

BUTLER | SNOW

January 31, 2020

VIA ELECTRONIC FILING

TPUC.DocketRoom@tn.gov

Hon. Robin L. Morrison, Chairman
c/o Ectory Lawless, Docket Room Manager
Tennessee Public Utility Commission
502 Deaderick Street, 4th Floor
Nashville, TN 37243

RE: *Tennessee-American Water Company's Response to Commission's Investigation of Impacts of Federal Tax Reform on the Public Utility Revenue Requirements, TPUC Docket No. 18-00039*

Dear Chairman Morrison:

Attached for filing please find the *Surrebuttal Testimony of John R. Wilde* in the above-captioned matter.

As required, an original of this filing, along with four (4) hard copies, will follow. Should you have any questions concerning this filing, or require additional information, please do not hesitate to contact me.

Very truly yours,

BUTLER SNOW LLP


Melvin J. Malone

clw

Attachment

cc: Elaine K. Chambers, Tennessee-American Water Company
Daniel Whitaker, Assistant Attorney General, Consumer Advocate Unit
Karen Stachowski, Assistant Attorney General, Consumer Advocate Unit

*The Pinnacle at Symphony Place
150 3rd Avenue South, Suite 1600
Nashville, TN 37201*

51455974.v1

MELVIN J. MALONE
615.651.6705
melvin.malone@butlersnow.com

T 615.651.6700
F 615.651.6701
www.butlersnow.com

BUTLER SNOW LLP

TENNESSEE-AMERICAN WATER COMPANY, INC.

DOCKET NO. 18-00039

SURREBUTTAL TESTIMONY

OF

JOHN R. WILDE

ON

**TENNESSEE-AMERICAN WATER COMPANY'S RESPONSE TO COMMISSION'S
INVESTIGATION OF IMPACTS OF FEDERAL TAX REFORM ON THE PUBLIC
UTILITY REVENUE REQUIREMENTS**

January 31, 2020

1 **Q. Please state your name.**

2 A. My name is John R. Wilde.

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

4 A. I am employed by American Water Works Service Company, Inc. ("Service Company")
5 as Vice President - Tax. The Service Company is a subsidiary of American Water Works
6 Company, Inc. ("American Water") that provides services to American Water's
7 subsidiaries, including Tennessee-American Water Company ("Tennessee-American,"
8 "TAWC" or the "Company").

9 **Q. Are you the same John R. Wilde who submitted written direct, supplemental and**
10 **rebuttal testimony in this proceeding?**

11 A. Yes.

12 **Q. What is the purpose of your surrebuttal testimony?**

13 A. The purpose of this surrebuttal testimony is to present the Company's response to the
14 analysis and recommendations of David N. Dittmore on behalf of the Consumer Advocate
15 Unit in the Financial Division of the Tennessee Attorney General's Office ("Consumer
16 Advocate") in his supplemental testimony submitted in Docket No. 18-00039 on or about
17 January 21, 2020.

18 **Q. As part of his supplemental testimony (Exhibit DND-1), Mr. Dittmore breaks out**
19 **portions of plant related EADIT that he then labels as Unprotected, and then uses a**
20 **method of regulatory accounting known as flow-through to provide a debt and equity**
21 **funded government provided tax benefit or subsidy to customers over a 3-year period.**
22 **In doing so, did Mr. Dittmore address all the known uncertainty regarding the topic**
23 **of what portion of the plant related EADIT is subject to the tax normalization rules,**

1 **and/or how that the portion could be separated out and flow-through to the customers**
2 **consistent with the tax normalization rules?**

3 A. No. The IRS has not completed the project it initiated in June of 2019, and outlined in
4 Notice 2019-33 that would address the remaining uncertainty regarding what portions of
5 plant related EADIT are subject to the tax normalization rules, and how balances not
6 subject to the tax normalization rules can be effectively separated out in a manner
7 consistent with the tax normalization rules. In addition, while the IRS is engaged in its
8 guidance initiative, it is reluctant to provide taxpayers with PLR's that will be needed to
9 address more taxpayer specific facts and circumstance The Company does not expect to
10 have clarification of the uncertainties related to tax normalization requirements outlined
11 above and in my rebuttal testimony until later this year.

12 **Q. Did Mr. Dittmore use ARAM to compute the amortization of the balance he labels**
13 **as “protected”?**

14 A. No. Although Mr. Dittmore labels his results as EADIT ARAM Amortization, the method
15 he uses is not ARAM. ARAM calculations need to be run specific to the ARAM EADIT
16 balance by item, and by vintage.¹ The ARAM calculation that the Company provided
17 therefore was done by item and vintage, as required. The amortization computation that
18 Mr. Dittmore has provided was not. Therefore, even if Mr. Dittmore's breakout of
19 unprotected EADIT were ultimately aligned with the yet-to-be-issued IRS guidance, his
20 calculation of the amortization for the “protected” portion (i.e., the EADIT subject to the

¹ See, e.g., PLR-151999-12 at 5 (I.R.S. Oct 23, 2013) (available at <https://www.irs.gov/pub/irs-wd/1334036.pdf>) (“[U]nder the ARAM, excess tax reserves pertaining to a particular vintage or vintage account are not flowed through to ratepayers until such time as the timing differences in the particular vintage account reverse.”) (citing Sec. 2.04 of Rev. Proc. 88-12).

1 tax normalization rules) would be inconsistent with the tax normalization rules and expose
2 the Company and its customers to the penalties for a normalization violation.

3 **Q. Did Mr. Dittmore acknowledge the remaining uncertainties previously discussed by**
4 **the Company in this docketed case, or those raised as part of the public record**
5 **captured by the IRS guidance initiative (pursuant to Notice 2019-33)?**

6 **A.** No, in fact he incorrectly states that he took his categorization of EADIT balances as
7 protected and unprotected based on how the Company had labeled these items as protected
8 or unprotected. In fact, the Company did not use those terms of art (protected, unprotected)
9 to classify its EADIT balances in the definitive manner Mr. Dittmore does. Rather, the
10 Company clearly labeled items (such as cost of removal and federal NOL (net operating
11 loss)) as “uncertain” where their status as “protected” or subject to tax normalization was
12 subject to further guidance from the IRS. In contrast, Mr. Dittmore portrays a definitive
13 split of plant related EADIT between “protected” and “unprotected” without carrying
14 forward the indication that the categorization might be uncertain. This is puzzling in light
15 of the fact that the Company’s reasons for indicating that whether certain balances are
16 subject to the tax normalization rules is uncertain are clearly explained both in my
17 supplemental direct testimony at pages 13-14² and in the public record created as part of
18 the ongoing IRS guidance initiative pursuant to Notice 2019-33, portions of which is
19 attached to Mr. Dittmore’s own direct testimony.³ Mr. Dittmore is familiar with both
20 my testimony and the portions of the Notice 2019-33 public record that he attached to his

² *Supplemental Direct Testimony of John R. Wilde* at 13-14 (filed Sept. 16, 2019).

³ *Direct Testimony of David N. Dittmore*, Exhibits DND-4, DND-5 (filed Nov. 21, 2019). Exhibit DND-4 to Mr. Dittmore’s direct testimony comprises the comments submitted by American Water Works Company, Inc. (“American Water”) on July 26, 2019 in response to Notice 2019-33. Exhibit DND-5 comprises the comments submitted by the Edison Electric Institute (“EEI”) and American Gas Association (“AGA”) in response to the Notice. The uncertainties relating to net operating loss and removal cost ADIT and EADIT are discussed at pages 2-6 and of the American Water comments and at pages 6-8 and 13-18 of the EEI/AGA comments.

1 direct testimony, so it unclear why he chose not to acknowledge the yet-to-be resolved
2 uncertainties in his labeling and treatment of the plant related EADIT balances.

3 **Q. Can you list and summarize the areas of uncertainty regarding the tax normalization**
4 **of EADIT that remain outstanding?**

5 A. Yes. Attached to my supplemental direct testimony and my rebuttal testimony, I provided
6 a schedule of plant related EADIT balances. In doing so, I designated cost of removal and
7 NOL balance as “uncertain” in terms of if that portion of the plant related EADIT balance
8 should be subject to the tax normalization in whole or part. In addition, to the
9 categorization of the NOL being uncertain, the public record captured pursuant to the IRS
10 guidance project Notice 2019-33 highlights the fact that the process of normalizing the
11 NOL pursuant ARAM is uncertain. The plant related EADIT balance will be realized as
12 book depreciation of the underlying assets occur over the next 40+ years, until then the
13 EADIT balance that will be realized is uncertain, as its classification as being subject to
14 the tax normalization rules or not. A subsequent change in the tax rate, would impact the
15 balance. A change in the tax method of accounting related to accounting for plant related
16 EADIT that is initiated by either the IRS or the Company could impact the EADIT balance
17 and/or its classification in terms of being subject to the tax normalization rules (See
18 Rebuttal Testimony of John R. Wilde, TPUC Docket No. 18-00039, confidentially
19 submitted Private Letter Ruling No. PLR-113227-19)) (hereinafter “*Confidential PLR*”).

20 **Q. How has the Company addressed these areas of uncertainty in its proposal in this**
21 **docket?**

22 A. Yes. As noted in the Company's previously submitted testimony in this docket, the Company
23 consistently used the ARAM method of accounting for all plant related EADIT, which is a

1 method known to produce results consistent with the tax normalization rules. Under the
2 Company's approach, a change in method of accounting that would reclassify plant related
3 EADIT balances from unprotected to protected would not result in having to recover
4 previously returned EADIT from customers due to the resulting inadvertent violation of the
5 tax normalization rules. (See *Confidential PLR*). Similarly, a future change in tax rate or
6 change in method of accounting should not result in in having to recover previously-
7 amortized plant related EADIT from customers. The reason is that in matching the
8 normalization of EADIT to the book depreciation reversal the EADIT balance that exists at
9 any given point in time is related only to the yet to be recovered utility plant balance (UPIS
10 net of Accumulated Depreciation). In addition, amortizing all plant related EADIT balances
11 using ARAM makes the original and any subsequent determination of an item in whole or
12 part as being subject to the tax normalization rules a moot point.

13 **Q. Mr. Dittmore contends that plant related EADIT is capital contributed to the utility**
14 **by past rate payers. Do you agree?**

15 A. No. Plant related ADIT, including EADIT, is based on and arises out of tax deductions
16 related to investments in Utility Plant that even Mr. Dittmore concedes (at page 8, lines
17 1-11) are currently funded by the utility and the government and not by customers. The
18 customers will fund the cost of the utility's investment in Plant in Service over time, as the
19 book depreciation expense is recovered in future rates. It is the cumulative accelerated tax
20 deductions over the cumulative book depreciation deduction that resulted in the tax benefit
21 represented by ADIT (including EADIT). Pursuant to the normalized method of regulatory
22 accounting followed by the Company and this Commission (since 1981), ratepayers paid
23 income tax expense related to the Company's authorized pre-tax return. The deductions at

1 issue resulted from the utility's redeployment of authorized after-tax return, issuance of
2 additional debt, and raising of additional equity to fund continued and additional
3 investments in utility plant. The purpose of accelerated tax depreciation and immediate
4 expensing of tax repairs is to provide taxpayers with the incentive and ability to invest more
5 on an incremental basis. The purpose of the tax normalization rules, and more generically
6 a regulatory jurisdiction's practice of requiring a normalized method of accounting, is to
7 achieve a matching of cost incurred to tax benefit, and to provide the utility with greater
8 ability and incentive to invest in UPIS. In contrast, Mr. Dittemore, on behalf of the
9 Consumer Advocate, urges the Commission to adopt flow-through as the method of
10 accounting for any portion of TCJA plant related EADIT that is not subject to the tax
11 normalization rules, and thus provide a tax benefit or rate subsidy directly correlated to a
12 utility's investment in UPIS. Providing that tax benefit only to those customers using the
13 system over the next three years, and not to the customers who will fund the investment
14 over the life of the underlying investment that gave rise to the tax benefit. Logically, how
15 can ADIT or EADIT be something the customer provided when it is the government that
16 is the debtor who was to be paid and who had the sole control over the tax rate at which it
17 will be repaid? It is the government that has full discretion to either forgiving the debt or
18 unilaterally increasing the amount due. The government provided a source of capital to
19 fund utility investments in infrastructure (ADIT) in the form of a temporary reduction of
20 taxes, and later the government as debtor changed the expectation regarding the balance
21 that would need to be paid in the future. That debt to the government is not yet settled and
22 will not be settled until the underlying assets are fully depreciated for book purposes; until

1 then the government retains sole right to change the balance via a tax rate change adjusting
2 ADIT and EADIT balances accordingly.

3 **Q. Mr. Dittemore in his supplemental testimony states that the federal income tax debt**
4 **represented by EADIT balances was effectively cancelled. Do you agree with that**
5 **characterization?**

6 A. No. The balance of ADIT (debt to the government for federal income tax incentives
7 claimed) is the cumulative book to tax differences based on the tax rate that is expected to
8 be in effect when the cumulative book to tax difference reverses. The enactment of the
9 TCJA simply changed the tax rate the utility currently expects to be in effect when those
10 cumulative book to tax differences reverse. Those cumulative book to tax differences will
11 likely reverse over a 40-year period or more (representing average life of Utility Plant in
12 Service), and at any time during that period the federal government could change the tax
13 rate again. Only if the book to tax differences actually reverse at 21% will the EADIT
14 balance be permanent or cancelled; until then the tax benefit balance of ADIT (and thus
15 EADIT) remains subject to change at the sole discretion of the government.

16 **Q. Mr. Dittemore's proposal will result in lower cost to use the underlying utility**
17 **property during the next three years, but Mr. Dittemore agrees that over the life of**
18 **the underlying utility property ratepayers will pay more for the use of that property**
19 **(see *Supplemental Testimony of David N. Dittemore* at p.7, l.19 – p.8, l.9). Do his**
20 **computations of the EADIT amortization reflect the cost implications resulting from**
21 **the corresponding change in ADIT?**

22 A. No. Mr. Dittemore only shows the short term effect of the amortization. He does not show
23 the additional cost of capital that would be incurred at an increasing rate by the Company

1 as the EADIT amortization occurs. This offsetting increase in cost of capital would build
2 during the proposed three years of EADIT amortization for items he labels as protected,
3 and reverse over remaining life of the underlying assets. As a result of paying out the
4 EADIT over three years versus over the life of the underlying Utility Plant in Service, the
5 utility, not yet having recovered the book depreciation expense, will finance the EADIT
6 with debt and equity, and customers will pay the utilities' additional cost of that debt and
7 equity over the life of the property.

8 **Q. Mr. Dittmore cites prior decisions by the Commission where a flow-through method**
9 **of accounting was adopted for unprotected EADIT balances including plant related**
10 **balances, and a period of flow-through consistent with the three (3) year period he**
11 **recommends in this case was used. Did you review the record in those cases?**

12 A. Yes, I did.

13 **Q. Is there additional information in the record of this case that distinguishes it from**
14 **those prior decisions?**

15 A. Yes. Beginning with its prefiled testimony, Tennessee American has provided the
16 Commission additional information to consider in this case. Tennessee American has
17 provided the Commission with more information related to the uncertainty that is faced by
18 the utility, their customers, and the Commission when disconnecting the amortization
19 period for plant related EADIT from the period over which those plant related investments
20 will be recovered for in rates through book depreciation. Further, Tennessee American's
21 pre-filed testimony provided the Commission with more information regarding how and
22 by whom EADIT was initially funded, when the customer will actually fund the cost that
23 gave rise to the tax deduction and resulting EADIT, and over what period the actual EADIT

1 benefit will become certain. It is these facts of record that distinguish this case from the
2 decisions cited by Mr. Dittemore. Even Mr. Dittemore in this case had to acknowledge
3 the intergenerational customer issues and increased cost to customers that are created by
4 his proposed three-year amortization of EADIT.

5 **Q. Has Mr. Dittemore's supplemental testimony caused Tennessee-American to change**
6 **its recommendations to the Commission in this matter?**

7 A. No. Mr. Dittemore's supplemental testimony offers no reason to accelerate the
8 amortization of Tennessee-American's unprotected EADIT, which consists primarily of
9 repairs deduction-related EADIT, that was not raised in his prior testimony and then
10 addressed in my rebuttal testimony. His proposed amortization of protected EADIT is
11 flawed because it does not properly apply ARAM to protected balances by item and by
12 vintage and because it assumes that certain asset balances – cost of removal and federal
13 NOL – are protected when in fact the status of those items is uncertain and under active
14 review by the IRS. Most important, his proposal is not in the long term best interests of
15 Tennessee-American's customers because it would provide customers today a rate subsidy
16 in the form of a tax benefit that will be realized and funded by future customers in future
17 periods.

18 As I explained in my pre-filed supplemental direct testimony and rebuttal
19 testimony, all plant-related EADIT is a permanent tax benefit accrued as a result of the
20 Company making investments in plant in service and claiming tax deductions in excess of
21 book at a time when the federal corporate income tax rate was 35%, which as a result of
22 the enactment of federal legislation will reverse as book depreciation is recovered as a cost
23 from customers at a time when the tax rate is 21%. However, the rate is subject to change

1 by the government, so the amount of permanent benefit will become certain only in future
2 years as book depreciation occurs and the underlying cumulative book to tax difference
3 reverses. Tennessee-American believes this permanent difference, which relates to the
4 deduction of costs not yet recovered in rates from customers, should be ratably credited to
5 those customers who will be required to pay the costs of the plant to which those permanent
6 differences and associated tax benefits relate. The use of ARAM closely aligns the
7 amortization of these benefits to the investments that gave rise to the benefits, and thus to
8 the customers who will bear the cost of those investments over their lives. The outstanding
9 balances of plant-related ADIT and EADIT reduce rate base, and customers' rates are thus
10 reduced by the working average cost of capital associated with those reductions in rate
11 base. The use of ARAM will lower the total cost of capital recovered from customers over
12 the underlying useful life of the plant in service investment. The use of ARAM also will
13 add to the stability of cost of service rates over the useful life of the property. ARAM
14 produces an amortization of EADIT that is patterned off of the book depreciation that
15 occurs during that year, and is fairly consistent on a year over year basis, as compared to a
16 flow-through method such as that proposed by Mr. Dittemore, which disconnects the
17 EADIT from the recovery of the underlying assets, creating a rate subsidy in the form of
18 artificially lower rates of customers who take service from those assets during only part of
19 their useful life, and increasing the cost of using those same assets for customers in the
20 later years after the subsidy ends. Alternatively, severing the amortization of EADIT from
21 the related plant in service as Mr. Dittemore recommends will increase cost of service
22 recovered from customers over the life of the property, distribute a tax benefit to customers
23 that is disproportionate to the cost to which the benefit relates, and thus benefit customers

1 during the abbreviated amortization period to the detriment of customers who continue to
2 pay for these investments over the property's remaining useful life. Using ARAM to
3 normalize all EADIT related to plant in service, in contrast, promotes inter-generational
4 equity, and rate stability and certainty.

5 For all of these reasons, and for the reasons set forth in my supplemental direct
6 testimony and rebuttal testimony, Tennessee-American continues to recommend that its
7 unprotected plant related EADIT, including repairs-related EADIT, be amortized pursuant
8 to ARAM in order to serve the long term best interests of its customers. Alternatively, as
9 stated in my rebuttal testimony, the Commission could adopt ARAM for all plant-related
10 excess ADIT, including repairs-related EADIT, and revisit the use of ARAM for
11 unprotected plant related EADIT at a later date, such as thirty (30) days after the issuance
12 of IRS guidance in IRS Notice 2019-33. This additional guidance is necessary so the
13 Commission, the Company, and the Consumer Advocate will have all the relevant
14 authoritative guidance to properly navigate the tax normalization rules. Until then,
15 Customers will receive amounts pursuant to ARAM and the benefit of any plant related
16 EADIT balance being a reduction in the rate base further reducing rates.

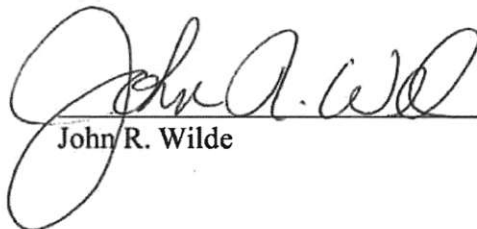
17 **Q. Does this conclude your surrebuttal testimony?**

18 **A. Yes.**

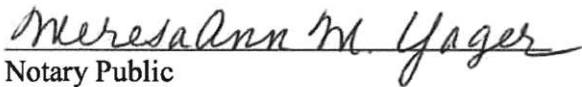
STATE OF New Jersey)
COUNTY OF Camden)

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared John R. Wilde, being by me first duly sworn deposed and said that:

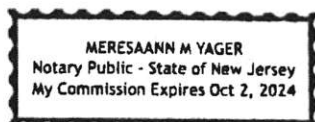
He is appearing as a witness on behalf of Tennessee-American Water Company before the Tennessee Public Utility Commission, and if present before the Commission and duly sworn, his testimony would be as set forth in his pre-filed testimony in this matter.


John R. Wilde

Sworn to and subscribed before me
this 29 day of January, 2020.


Notary Public

My Commission Expires: 10/2/2024

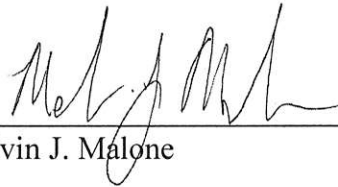


CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail upon:

Daniel P. Whitaker III
Karen H. Stachowski
Assistant Attorney General
Office of the Tennessee Attorney General
Consumer Advocate Unit, Financial Division
P.O. Box 20207
Nashville, TN 37202-0207
Daniel.Whitaker@ag.tn.gov
Karen.Stachowski@ag.tn.gov

This the 31st day of January, 2020.

A handwritten signature in black ink, appearing to read "Melvin J. Malone", is written over a horizontal line.

Melvin J. Malone