifically, interim rate adjustments the regulated utility makes to reflect the reduction in the corporate tax rate will comply with a normalization method of accounting if there is consistency in the treatment of (i) adjustments made to ADFIT and ETR, and (ii) such adjusted reserves are used in determining the limitation on rate base reduction for the ADFIT and ETR in the computation of the regulated utility's rate base.

For example, assume a calendar year regulated public utility set rates in 2016, based on a 2015 historic test period, which assumed a 35 percent corporate tax rate, and these rates were put into effect in 2017. Further assume that the regulated public utility adjusted its rates for 2018 by changing the estimated 35 percent corporate tax rate to the reduced 21 percent corporate tax rate (the rate applicable to 2018), computed its change in ADFIT based on the reduced rate, and recorded an ETR for this change in rate. Alternatively, assume the same fact pattern above, but the utility also began to reduce its ETR, which resulted from the corporate tax rate reduction, consistent with the ARAM or the alternative method, and adjusted rate base, for its ETR consistent with the revised reserve balances. In either case, the regulated public utility did not update its gross rate base (rate base before deferred tax balances), its depreciation deductions or other elements of cost of service including its weighted average cost of capital. Thus, the gross rate base and the depreciation deduction are based on the 2015 historic test period, and the tax expense, the ADFIT and the ETR are based on the 2018 tax rate. The consequences of these adjustments resulted in lower current and deferred federal income tax costs, and an adjustment to the regulated public utility's earnings on capital as a result of the adjustments made to the ADFIT and the ETR, which offset rate base. Your guidance should conclude that these methodologies are normalization methods of accounting.

We believe it is important that any guidance clarify that the computation of the ARAM, or in certain cases the alternative method, provides a limitation on how fast and to what extent the ETR can be taken into account as a benefit to customers. As a consequence of this "Limitation Principle," the guidance should recognize that a normalization method of accounting permits the regulated public utility: (i) to not take into account the ETR, or any portion of it, as a benefit to customers, and (ii) to the extent an amount could have been taken into account as a benefit to customers in a prior period, but was not taken into account, the regulated public utility is permitted to take the amount into account to "catch up" at any time, but is not permitted to exceed the cumulative limitation. We believe the guidance should specifically state that the limitation is cumulative, and not determined on an annual or other alternative basis.

We believe that the Limitation Principle is consistent with the meaning of the phrase "reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under ARAM." This phrase read in the context of the statute, which reads: "A normalization method of accounting shall not be treated as being used . . . if the taxpayer . . . reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method," does not prescribe the ARAM, or in certain cases the alternative method, as the amount by which the ETR must be reduced to be treated as a normalization method of accounting. Rather, the statute provides a comparison between the taxpayer's reduction of its ETR and the reduction under the ARAM, or alternative method, and prohibits the reduction of the ETR either "more rapidly or to a greater extent than such reserve would be reduced under the [ARAM]" or in certain cases the alternative method.

(6) Whether the proration formula required by § 1.167(l)-1(h)(6)(ii) must be applied to excess deferred tax activity related to reversals (refunds) of excess deferred taxes if the company uses a future test period or a part-historical, part-future test period.

When using a future test period, the ADFIT is prorated to determine the period during which the taxpayer will be treated as having received amounts credited or charged to the reserve account which is treated as zero-cost capital or an offset to rate base. See Treasury Regulation section 1.167(l)-1(a)(1). We believe that proration is applicable to the ETR, when a future test period is used, in the same manner and for the same reason as it applies to the ADFIT.

(7) Methodology of reversing protected (by the normalization rules) versus unprotected ADIT after the 2017 rate changes.

A regulated public utility's ADFIT and ETR are attributable to timing differences between the methods of accounting in its regulated books of account and in preparing its tax return. As liabilities, these accounts represent tax expense that has been accounted for in rates, but which has not been paid to the government. As assets, these accounts represent tax paid to the government that has not been collected in rates. As discussed above, in the case of NOLs, the DTA is established to offset the ADFIT in recognition that the depreciation deducted for tax purposes did not give rise to a tax benefit. The ADFIT represents the amount the regulated public utility expects to pay to the government, and the ETR represents the amount the regulated utility does not expect to pay to the government, but does expect to return to customers because it collected it from customers in the past. Normalization "protects" a regulated public utility's ADFIT and ETR that are attributable to different: (i) depreciation methods, including the time and manner in which salvage value is taken into account, and (ii) depreciation useful lives. The ADFIT and the ETR include items other than depreciation. Depreciation-related ADFIT and ETR are protected and other items are not protected. However, a normalization method of accounting may be used for all items, both protected and not protected.

Your guidance should clarify the scope of the protected depreciation-related ETR consistent with the treatment of the ADFIT. In this regard, your guidance should state that (i) deferred tax differences attributable to differences in regulatory and tax depreciation life and rate are protected, but deferred tax differences attributable to differences in regulatory and tax basis of assets are not protected; (ii) salvage value taken into account for regulatory purposes over the life of the asset, but only taken into account at the end of the life of an asset for tax purposes, is taken into account under the tax normalization rules and is thus protected; (iii) the cost of removing an asset (cost of removal or "COR") at the end of its operating life, which is taken into account for regulatory purposes over the regulatory life of the asset, but deducted for tax purposes at the end of the asset's operating life, is generally not subject to the tax normalization rules because the deduction is allowed under section 162 of the Code and not section 168 of the Code; and (iv) for regulated public utilities using the ARAM, the minimum period of time over which the utility may return the protected ETR to customers begins after the effective date of the corporate tax rate reduction and the timing difference begins to reverse, and ends with the end of the regulatory life of the asset. It is also important to recognize that in some instances the commingling of reserves present particular circumstances to normalize amounts that would not be normalized if accounted for separately. These principles may be illustrated by examples.

Example 1 – Repair Deductions. The difference in the treatment of repairs is a good example of basis differences that do not produce protected deferred taxes. Assume for federal income tax purposes, a regulated public utility is allowed a tax deduction of $1,000 for the cost to replace an asset, which is treated as the repair of a unit of property deductible under section 162 of the Code, but for regulatory accounting purposes the regulated public utility capitalizes the replacement cost of the asset. While this provides the regulated public utility a tax benefit in the first year and it recovers the cost of the replacement from customers over the regulatory life of the asset, there is no depreciation deduction under section 168 of the Code, and therefore the normalization rules do not protect the ADFIT or ETR attributable to this different treatment. Your guidance should recognize that a taxpayer using the alternative method with commingled protected depreciation-ETR and cost basis adjustments attributable to repairs may identify the repairs-ETR by calculating its gross repairs deduction, net of book depreciation, and separately treat the protected depreciation-ETR in a manner that is compliant with the normalization provisions.

Example 2 – Contributions in Aid of Construction. Assume for federal income tax purposes, a regulated public utility is required to report as taxable income the receipt of a contribution in aid of construction from a customer and depreciate the cost of the asset constructed, but for regulatory purposes the regulated public utility neither reports the amount as income nor capitalizes the asset. In the absence of the regulated public utility charging the customer a gross-up for the detrimental tax effect, this difference in treatment results in the regulated public utility creating a DTA. In this case, the IRS has recognized that there is a depreciation deduction under section 168 of the Code and the regulatory treatment is effectively a full depreciation expense in the year the asset is acquired, and thus there is no basis difference, but rather a life difference. Consequently, the DTA is subject to the tax normalization rules and the utility is required by these rules to collect the DTA from customers.

Example 3 – Salvage Value. Assume a regulated public utility acquires an asset at a cost of $1,000, which has a ten-year regulatory life, and a $100 salvage value. The applicable regulatory annual depreciation rate would be 10 percent and the salvage rate would be negative 1 percent, thereby producing a combined rate ("Life Rate") of 9 percent. The utility would recover $900 over the ten-year life of the asset and any ETR attributable to the asset would be returned to customers over the period of time that begins when the depreciation timing difference reverses after the effective date of the corporate rate reduction and ends at the conclusion of the asset's 10-year life. This is so because both the life / rate difference between book depreciation and tax depreciation, including the different treatment of salvage value, is subject to the tax normalization rules. The fact that the 9 percent Life Rate suggests a life of 11 years (100% / 9%) does not extend the life of the asset or the period over which the ETR is returned to customers beyond 10 years.

Example 4 – Salvage Value and Cost of Removal Separately Identified. Whether COR is separately identified or not has a bearing on the regulatory life used for calculating the timing of the ARAM deferred tax reserve reversal. Section 13001(d) of the TCJA defines ARAM as the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Many utilities compute a Life Rate taking into account both salvage value and COR, and it is common that COR exceeds salvage value, resulting in negative net salvage value. To the extent that salvage and COR are stated separately in the computation of regulated depreciation expense in a year in which the timing differences for the property reverse, the adjustment to the ETA reserve should use depreciation expense calculated on the book life. In other words, if COR is separate, it is not taken into account in computing ARAM for the depreciation-related ETR.

Assume the same facts as in Example 3 (the $1,000 asset having a ten-year life and a $100 salvage value), but that the asset also has a $200 COR. In this Example 4, the applicable annual depreciation rate would be 10 percent, the salvage rate would be a negative 1 percent, and the COR rate would be 2 percent producing a Life Rate of 11 percent (10% less 1%, plus 2%). In this case the Life Rate is higher than it would be were salvage value not considered. In effect, the annual depreciation charge creates a reserve for COR net of salvage over the operating life of the asset. At the end of 10 years, $1,000 will have been charged to the accumulated depreciation reserve, $200 charged to the accumulated COR reserve, and $100 charged to the accumulated salvage reserve. The net result is that $1,100 is expensed ($1,000 depreciation plus $200 COR less of $100 of salvage amount) and both the COR and salvage value are realized for tax purposes at the end of the asset's life.

Since book depreciation expense is included in the regulated public utility's cost of service used for establishing its rates, customers pay for the COR as book depreciation is factored into their rates. However, for tax purposes, COR is deductible only when actually incurred. Therefore, for tax purposes, the regulated public utility reports its customer collections that fund the COR reserve as taxable income over the operating life of the asset, claiming an offsetting tax deduction only at the end of the life of that asset. Since COR is normalized in setting rates, customers are provided a tax benefit commensurate with their funding of COR. In other words, they are provided the COR tax benefit as they fund the COR reserve prior to the time the regulated public utility actually claims the deduction (and receives the benefit) on its tax return.

Accounting Standards Codification ("ASC") 980-740-25-2, which is commonly followed by regulated public utilities, provides that if, as a result of an action by a regulator, it is probable that the future increase or decrease in taxes would be recovered from or returned to customers through future rates, an asset or liability shall be recognized for that probable future revenue or reduction in future revenue. Moreover, that asset or liability also is accounted for as a temporary difference for which a deferred tax liability or asset is recognized. This accounting principle requires the regulated public utility that is recovering COR through rates before it claims the associated tax deduction to create a DTA, which represents the future benefit the regulated public utility will derive from the eventual COR tax deduction.

If subsequent to the TCJA enactment, the regulated public utility is able to separately identify the portion of its accumulated book depreciation reserve that relates to the COR accrual balance by distinguishing between COR differences and depreciation method/life differences, including salvage value, even though both differences are derived from the book depreciation rates and expense, the regulated utility's system can track the reversals of these differences separately. Since depreciation, including salvage, can be identified separate from COR, and the COR is deducted under section 162, the COR-related ETA is not subject to the tax normalization rules and may be recovered by the regulated public utility as rapidly as permitted by its regulator independent of its depreciation-related ETR. As in Example 3, the fact that the 11 percent Life Rate suggests a life of 9 years (100% / 11%) does not reduce the life of the asset from 10 years for purposes of returning the ETR to customers. Your guidance should provide that a regulated public utility that accounts for its COR-related ETA separate from its depreciation-related ETR is not required to use a normalization method of accounting for its COR-related ETA.

Example 5 - Salvage Value and Cost of Removal Not Separately Identified. In some cases, regulated public utilities do not separately identify COR-related ETR. If salvage value and COR are not separately stated in the computation of regulated depreciation expense in a year in which the timing differences for the property reverses, the amount of the adjustment to the ETA reserve using the depreciation expense should be calculated on the combined rate (including COR).

Assume the same facts as in Example 4, but the regulated public utility does not identify COR-related ETA separate from its protected depreciation-related ETR. Under the facts of this Example 5, the total ETR related to depreciation, salvage, and COR must be protected under the normalization rules, because, without protecting the total, it is uncertain whether a normalization method of accounting is being applied to the protected depreciation-related ETR. Furthermore, even if cost of removal were protected, the accounting for cost of removal produces a DTA and ETA, and under the Limitation Principle, a normalization method of accounting does not preclude the more rapid collection from customers of a pre-paid tax. Your guidance should provide that a regulated public utility that does not account for its COR-related ETA separately from its depreciation-related ETR must take both its COR-related ETA and its depreciation-related ETR into account in determining its normalization method of accounting. Since the tax deduction for COR occurs at the end of the life of the asset and the regulatory reserve is included in the ETR, a normalization method of accounting must include, in addition to book depreciation, depreciation for COR recovery and COR costs incurred.

Example 6 – Interest Capitalization. Regulated public utilities capitalize interest in different amounts and under different rules for regulatory accounting and tax purposes. Assume a regulated public utility capitalizes an allowance for funds used during construction ("AFUDC") of utility plant additions for regulatory purposes in accordance with generally accepted accounting principles ("GAAP"). Without regard to the capitalization of AFUDC interest for book purposes, the regulated public utility is required under uniform capitalization ("UNICAP") rules of section 263A(f) of the Code to capitalize interest for federal income tax purposes. These are two distinct interest capitalization provisions, the first of which, AFUDC, is a regulatory and GAAP convention, and the second of which, UNICAP, is a tax provision. As two distinct provisions, they produce two basis adjustments, and as basis adjustments they are not protected by normalization. Unlike two different depreciation systems that result in a difference in the timing of depreciation, but do not result in a difference in the total amount of depreciation over the life of the asset, these two interest provisions result in significant differences in the amount of interest that is capitalized, which in turn results in differences between the total book and total tax amount of depreciation over the life of the asset.

Section 2. Transitional Rules

The uncertainties in the proper application of section 13001(d) of the TCJA are evidenced by the Treasury Department and the IRS request for comments in Notice 2019-33. In addition to providing guidance on the issues discussed above, we ask that your guidance provide a path by which a regulated public utility can correct any mistakes it may have made in the implementation of 13001(d) of the TCJA. As indicated above, in many cases regulators have not or will not allow regulated public utilities to defer providing customers the benefits from the ETR that was created by the TCJA until after guidance is issued. In fact, most regulated public utilities have already been required to adjust rates for effects of the TCJA. We suggest that your guidance provide regulated public utilities a reasonable time after the issuance of the guidance to determine the proper application of that guidance to their individual facts and circumstances, and take any corrective actions that may be necessary. Any such corrective action will require the taxpayer to consult with its regulator and obtain its regulator's consent to the change. We also ask that your guidance provide relief from any potential violation of section 13001(d) of the TCJA for any regulated public utility that follows a prescribed transitional path to correct potential normalization violations on a prospective basis and that these violations be forgiven.

We suggest a two-step transitional process. The first step is a period for the taxpayer to identify whether it is complying with the normalization rules as required by section 13001(d) of the TCJA, as clarified by your guidance. The second step is to take any corrective action that may be necessary.

A taxpayer should be given a reasonable period after the issuance of guidance to evaluate its compliance with a view toward making a disclosure in its next filed federal income tax return of any potential normalization violation it intends to correct. To provide a reasonable period to properly consider its circumstances, the return on which any disclosure is made would be the original return for the first year that ends after the issuance of the guidance. For example, if your guidance is issued before January 1, 2020, a calendar year taxpayer would have until the time it files its 2019 tax return to determine its compliance with section 13001(d) of the TCJA, which would be no later than October 15, 2020.

We believe that Rev. Proc. 2017-47, 2017-38 I.R.B. 233, provides a template for how a regulated public utility would be expected to take corrective action. However, there are two important differences that need to be considered. The first is that taxpayers may need to take corrective action with respect to a practice or procedure that was not inadvertently adopted, as provided in Rev. Proc. 2017-47, because of the specificity with which interim rate adjustments have been made. Second, since some regulators have used special procedures to implement interim rates, they should be required to use similar procedures, if they are available, to approve corrective actions, and not be permitted to wait until the next regular rate proceeding. For each failure to comply with the normalization rules that a taxpayer identifies and discloses, the taxpayer would be required to change its Inconsistent Practice or Procedure (as defined in section 4.06 of Rev. Proc. 2017-47) to a Consistent Practice or Procedure (as defined in section 4.05 of Rev. Proc. 2017-47) at the Next Available Opportunity (as defined in section 4.07 of Rev. Proc. 2017-47 with the modification discussed above), provided the Taxpayer's Regulator (as defined in section 4.01 of Rev. Proc. 2017-47) adopts or approves the change.

Section 3. Form of Guidance

We appreciate that the Treasury Department and the IRS are under tremendous pressures to implement the TCJA. Regulated public utilities are also under significant pressure to take the customer positive effects of the TCJA into consideration in their rates. Regulated public utilities expect to provide billions of dollars of excess deferred income tax benefits resulting from the TCJA to customers. We recommend that the Treasury Department and the IRS identify the appropriate stakeholders in the implementation of section 13001(d) of the TCJA, and involve them in drafting the implementation of the guidance to expedite its release and assure it deals with the issues properly. For many of the issues identified above, revenue rulings or revenue procedures would seem more appropriate than Treasury Regulations because of the specialized nature of the issues, the limited number of taxpayers, and the ability of the affected taxpayers to bring consensus resolutions of the issues to the Treasury Department and the IRS on a timely basis.

We appreciate your consideration of these comments and are available to answer any questions. If you have any questions or need further clarifications, please contact Alex Zakupowsky of Miller & Chevalier at 202-626-5950.

Sincerely,

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