

Utility Commission issued its *Order Opening an Investigation and Requiring Deferred Accounting Treatment* (hereafter “2018 Tax Reform Order”). Therein, the Commission ordered Atmos Energy Corporation (“Atmos Energy”), Chattanooga Gas Company (“CGC”), Kingsport Power Company d/b/a AEP Appalachian Power (“Kingsport Power”), Piedmont Natural Gas Company (“Piedmont Natural Gas”), and Tennessee American Water to immediately apply deferred accounting treatment with respect to the impact of the lowering of the federal corporate income tax rate and to provide the Commission no later than March 31, 2018, the amounts deferred and a proposal to reduce rates or otherwise make adjustments to account for the tax benefits resulting from the 2017 Tax Act.¹ The *2018 Tax Reform Order* directed Staff to assist the remaining water, wastewater, and natural gas utilities under the Commission’s jurisdiction in calculating the tax impacts on their earnings resulting from the 2017 Tax Act and report the results to the Commission.

The *2018 Tax Reform Order* specifically required Tennessee American to:

1. Track and accumulate monthly in a deferred account the portion of its revenue representing the difference between the cost of service approved by the Commission in its most recent rate case and the cost of service that would have resulted had the provision for federal income taxes been based on 21% rather than 35%;
2. Calculate the excess deferred tax reserve caused by the reduction in the corporate federal income tax rate and recognize as a deferred liability the estimated reduction of the utilities’ revenue requirement resulting from the TCJA; and
3. Calculate and defer any other tax effects resulting from the TCJA on revenue requirements that are not included in the preceding calculations.

On April 2, 2018, the Company filed the *Response of Tennessee American Water Company to the Commission’s Investigation of the Impact of Federal Income Tax Reform on the Revenue Requirements of Public Utilities*.

¹ See *In re: Tennessee Public Utility Commission Investigation of Impacts of Federal Tax Reform on Public Utility Revenue Requirements*, Docket No. 18-00001, *Order Opening Investigation and Requiring Deferred Accounting Treatment* (February 6, 2018) (hereinafter *TPUC 2018 Tax Reform Order*).

PROCEDURAL HISTORY

The Consumer Advocate filed a *Petition to Intervene* on April 24, 2018, which was subsequently granted. After conducting discovery and filing testimony, the parties to this matter invested in a two-step process to resolve this matter. A settlement was reached on the “Phase One issues, encompassing and resolving directives numbers 1 and 3 listed above from the 2018 Tax Reform Order.”² The Company and the Consumer Advocate filed a *Stipulation and Settlement Agreement Regarding Phase One Issues* on July 24, 2019. The settlement of Phase One issues was heard and approved on August 12, 2019, and on October 25, 2019, the Commission issued its *Order Approving Stipulation and Settlement Agreement Resolving Phase One of the Docket*.

The parties, however, did not resolve the “Phase Two” issues regarding the calculation and disposition of excess accumulated deferred income taxes (“EADIT”). The Commission delayed consideration of Phase Two issues due to an unresolved question concerning the classification of certain EADIT as either “Protected” or “Unprotected.”³ The classification question stems from the appropriate tax treatment of EADIT attributable to certain repairs of utility plant (“Repairs Deduction”). If such EADIT is classified as “Protected,” it must be amortized in accordance with tax normalization rules issued by the Internal Revenue Service (“IRS”). However, if the EADIT balance related to the Repairs Deduction is determined to be “Unprotected,” the Commission has discretion to order its own amortization period and methodology. The IRS indicated it would issue guidance to clarify the normalization requirements for excess tax reserves arising from the 2017 Tax Act.⁴

² *Order Approving Stipulation and Settlement Resolving Phase One of the Docket*, pp. 3-4 (October 25, 2019).

³ *Id.* at 6.

⁴ David N. Dittmore, Pre-Filed Direct Testimony, p. 11 (November 21, 2019).

SUMMARY OF PHASE TWO PRE-FILED TESTIMONY OF THE PARTIES

Tennessee American Water Supplemental Pre-Filed Testimony

On behalf of the Company, Mr. John R. Wilde provided Supplemental Pre-Filed Testimony on September 16, 2019, discussing the Company's updated estimates of EADIT and the amortization of both the protected and unprotected balances. On December 31, 2017, Tennessee American Water had an Accumulated Deferred Income Tax ("ADIT") balance which reflected accelerated tax deductions at a rate of 35% or more. Upon enactment of the 2017 Tax Act, the tax rate was reduced to 21%, resulting in an excess amount of taxes in the ADIT account balance, which should be returned to customers.⁵ A portion of this excess is termed "Protected" and is subject to the normalization method of accounting. The tax normalization rules require the total Protected ADIT balance be returned to ratepayers over the same period as the underlying investment in utility plant is factored into rates. Further, a 2010 consent decree issued by the IRS stated a normalized method of accounting should be used to account for ADIT related to tax repairs.⁶

According to the Company, normalization accounting requires the total tax benefit or cost directly associated with the utility making an investment, incurring a cost, or receiving income would be factored into rates over the same period of time the underlying investment, cost, or income is factored into customer rates. The flow through method of accounting disconnects when a tax impact is factored into rates related to making an investment, incurring a cost, or receiving income.⁷ While the 2017 Tax Act does not provide for a specific normalization ("amortization") method, it does, however, set a limit on how fast the amounts can be factored

⁵ John R. Wilde, Supplemental Pre-Filed Testimony, p. 2 (September 16, 2019).

⁶ *Id.* at 3.

⁷ *Id.* at 2-4.

into rates. Specifically, the amounts cannot be returned any faster than the pattern created by using the Average Rate Assumption Method (“ARAM”) to compute depreciation. The 2017 Tax Act does, however, recognize that companies may not have the necessary information to compute depreciation using the ARAM. Therefore, if qualified, those companies may use the Reverse South Georgia Method (“RSGM”) to compute the depreciation. There are two criteria that must be met in order to use the RSGM. First, the taxpayer was required by a regulatory agency to compute depreciation on the basis of an average life or composite rate method; and second, the underlying records of the taxpayer do not contain the necessary information to compute the ARAM.⁸

Mr. Wilde testified that the Company has the records and intends to use the ARAM for plant-related ADIT, including EADIT balances. The Company stated this method provides a tax benefit to the customers who will fund those investments and is consistent with the tax normalization requirements of the 2017 Tax Act.⁹ The Company asserted it was unable to compute depreciation using the ARAM when direct testimony was filed in this docket. Since that time, the Company has updated its databases and settings which allow it to execute ARAM.¹⁰

According to Mr. Wilde, the Company’s parent company applied for and received a conditional *Consent Agreement* from the IRS requiring both the parent and Tennessee American to use a normalized method of accounting for its repairs deduction.¹¹ The Company asserted it meets the conditions of the *Consent Agreement* and must not reduce its excess tax reserve more

⁸ *Id.* at 4.

⁹ *Id.* at 5.

¹⁰ *Id.* at 10.

¹¹ *Id.* at 5-6.

rapidly than what it would be reduced using the ARAM. To do otherwise would result in the Company being in violation of the normalization requirements.¹²

According to Mr. Wilde, the fact that the *Consent Agreement* predates the 2017 Tax Act does not affect its application to the EADIT created by the 2017 Tax Act.¹³ Relying on the language in the 2017 Tax Act and a decision of the Kentucky Public Service Commission, the Company claims normalization of repairs-related EADIT is required. Additionally, while the Indiana Commission did not definitively resolve the question, it did approve a settlement whereby the Company would amortize all plant-related EADIT pursuant to the ARAM pending an IRS resolution of a request for a private letter ruling (“PLR”) on the question of whether the company’s repairs-related EADIT was subject to tax normalization.¹⁴

The Company estimated an EADIT balance of \$16,843,171, of which \$17,273,004 is plant related and \$429,833 is non-plant related.¹⁵ Mr. Wilde cautioned that the underlying tax positions and EADIT balance are subject to change through the statute of limitations period, which is three years after the Company files its income tax returns.¹⁶ According to Mr. Wilde’s Exhibit JRW-2S, \$5,045,921 of the EADIT balance is related to repairs.

The Company proposed to determine normalization periods for all federal EADIT related to plant in service as of the date of the enactment of the 2017 Tax Act with a 20-year period to amortize EADIT. For both cases, the amortization was computed beginning January 1, 2018, the effective date of the 2017 Tax Act. Mr. Wilde asserted for the period of January 1, 2018 until

¹² *Id.* at 5-7.

¹³ *Id.* at 7.

¹⁴ *Id.* at 7-10.

¹⁵ *Id.* at 11.

¹⁶ *Id.*

the start of the credit, the amortization was treated as deferred and the Company's proposal to return this amount through the Capital Riders remained unchanged.¹⁷

The Company proposed to use the ARAM to normalize both protected and unprotected EADIT which will align the normalization of these differences to the investments that gave rise to the benefits and add stability of cost of service rates over the useful life of the property. The Company believes that severing the amortization of the EADIT will increase cost of service recovered from customers over the life of the property and distribute a tax benefit to customers that is disproportionate to the cost to which the benefit relates.¹⁸

Mr. Wilde argued that if the Company uses an immediate flow-through of EADIT, current customers receive the entire refund to the detriment of future customers. In this scenario, the entirety of the EADIT will have been returned, thereby increasing rate base for future customers. Normalization spreads the benefit to both current and future customers and for these reasons, the Company believes the normalization concept should be applied to plant-related EADIT including repairs, and it should be amortized pursuant to ARAM regardless of whether it is protected or unprotected.¹⁹

The Company used a 20-year period to amortize EADIT balances not related to plant in service because the vast majority of the assets associated with this EADIT balance will reverse over periods greater than 20 years.²⁰ According to Mr. Wilde, such a normalization allows the Company to pay money back to customers in approximately the same time frame it would have paid it to the government. If it is required to pay the funds back more quickly, it must secure the funds to do so from other sources: external capital or internal funds. If the Company must derive

¹⁷ *Id.* at 11-12.

¹⁸ *Id.* at 12-15.

¹⁹ *Id.* at 15-16.

²⁰ *Id.* at 16.

the funds from outside sources, there will be additional costs, thereby necessitating an increase in utility rates.²¹

Consumer Advocate Pre-Filed Direct Testimony

In Pre-Filed Direct Testimony filed on November 21, 2019, Mr. Dittemore agreed with the Company's EADIT balance of \$16,843,171 and the repairs deduction of \$5,045,921.²² Mr. Dittemore also agreed to the use of the ARAM resulting in deductions of \$660,206 and \$692,017 for 2018 and 2019 respectively. The Consumer Advocate also indicated it did not contest the Company's position that the language in the *Consent Agreement* requires that TAWC's repairs deduction should be normalized.²³

While the 2017 Tax Act requires that the balance of the protected EADIT must be amortized pursuant to the ARAM, Mr. Dittemore expressed that there is some uncertainty regarding the treatment of the repairs deduction as protected. Repairs are depreciation and, according to the Consumer Advocate, could be considered unprotected and returned to ratepayers over a shorter period of time.²⁴

Mr. Dittemore testified the issue of the repairs deduction has been addressed in other jurisdictions involving affiliates of TAWC, such as Indiana-American Water Company in a case before the Indiana Utility Regulatory Commission ("IURC").²⁵ Mr. Dittemore asserts the issues related to the repairs deduction are identical to those issues in the IURC case. As part of a settlement in the IURC matter, a private letter ruling ("PLR") was requested from the IRS for a determination as to whether the repairs deduction is protected; a determination which could

²¹ *Id.* at 17.

²² David N. Dittemore, Pre-Filed Direct Testimony, p. 3 (November 21, 2019).

²³ *Id.* at 3-4.

²⁴ *Id.* at 6-7.

²⁵ *Id.* at 8-9.

impact the length of amortization.²⁶ Given the PLR sought in Indiana, Mr. Dittmore saw no value in seeking essentially the same PLR here. The Consumer Advocate recommended this docket remain open until such time as the IRS responds to the Indiana PLR or issues guidance as has been indicated in IRA Notice 2019-33. Should the IRS make a determination that the repairs deduction in the Indiana case is protected then this docket should be closed and the amortization adopted in this proceeding considered final.²⁷ For this reason, Mr. Dittmore recommended the Commission adopt the EADIT balances for 2018-2020 as presented by the Company.

Tennessee American Water Pre-Filed Rebuttal Testimony

In the Rebuttal Testimony of Mr. Wilde, the Company found Mr. Dittmore's recommendation consistent with TAWC's EADIT amortization proposal to a certain extent. TAWC put forth that it is in the best interest of customers and sound public policy to use ARAM to normalize all plant-related EADIT, whether or not there is a tax normalization requirement, while Mr. Dittmore testifies that he would like the Commission to revisit the issue if the IRS determines that such normalization is not required for repairs-related EADIT.²⁸

Mr. Wilde also testified that TAWC disagrees with Mr. Dittmore's suggestion that the Commission should revisit the use of ARAM for tax repairs-related EADIT as an isolated issue and base its actions on a singular finding of the IRS with respect to tax repairs-related EADIT. Instead, Mr. Wilde asserted that if the Commission desired to re-evaluate the use of ARAM for tax repairs-related ADIT, it should do so in the context of using methods other than ARAM for all plant-related ADIT.²⁹

²⁶ *Id.* at 7-9.

²⁷ *Id.* at 11-12.

²⁸ John R. Wilde, Pre-Filed Rebuttal Testimony, p. 3 (December 20, 2019).

²⁹ *Id.*

Consumer Advocate Supplemental Pre-Filed Testimony

The Consumer Advocate submitted Supplemental Pre-Filed Testimony on January 21, 2020 and indicated a change in its position based on developments both inside and outside the docket. In light of a PLR issued by the IRS to the Company's affiliate,³⁰ Mr. Dittemore attested that his position had changed substantially and that there was no longer a need to delay or reopen the proceedings on the docket.³¹ Mr. Dittemore calculated a credit of \$2,858,248 to the pending TAWC Capital Riders filing that incorporates ARAM amortization presented by the Company applied to Protected EADIT balances for 2018 and 2019.³² It also includes \$1,905,735 in credits applicable to the amortization of all Unprotected EADIT. Mr. Dittemore proposed a three-year amortization period for Unprotected EADIT.³³

Tennessee American Water Surrebuttal

In his Surrebuttal Testimony, Mr. Wilde stated that the IRS has not completed the project it initiated in June 2019 and outlined in Notice 2019-33 that would address the remaining uncertainty regarding what portions of plant related EADIT are subject to the tax normalization rules and how balances not subject to the tax normalization rules can be effectively separated out in a manner consistent with tax normalization rules.³⁴ Additionally, Mr. Wilde testified that while this issue is being sorted out, the IRS is reluctant to give guidance via PLRs, and the Company does not expect guidance to be issued until later this year.³⁵

³⁰ Private Letter Ruling No. PLR -113227-19 ("Confidential PLR") has been designated "confidential" by the Company under the terms of a protective order in this docket. No party has challenged the "confidential" designation.

³¹ David N. Dittemore, Pre-Filed Direct Testimony, pp. 3-4 (January 21, 2020).

³² *Id.* at 5-6; Supplemental Exhibit DND-1.

³³ *Id.* at 6-7.

³⁴ John R. Wilde, Pre-Filed Surrebuttal Testimony, p. 2 (January 31, 2020).

³⁵ *Id.*

Mr. Wilde asserted that Mr. Dittemore's EADIT ARAM amortization is inconsistent with tax normalization rules and would expose TAWC to penalties for normalization violations. The Company claimed Mr. Dittemore incorrectly stated his categorization of EADIT balances as protected and unprotected based on how TAWC had labeled these items as protected or unprotected. TAWC claims it did not use those terms. Mr. Wilde argued that TAWC clearly labeled items as "uncertain" where their status as protected was subjected to further IRS guidance, as shown in TAWC schedules designating items "uncertain" in terms of the portion of plant related EADIT balance that should be subject to tax normalization in whole or in part.³⁶

Mr. Wilde stated that TAWC consistently used ARAM for all plant related EADIT. Under TAWC's approach, a change in the method of accounting that would reclassify plant related EADIT balances from unprotected to protected would not result in having to recover previously returned EADIT from customers due to the resulting inadvertent violation of tax normalization rules.³⁷ Further, amortizing all plant related EADIT balance using ARAM makes original and subsequent determination of an item in whole or part as being subject to tax normalization rules a moot point.³⁸

TAWC disagreed on the three-year amortization period for unprotected EADIT recommended by Mr. Dittemore.³⁹ By returning EADIT over three years versus the life of the utility plant in service (even if unprotected) the utility will finance the EADIT with debt and equity, and customers will pay additional costs of that debt and equity over the life of the property because the utility had not yet recovered the book depreciation expense.⁴⁰ The

³⁶ *Id.* at 3-4.

³⁷ *Id.* at 4-5 (also citing "Confidential PLR").

³⁸ *Id.* at 5.

³⁹ *Id.* at 7-8.

⁴⁰ *Id.* at 8.

Company maintained its recommendation that all plant-related EADIT, included repairs-related EADIT, be amortized using ARAM.⁴¹

THE HEARING

The Hearing in this matter was originally noticed by the Commission on February 28, 2020 to be held on March 9, 2020, before the assigned voting panel during the regularly scheduled Commission Conference. However, the growing impact of the COVID-19 pandemic resulted in TAWC filing the *Agreed Motion for Continuance and to Submit Case to Commission for “Paper” Hearing on the Merits* (“*Agreed Motion*”) on March 5, 2020. As part of the *Agreed Motion*, the parties waived opening and closing statements and the presentation and cross-examination of witnesses. The *Agreed Motion* was granted.⁴²

The Hearing in this matter was noticed by the Commission on May 1, 2020 and held electronically via WebEx. Pursuant to Executive Order No. 16 issued by Governor Bill Lee on March 20, 2020, the Commission met electronically and without a physical quorum.⁴³ Electronic access to the Hearing was made available to the parties and the public. Making appearances were the following:

Tennessee- American Water Company – Melvin Malone, Esq. Butler Snow LLP, 150 3rd Avenue South, Suite 1600, TN 37201

Consumer Advocate– Daniel Whitaker, III., Esq. Office of the Tennessee Attorney General and Reporter, Post Office Box 20207, Nashville, Tennessee, 37219

⁴¹ *Id.* at 9, 11.

⁴² *Order Granting Agreed Motion* (May 11, 2020).

⁴³ Due to the state of emergency declared by Governor Bill Lee relative to the Coronavirus Disease 2019 (“COVID-19”) pandemic in Tenn. Exec. Order No. 14 on March 12, 2020, (superseded by Tenn. Exec. Order No. 15 on March 19, 2020 which was extended until June 30, 2020 in Tenn. Exec. Order No. 36 on May 12, 2020), the Commission Conference was held electronically via WebEx. The public health emergency places limitations on public gatherings and meetings in order to prevent the spread of COVID-19. In convening the Commission Conference electronically, the Commission relied upon Tenn. Exec. Order No. 16 (March 20, 2020), which was extended until June 30, 2020 by Tenn. Exec. Order No. 34 (May 6, 2020), and affirmed on the record that the electronic meeting was necessary to conduct the essential business of the agency and to protect the health, safety, and welfare of Tennesseans.

Pursuant to an *Agreed Motion* filed on March 5, 2020, the parties did not present witnesses or argument at the Hearing. An opportunity for public comment was offered, but no member of the public sought recognition.

FINDINGS AND CONCLUSIONS

Based on the testimony and presentations of the parties, updated calculations provided to the Commission via Staff Data Requests, as well as the administrative record as a whole, the Hearing Panel voted unanimously that the total amount of EADIT is \$16,843,171. For purposes of resolving this docket, the Hearing Panel concluded unanimously the Repairs Deduction-Related EADIT should be classified as Unprotected EADIT; and that the Federal Net Operating Loss-Related EADIT and Cost of Removal-Related EADIT should be treated as Protected EADIT. Based on these findings and conclusions, the Hearing Panel unanimously voted to find the Protected portion of EADIT is \$12,543,770; and that the Unprotected amount is \$4,299,401.

The Hearing Panel further found that the Protected EADIT shall be amortized using the ARAM and that the Unprotected EADIT shall be amortized over a three-year period. The annual amortized EADIT tax savings shall be returned to ratepayers as an offset to the Company's annual Capital Recovery Riders surcharge mechanism through application of a surcharge credit calculated based on a percent of authorized base rate revenue beginning in Docket No. 19-00105.

Finally, the surcharge credit for the 2020 Capital Recovery Riders under consideration in Docket No. 19-00105 shall include calculations for ARAM amortization of Protected EADIT for 2020 and catch-up ARAM amortization for 2018 and 2019, as well as the first of three years of amortization of Unprotected EADIT, all of which shall be appropriately grossed-up and expressed as a percent of authorized base rate revenue in Docket No. 19-00105.

IT IS THEREFORE ORDERED THAT:

1. The total amount of Excess Accumulated Deferred Income Tax (“EADIT”) is \$16,843,171, consisting of Protected EADIT of \$12,543,770 and Unprotected EADIT of \$4,299,401.
2. The Protected portion of EADIT shall be amortized using the Average Rate Assumption Method. The Unprotected portion of EADIT shall be amortized over a three-year period and returned to ratepayers through an application surcharge credit calculated based on a percent of authorized base rate revenue authorized in Commission Docket No. 19-00105.
3. Any party aggrieved by the Commission’s decision in this matter may file a Petition for Reconsideration with the Commission within fifteen (15) days from the date of this Order.
4. Any party aggrieved by the Commission’s decision in this matter has the right to judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty (60) days from the date of this Order.

Vice Chair Kenneth C. Hill, Commissioner Herbert H. Hilliard, and Commissioner David F. Jones.

ATTEST:



Earl R. Taylor, Executive Director