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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: ***Petition of Tennessee-American Water Company Regarding the 2020 Investment and Related Expenses Under the Qualified Infrastructure Investment Program Rider, the Economic Development Investment Rider and the Safety and Environmental Compliance Rider*, TPUC Docket No. 19-00105**

Dear Chairman Morrison:

Attached for filing please find *Tennessee American Water Company's Responses to Second Discovery Requests of the Consumer Advocate* 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
Attachments
cc: Elaine Chambers, TAWC
Daniel P. Whitaker III, Consumer Advocate Unit

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BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
NASHVILLE, TENNESSEE

PETITION OF TENNESSEE-AMERICAN WATER COMPANY REGARDING THE 2020 INVESTMENT AND RELATED EXPENSES UNDER THE QUALIFIED INFRASTRUCTURE INVESTMENT PROGRAM RIDER, THE ECONOMIC DEVELOPMENT INVESTMENT RIDER AND THE SAFETY AND ENVIRONMENTAL COMPLIANCE RIDER	)	**DOCKET NO. 19-00105**

TENNESSEE-AMERICAN WATER COMPANY'S RESPONSES TO SECOND DISCOVERY REQUESTS OF THE CONSUMER ADVOCATE

Tennessee-American Water Company ("TAWC"), by and through counsel, hereby submits its Responses to the Second Discovery Requests propounded by the Consumer Advocate Unit in the Financial Division of the Attorney General's Office ("Consumer Advocate").

GENERAL OBJECTIONS

1. TAWC objects to all requests that seek information protected by the attorney-client privilege, the work-product doctrine and/or any other applicable privilege or restriction on disclosure.

2. TAWC objects to the definitions and instructions accompanying the requests to the extent the definitions and instructions contradict, are inconsistent with, or impose any obligations beyond those required by applicable provisions of the Tennessee Rules of Civil Procedure or the rules, regulations, or orders of the Tennessee Public Utility Commission ("TPUC" or "Authority").

3. The specific responses set forth below are based on information now available to TAWC, and TAWC reserves the right at any time to revise, correct, add to or clarify the objections or responses and supplement the information produced.

4. TAWC objects to each request to the extent that it is unreasonably cumulative or duplicative, speculative, unduly burdensome, irrelevant or seeks information obtainable from some other source that is more convenient, less burdensome or less expensive.

5. TAWC objects to each request to the extent it seeks information outside TAWC's custody or control.

6. TAWC's decision, now or in the future, to provide information or documents notwithstanding the objectionable nature of any of the definitions or instructions, or the requests themselves, should not be construed as: (a) a stipulation that the material is relevant or admissible, (b) a waiver of TAWC's General Objections or the objections asserted in response to specific discovery requests, or (c) an agreement that requests for similar information will be treated in a similar manner.

7. TAWC objects to those requests that seek the identification of "any" or "all" documents or witnesses (or similar language) related to a particular subject matter on the grounds that they are overbroad and unduly burdensome, and exceed the scope of permissible discovery.

8. TAWC objects to those requests that constitute a "fishing expedition," seeking information that is not relevant or reasonably calculated to lead to the discovery of admissible evidence and is not limited to this matter.

9. TAWC does not waive any previously submitted objections to the Consumer Advocate's discovery requests.

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00105
SECOND DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: Kurt A. Stafford

Question:

1. Refer to the response to Consumer Advocate Request No. 1-2 (subpart a):

   a. Describe the frequency of testing described in this response further differentiated between TAWC testing and that conducted by third-part agencies or testing labs; and
   b. Provide a summary of the results of the testing for the years 2018 and 2019, and identify any aspects of the results which were out of compliance with "applicable standards" as referenced in the response.

Response:

a. The Company performs hundreds of water quality tests each year to ensure compliance with all applicable water quality standards and provide safe water to Customers. In addition to meeting all regulatory water quality standards, the Company goes above and beyond to ensure Customers receive safe drinking water. For example, in each of the past 19 years, the Company has received the Environmental Protection Agency's (EPA) Partnership for Safe Water Award. The Partnership for Safe Water is a voluntary program whose mission is to help water providers assess and optimize their water treatment processes through a process of continuous improvement. The testing required for water quality compliance is extensive. Some tests are run daily, whereas others may take place every few years as described by state and federal regulations. The majority of water quality testing, which involves wet chemistry tests, are performed by Company lab technicians at the Company's laboratory. All water quality tests involving organic chemistry are collected by Company personnel and sent to the American Water Central Laboratory in Belleville, Illinois for analysis. A very small number of tests are performed by third-party laboratories. These include specialize testing for contaminants like radionuclides and cryptosporidium.
b. The Company did not have any water quality violations in 2018 and 2019. The results of water quality testing are best summarized in the Company's yearly Consumer Confidence Report (CCR). This report summarizes the results of annual water quality testing in relation to applicable regulatory standards. It is mandated as a regulatory requirement by the EPA. The CCR is completed by water suppliers and it is intended to help inform and educate Customers in regard to the source and quality of their drinking water. The 2018 CCR, along with other CCRs dating back to 2014, can be found on the Company's website at: https://amwater.com/tnaw/water-information/water-quality/water-quality-reports. The CCR for 2019 will be available by March 1, 2020.

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00105
SECOND DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: Kurt A. Stafford

Question:

2. Refer to the response to Consumer Advocate Request No. 1-2 (subpart b):

   a. Identify any internal goals or metrics TAWC has in place to measure the provision of adequate or acceptable service, including an overview of how such goals or metrics are computed as well as identifying the actual metric goal of the Company; and
   b. Provide the actual results of such internal metrics for the years 2018 and 2019.

Response:

a. TAWC objects to this request on the grounds that it is overbroad. Subject to and without waiving this objection, TAWC responds as follows. Providing adequate service to Customers is a process that starts with long-term planning and has numerous components. The ability to ensure that Customer service demands are met starts with the comprehensive planning process. The Comprehensive Planning Study (CPS) is a document which identifies system improvements needed to meet future water system demands and continue supplying adequate service to Customers. These improvements are then prudently integrated into the Company's Strategic Capital Expenditure in the form of capital projects which help ensure continued adequate service. Additionally, as development occurs in the TAWC service area and new Customers request connections to the water distribution system, the increased water demand related to the new connections is modeled through the Company's hydraulic model. This computer model simulates the added system demands to ensure adequate service can be provided to both new Customers requesting service as well as all existing Customers. Finally, the Company continues its ongoing work of replacing existing water infrastructure, such as pipe, hydrants, pumps, valves, etc., which ensures adequate service continues within the distribution system. Further, among the tools employed to provide adequate service are tests to meet state and federal water quality standards, tests to meet system demands, and system monitoring for reliability.

b. TAWC objects to this request on the grounds that it is overbroad. Subject to and without waiving this objection, TAWC responds as follows. Service adequacy is monitored on a real-time basis to ensure high quality service to all TAWC Customers. Therefore, hard copy results are not provided as any issue potentially impacting service adequacy is addressed immediately. Within the water distribution system, adequate or acceptable service is ensured by continuously monitoring, among other things, key indicators at numerous Company owned water facilities. These key indicators consist of sensors and other real-time data collection equipment. These key indicators are installed in locations which help the Company ensure adequate service to its Customers. These locations typically include remote facilities such as water storage tanks, booster pump stations and various plant facilities. These indicators measure variables such as the height of water in water storage tanks, the water pressure at booster pump stations and the flow rate of pumps at the water treatment

plant. This information is transmitted back to a central location where Certified Water Operators monitor and interpret these indicators using the Supervisory Control And Data Acquisition (SCADA) program. SCADA allows this data to be visually displayed on a computer screen. Trends are graphed and any occurrence noticed in the system outside of the normal trends are flagged and investigated. This continuous focus allows the Company to react immediately to any abnormalities in the system, such as a pump failure, to ensure Customers continue receiving adequate service.

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00105
SECOND DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: Kurt A. Stafford

Question:

3. Regarding the response to Consumer Advocate Request No. 1-2 (subpart c), identify, and provide the results, for all internal metrics relied upon by TAWC to measure reliability for 2018 and 2019. Provide an overview of how such metric is computed, identify the internal goal for reliability, and provide all supporting documents.

Response:

Water main breaks are the main cause of Customer disruptions and impact system reliability. To a lesser degree mechanical failures, such as pump and control equipment failures, can also impact system reliability. However, mechanical equipment is monitored by SCADA as described in the response to CAD DR 2 Question 2. This means mechanical issues are identified quickly and addressed. Preventative maintenance of mechanical equipment as well as routine inspections of remote facilities further reduces the likelihood of mechanical failure. Main breaks are documented and tracked by the Company. The Company looks at main breaks in total for each year and each month. The goal is to see a downward trend in the total number of main breaks on a year-over-year basis. Also, yearly totals are compared to ten-year averages to check for an overall reduction in the number of breaks.
The total main breaks for 2018 were 353. For 2019, there were 211 main breaks through September 2019. For further main break information, see the Company's response to CAD DR 1 Question 14.

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00105
SECOND DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: Elaine K. Chambers

Question:

4. Provide an estimate of TAWC's average Rate Base for 2020 with a listing of all assumptions relied on to compute the estimate.

Response:

4. TAWC objects to this request on the grounds that it is overbroad, speculative, and unduly burdensome,

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00105
SECOND DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: Kurt Stafford

Question:

5. Regarding the response to Consumer Advocate Request No. 1-5, provide the following:

   a. Miles of 1) Distribution Main and 2) Transmission Main less than 50 years old which are planned to be replaced in 2020; and
   b. Number of 1) Hydrants and 2) Valves less than 50 years old which are planned to be replaced in 2020.

Response:

a. (1) For distribution mains, 0 miles are being replaced which are less than 50 years old.
(2) For transmission mains, 0 miles are being replaced which are less than 50 years old. Transmission mains are identified as mains 16-inch or larger.

b. (1) Valves replaced newer than 50 years: 3
(2) Hydrants replaced new than 50 years: 0

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00105
SECOND DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: John R. Wilde

Question:

6. Refer to the WKP 2020 Tax Depreciation Balances tab within TAW Schedule 1. Provide support for the repair percentages found in rows AT 9 through BAIO.

Response:

Through 2018, please see responses for data requests in Case 19-00031. Attachment 1 is a copy of the responses to CAD Set 1-4 and CAD Set 2-18.

For 2019 & 2020, the company used an average of the last 11 years' worth of tax return deductions over the replacement property used to calculate the deduction. This is split between transmission property (main, hydrants and service lines) and non-transmission property (all other property). See below for the calculation.

	Transmission Property		
	Repair Deduction	Replacement Property	Average
2018	2,598,016	5,495,895	47%
2017	4,829,695	9,291,948	52%
2016	3,019,990	3,757,037	80%
2015	3,313,236	4,422,254	75%
2015 adj	(6,106,417)		
2014	2,890,721	4,346,869	67%
2013	1,982,653	3,454,342	57%
2012	4,282,481	6,461,473	66%
2011	2,192,505	3,553,581	62%
2010	1,108,251	1,571,831	71%
2009	847,547	1,321,043	64%
2008	2,305,504	3,159,302	73%
Total	23,264,182	46,835,576	49.67%

	Non-Transmission Property		
	Repair Deduction	Replacement Property	Average
2018	1,553,825	1,907,207	81%
2017	2,088,116	3,727,826	56%
2016	3,355,308	9,212,575	36%
2015	1,794,864	18,569,309	10%
2014	654,777	4,321,373	15%
Total	9,446,891	37,738,289	25.03%

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00031
FIRST DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: Elaine K. Chambers

Question:

4. The tab "WKP 2018 Tax Depreciation Balances within the TAWC Capital Riders Reconciliation file contains hard coded percentages for Repair Deductions for each year 2014 - 2018. Provide supporting workpapers and documentation for the hard-coded percentages contained within this worksheet by year.

Response:

Please see "TAW_R_CPADDR1_NUM004_081619_Attachment". For the repairs deductions in the Capital Rider Reconciliation, the Company used the percentage of actual repairs over total property per the tax returns for 2014-2016 (referenced as a, b & c in the attachment). For 2017 T&D, the repairs percentage is the deduction per the tax return over replacement property (referenced as d). For 2017 and 2018 non T&D, a 4 year average of repair deductions over replacement property was used (referenced as f). For 2018 T&D, a 10 year average of repair deductions over replacement property was used (referenced as e).

Tennessee-Amercian Water
19-00031
CPADDR1_NUM004_081619

Repair Percentage per filing

	Repairs By Year									
	2014		2015		2016		2017		2018	
	Repairs %		Repairs %		Repairs %		Repairs %		Repairs %	
T&D	22.93%	a	17.71%	b	35.94%	c	51.98%	d	49.99%	e
Non T&D	22.93%	a	17.71%	b	35.94%	c	22.03%	f	22.03%	f

a - 2014 percentage of repairs deduction on the tax return over total property
b - 2015 percentage of repairs deduction on the tax return over total property
c - 2016 percentage of repairs deduction on the tax return over total property
d - The percentage of repairs over replacement property (T&D) for 2017 only
e - Estimated rate based on 10 year average of repairs over replacement property (T&D)
f - Estimated rate based on 4 year average of repairs over replacement property (Non T&D)

	2014	2015	2016
Repair Deduction	3,545,498	5,108,100	6,375,298
Property in Service	15,461,501	28,850,571	17,738,934
Percentage of Repairs	22.93%	17.71%	35.94%
	a	b	c

	2017	2018	2017/2018
Repair Deduction	4,829,695	2,066,617	1,973,266
Replacement Property	9,291,948	4,133,968	8,957,771
Percentage of Repairs	51.98%	49.99%	22.03%
	d	e	f

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00031
SECOND DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: John R. Wilde

Question:

18. Refer to the following:

    a. Attachment provided in response to CA Request No. 1-4 in the current docket;

    b. "WKP 2018 ADIT Summary" tab, within the Capital Rider Reconciliation file - Revised 5 16 19; and

    c. Exhibit RT-EKC-1, provided in Docket No. 18-00120.

The total Repair deductions found within Attachment 1-4 is $15,726,113 for the period 2014 – 2018, calculated by the Company and determined to be associated with the Capital Riders. This contrasts with total Repair Deductions (presumably) for all TAWC property of $23,898,474 during this period, calculated from data shown on Attachment 1-4. Thus, during this period, the calculated Repair Deductions associated with Capital Rider expenditures as a percentage of total Repair Deductions was 65.8%.

1. Provide a narrative explanation of the types of Non-(Capital Rider) Eligible Plant identified within Exhibit RT-EKC-1 that was eligible for the Repair Deduction.

2. Provide the Amount, Project Title, Account Number, and Account Description of all Non-Eligible Plant, by year, as shown on Exhibit RT-EKC-1. The information provided should be consistent in form with that provided within the "WKP 2018 Tax Depreciation Balances" tab, columns G, I and K.

3. Confirm that the majority of plant eligible for the Repair Deduction is comprised of Service lines, Distribution lines, Main installation, and Main replacements.

4. Given that the ratio of Repairs used within the Capital Rider calculation for the period 2014 – 2016 uses a denominator of Total Plant, provide a comprehensive explanation why the resulting ratio should not be applied to all Capital Rider expenditures.

5. Referring to the Company's Response to CA Request No. 1-4, provide a complete explanation justifying the various methods used to determine the Repair Deduction over the five-year period. What is the rationale for the use of four different methodologies over this six-year period, rather than the consistent use of one methodology?

6. Identify the annual Repair Deduction claimed on TAWC property within the appropriate entities' federal tax return for the period 2014 – 2018.

Response:

1. Any utility plant in service addition that would involve the replacement of something less than a tax unit of property or a major component thereof.

2. See attachment "TAW_R_CPADDR2_NUM018_090919_Attachment1".

3. Generally, a majority of the Plant eligible for the Repairs Deduction is comprised of service lines, distribution lines, main installations and main replacements but also includes the non-network property located in the Company's plants and buildings.

4. As explained in 1 above not all property additions are eligible for a tax repair, and rider eligible property additions could have included a disproportionate percentage of addition not eligible for a tax repair deduction. In addition, the tax repairs method being used was modified in 2015 to exclude meters, so 2014 percentage and prior repair deductions would overstate the deduction actually claimed inclusive of the 2015 481(a) adjustment. Therefore, as a refinement the percentage was applied to property that would have been most likely to have resulted in a tax repair deduction. In addition, to the extent a tax repair was not estimated, the calculation would have considered if the property was bonus eligible. Therefore, if the repair estimate was to be modified, then the bonus and depreciation estimate has to be modified accordingly. For 2014-2016, see the following table indicating what the change in tax repair deduction would be, however, that number would need to be adjusted for tax depreciation and bonus, and would result insignificant change in the estimate.

	2014	2015	2016
Rider Property	6,823,293	24,365,106	13,575,732
Repair % used	22.93%	17.71%	35.94%
Rider Property * Repairs % used	1,564,581	4,315,060	4,879,118
Rider Repair calculated	1,348,263	3,975,280	4,413,887
Difference	216,318	339,780	465,231

5. The question inquires about a 6 year period, but the Company's estimate only covers 2014-2018 a five year period. In addition, the Company is aware of using only two methods, for 2014-2016 it applied the ratio of total repairs claimed over total utility plant additions to rider property that was eligible for a tax repair deduction. In 2017-2018 it used ratio of tax repairs over total replacement property. In an attempt to address all the complexities of making a repairs determination on a portion of the plant additions in any given year, the Company may have made the determination overly complex for 2014-2018 period. However, those complexities do exist, and an oversimplied method will not account for them either. As a matter of simplicity the Company could have used a single method for all 4 years, using the ratio of actual repair deductions claimed to total Utility Plant Additions. The Company will provide this alternative calculation with the corresponding adjustments to tax depreciation and bonus depreciation. See "TAW_R_CPADDR2_NUM018_090919_Attachment2"..

6. The Company took the following as a tax repairs deduction - Year 2017 – $6,917,812; Year 2016 – $6,375,298; Year 2015 – $5,108,100; Year 2014 - $3,545,498. In addition, in 2015, the company filed a section 481(a) adjustment related to repairs, specifically reversing the deductions taken in prior years related to meters. This adjustment was spread over the 2015-2018 tax returns. The net adjustment was $3,304,563.

TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 19-00105
SECOND DISCOVERY REQUEST OF THE
CONSUMER ADVOCATE AND PROTECTION DIVISION

Responsible Witness: John R. Wilde

Question:

7. Refer to the WKP 2020 Tax Depreciation Balances tab within TAW Schedule 1. With respect to the calculations found in rows 51 - 64, respond to the following:

   a. Provide a complete explanation why such calculation is superior to relying upon the average net ADIT balances at 12/31/19 and 12/31/20 in arriving at the appropriate net ADIT balance to incorporate into the TAWC Capital Riders; and

   b. Identify any tax guidance requiring this specific calculation in order to comply with normalization requirements related to projecting ADIT balances within surcharge rider calculations.

Response:

To clarify, I believe you are referring to WKP 2020 ADIT Summary, not WKP 2020 Tax Depreciation Balances. Assuming that, see responses below:

a. The IRS specifies how the averaging of ADIT should be in a rate filing when the rates go into effect at the beginning of the test period as opposed to the end of the test period when a future test period is used. Therefore, simple averaging cannot be used.
b. Please see TAW_R_CADDR2_NUM007_02132020_Attachment. This is the IRS Regulation 1.167(I)-1. The information starts on page 14. A few items are highlighted but the whole section applies and examples are provided.

Federal Tax Regulations, Regulation, §1.167(l)-1, Internal Revenue Service, Limitations on reasonable allowance in case of property of certain public utilities

Federal Tax > Federal Tax Primary Sources > Federal Tax Regulations > Federal Tax Regulations > Final and Temporary Regulations > INCOME TAX > Normal Tax and Surtax > COMPUTATION OF TAXABLE INCOME > Itemized Deductions for Individuals and Corporations > §1.167(l)-1, Limitations on reasonable allowance in case of property of certain public utilities

Reg. § 1.167(l)-1 does not reflect P.L. 101–508; Reg. § 1.167(l)-1(d) does not reflect P.L. 97-34.

(a) ***In general***

(1) ***Scope.—*** Section 167(l) in general provides limitations on the use of certain methods of computing a reasonable allowance for depreciation under section 167(a) with respect to "public utility property" (see paragraph (b) of this section) for all taxable years for which a Federal income tax return was not filed before August 1, 1969. The limitations are set forth in paragraph (c) of this section for "pre-1970 public utility property" and in paragraph (d) of this section for "post-1969 public utility property." Under section 167(l), a taxpayer may always use a straight line method (or other "subsection (l) method" as defined in paragraph (f) of this section). In general, the use of a method of depreciation other than a subsection (l) method is not prohibited by section 167(l) for any taxpayer if the taxpayer uses a "normalization method of regulated accounting" (described in paragraph (h) of this section). In certain cases, the use of a method of depreciation other than a subsection (l) method is not prohibited by section 167(l) if the taxpayer used a "flow-through method of regulated accounting" (described in paragraph (i) of this section) for its "July 1969 regulated accounting period" (described in paragraph (g) of this section) whether or not the taxpayer uses either a normalization or a flow-through method of regulated accounting after its July 1969 regulated accounting period. However, in no event may a method of depreciation other than a subsection (l) method be used in the case of pre-1970 public utility property unless such method of depreciation is the "applicable 1968 method" (within the meaning of paragraph (e) of this section). The normalization requirements of section 167(l) with respect to public utility property defined in section 167(l)(3)(A) pertain only to the deferral of Federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under section 167 and the use of straight line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. Regulations under section 167(l) do not pertain to other book-tax timing differences with respect to State income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items. The rules provided in paragraph (h)(6) of this section are to insure that the same time period is used to determine the deferred tax reserve amount resulting from the use of an accelerated method of depreciation for cost of service purposes and the reserve amount that may be excluded from the rate base or included in no-cost capital in determining such cost of services. The formula provided in paragraph (h)(6)(ii) of this section is to be used in conjunction with the method of accounting for the reserve for deferred taxes (otherwise proper under paragraph (h)(2) of this section) in accordance with the accounting requirements prescribed or approved, if applicable, by the regulatory body having jurisdiction over the taxpayer's regulated books of account. The formula provides a method to determine the period of time during which the taxpayer will be treated as having received amounts credited or charged to the reserve account so that the disallowance of earnings with respect to such amounts through rate base exclusion or treatment as no-cost capital will take into account the factor of time for which such amounts are held by the taxpayer. The formula serves to limit the amount of such disallowance.

(2) ***Methods of depreciation.—*** For purposes of section 167(l), in the case of declining balance method each different uniform rate applied to the unrecovered cost or other basis of the property is a different

method of depreciation. For purposes of section 167(l), a change in a uniform rate of depreciation due to a change in the useful life of the property or a change in the taxpayer's unrecovered cost or other basis for the property is not a change in the method of depreciation. The use of "guideline lives" or "class lives" for Federal income tax purposes and different lives on the taxpayer's regulated books of account is generally not treated for purposes of section 167(l) as a different method of depreciation. Further, the use of an unrecovered cost or other basis or salvage value for Federal income tax purposes different from the basis or salvage value used on the taxpayer's regulated books of account is not treated as a different method of depreciation.

(3) ***Application of certain other provisions to public utility property.***— For rules with respect to application of the investment credit to public utility property, see section 46(e). For rules with respect to the application of the class life asset depreciation range system, including the treatment of the use of "class lives" for Federal income tax purposes and different lives on the taxpayer's regulated books of account, see § 1.167(a)-11 and § 1.167(a)-12.

(4) ***Effect on agreements under section 167(d).***— If the taxpayer has entered into an agreement under section 167(d) as to any public utility property and such agreement requires the use of a method of depreciation prohibited by section 167(l), such agreement shall terminate as to such property. The termination, in accordance with this subparagraph, shall not affect any other property (whether or not public utility property) covered by the agreement.

(5) ***Effect of change in method of depreciation.***— If, because the method of depreciation used by the taxpayer with respect to public utility property is prohibited by section 167(l), the taxpayer changes to a method of depreciation not prohibited by section 167(l), then when the change is made the unrecovered cost or other basis shall be recovered through annual allowances over the estimated remaining useful life determined in accordance with the circumstances existing at that time.

(b) ***Public utility property***

(1) ***In general.***— Under section 167(l)(3)(A), property is "public utility property" during any period in which it is used predominantly in a "section 167(l) public utility activity." The term "section 167(l) public utility activity" means the trade or business of the furnishing or sale of—

(i) Electrical energy, water, or sewage disposal services,

(ii) Gas or steam through a local distribution system,

(iii) Telephone services,

(iv) Other communication services (whether or not telephone services) if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or

(v) Transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, are regulated, i.e., have been established or approved by a regulatory body described in section 167(l)(3)(A). The term "regulatory body described in section 167(l)(3)(A)" means a State (including the District of Columbia) or political subdivision thereof, any agency or instrumentality of the United States, or a public service or public utility commission or other body of any State or political subdivision thereof similar to such a commission. The term "established or approved" includes the filing of a schedule of rates with a regulatory body which has the power to approve such rates, even though such body has taken no action on the filed schedule or generally leaves undisturbed rates filed by the taxpayer involved.

(2) *Classification of property.*— If property is not used solely in a section 167(l) public utility activity, such property shall be public utility property if its predominant use is in a section 167(l) public utility activity. The predominant use of property for any period shall be determined by reference to the proper accounts to which expenditures for such property are chargeable under the system of regulated accounts required to be used for the period for which the determination is made and in accordance with the principles of § 1.46-3(g)(4) (relating to credit for investment in certain depreciable property). Thus, for example, for purposes of determining whether property is used predominantly in the trade or business of the furnishing or sale of transportation of gas by pipeline, or furnishing or sale of gas through a local distribution system, or both, the rules prescribed in § 1.46-3(g)(4) apply, except that accounts 365 through 371, inclusive (Transmission Plant), shall be added to the accounts enumerated in subdivision (i) of such paragraph (g)(4).

(c) *Pre-1970 public utility property*

(1) *Definition*

(i) Under section 167(l)(3)(B), the term "pre-1970 public utility property" means property which was public utility property at any time before January 1, 1970. If a taxpayer acquires pre-1970 public utility property, such property shall be pre-1970 public utility property in the hands of the taxpayer even though such property may have been acquired by the taxpayer in an arm's-length cash sale at fair market value or in a tax-free exchange. Thus, for example, if corporation X which is a member of the same controlled group of corporations (within the meaning of section 1563(a)) as corporation Y sells pre-1970 public utility property to Y, such property is pre-1970 public utility property in the hands of Y. The result would be the same if X and Y were not members of the same controlled group of corporations.

(ii) If the basis of public utility property acquired by the taxpayer in a transaction is determined in whole or in part by reference to the basis of any of the taxpayer's pre-1970 public utility property by reason of the application of any provision of the code, and if immediately after the transaction the adjusted basis of the property acquired is less than 200 percent of the adjusted basis of such pre-1970 public utility property immediately before the transaction, the property acquired is pre-1970 public utility property.

(2) *Methods of depreciation not prohibited.*— Under section 167(l)(1), in the case of pre-1970 public utility property, the term "reasonable allowance" as used in section 167(a) means, for a taxable year for which a Federal income tax return was not filed before August 1, 1969, and in which such property is public utility property, an allowance (allowable without regard to section 167(l)) computed under—

(i) A subsection (l) method, or

(ii) The applicable 1968 method (other than a subsection (l) method) used by the taxpayer for such property, but only if—

(a) The taxpayer uses in respect of such taxable year a normalization method of regulated accounting for such property.

(b) The taxpayer used a flow-through method of regulated accounting for such property for its July 1969 regulated accounting period, or

(c) The taxpayer's first regulated accounting period with respect to such property is after the taxpayer's July 1969 regulated accounting period and the taxpayer used a flow-through method of regulated accounting for its July 1969 regulated accounting period for public utility property of the same kind (or if there is no property of the same kind, property of the most similar kind) most

recently placed in service. See paragraph (e)(5) of this section for determination of same (or similar) kind.

(3) ***Flow-through method of regulated accounting in certain cases.—*** See paragraph (e)(6) of this section for treatment of certain taxpayers with pending applications for change in method of accounting as being deemed to have used a flow-through method of regulated accounting for the July 1969 regulated accounting period.

(4) ***Examples.—*** The provisions of this paragraph may be illustrated by the following examples:

Example (1). Corporation X, a calendar-year taxpayer subject to the jurisdiction of a regulatory body described in section 167(l)(3)(A), used the straight line method of depreciation (a subsection (l) method) for all of its public utility property for which depreciation was allowable on its Federal income tax return for 1967 (the latest taxable year for which X, prior to August 1, 1969, filed a return). Assume that under paragraph (e) of this section, X's applicable 1968 method is a subsection (l) method with respect to all of its public utility property. Thus, with respect to its pre-1970 public utility property, X may only use a straight line method (or any other subsection (l) method) of depeciation for all taxable years after 1967.

Example (2). Corporation Y, a calendar-year taxpayer subject to the jurisdiction of the Federal Power Commission, is engaged exclusively in the transportation of gas by pipeline. On its Federal income tax return for 1967 (the latest taxable year for which Y, prior to August 1, 1969, filed a return), Y used the declining balance method of depreciation using a rate of 150 percent of the straight line rate for all of its nonsection 1250 public utility property with respect to which depreciation was allowable. Assume that with respect to all of such property, Y's applicable 1968 method under paragraph (e) of this section is such 150 percent declining balance method. Assume that Y used a normalization method of regulated accounting for all relevant regulated accounting periods. If Y continues to use a normalization method of regulated accounting, Y may compute its reasonable allowance for purposes of section 167(a) using such 150 percent declining balance method for its non-section 1250 pre-1970 public utility property for all taxable years beginning with 1968, provided the use of such method is allowable without regard to section 167(l). Y may also use a subsection (l) method for any of such pre-1970 public utility property for all taxable years beginning after 1967. However, because each different uniform rate applied to the basis of the property is a different method of depreciation, Y may not use a declining balance method of depreciation using a rate of twice the straight line rate for any of such pre-1970 public utility property for any taxable year beginning after 1967.

Example (3). Assume the same facts as in example (2) except that with respect to all of its nonsection 1250 pre-1970 public utility property accounted for in its July 1969 regulated accounting period Y used a flow-through method of regulated accounting for such period. Assume further that such property is the property on the basis of which the applicable 1968 method is established for pre-1970 public utility property of the same kind, but having a first regulated accounting period after the taxpayer's July 1969 regulated accounting period. Beginning with 1968, with respect to such property Y may compute its reasonable allowance for purposes of section 167(a) using the declining balance method of depreciation and a rate of 150 percent of the straight line rate, whether it uses a normalization or flow-through method of regulated accounting after its July 1969 regulated accounting period, provided the use of such method is allowable without regard to section 167(l).

(d) ***Post-1969 public utility property***

(1) ***In general.—*** Under section 167(l)(3)(C), the term "post-1969 public utility property" means any public utility property which is not pre-1970 public utility property.

(2) ***Methods of depreciation not prohibited.—*** Under section 167(l)(2), in the case of post-1969 public utility property, the term "reasonable allowance" as used in section 167(a) means, for a taxable year, an allowance (allowable without regard to section 167(l)) computed under—

(i) A subsection (l) method,

(ii) A method of depreciation otherwise allowable under section 167 if, with respect to the property, the taxpayer uses in respect of such taxable year a normalization method of regulated accounting, or

(iii) The taxpayer's applicable 1968 method (other than a subsection (l) method) with respect to the property in question, if the taxpayer used a flow-through method of regulated accounting for its July 1969 regulated accounting period for the property of the same (or similar) kind most recently placed in service, provided that the property in question is not property to which an election under section 167(l)(4)(A) applies. See § 1.167(l)-2 for rules with respect to an election under section 167(l)(4)(A). See paragraph (e)(5) of this section for definition of same (or similar) kind.

(3) *Examples.*— The provisions of this paragraph may be illustrated by the following examples:

Example (1). Corporation X is engaged exclusively in the trade or business of the transportation of gas by pipeline and is subject to the jurisdiction of the Federal Power Commission. With respect to all its public utility property, X's applicable 1968 method (as determined under paragraph (e) of this section) is the straight line method of depreciation. X may determine its reasonable allowance for depreciation under section 167(a) with respect to its post-1969 public utility property under a straight line method (or other subsection (l) method) or, if X uses a normalization method of regulated accounting, any other method of depreciation, provided that the use of such other method is allowable under section 167 without regard to section 167(l).

Example (2). Assume the same facts as in example (1) except that with respect to all of X's post-1969 public utility property the applicable 1968 method (as determined under paragraph (e) of this section) is the declining balance method using a rate of 150 percent of the straight line rate. Assume further that all of X's pre-1970 public utility property was accounted for in its July 1969 regulated accounting period, and that X used a flow-through method of regulated accounting for such period. X may determine its reasonable allowance for depreciation under section 167 with respect to its post-1969 public utility property by using the straight-line method of depreciation (or any other subsection (l) method), by using any method otherwise allowable under section 167 (such as a declining balance method) if X uses a normalization method of regulated accounting, or, by using the declining balance method using a rate of 150 percent of the straight line rate, whether or not X uses a normalization or a flow-through method of regulated accounting.

(e) *Applicable 1968 method*

(1) *In general.*— Under section 167(l)(3)(D), except as provided in subparagraphs (3) and (4) of this paragraph, the term "applicable 1968 method" means with respect to any public utility property—

(i) The method of depreciation properly used by the taxpayer in its Federal income tax return with respect to such property for the latest taxable year for which a return was filed before August 1, 1969,

(ii) If subdivision (i) of this subparagraph does not apply, the method of depreciation properly used by the taxpayer in its Federal income tax return for the latest taxable year for which a return was filed before August 1, 1969, with respect to public utility property of the same kind (or if there is no property of the same kind, property of the most similar kind) most recently placed in service before the end of such latest taxable year, or

(iii) If neither subdivision (i) nor (ii) of this subparagraph applies, a subsection (l) method.

If, on or after August 1, 1969, the taxpayer files an amended return for the taxable year referred to in subdivisions (i) and (ii) of this subparagraph, such amended return shall not be taken into consideration in determining the applicable 1968 method. The term "applicable 1968 method" also means with respect

to any public utility property, for the year of change and subsequent years, a method of depreciation otherwise allowable under section 167 to which the taxpayer changes from an applicable 1968 method, if such new method results in a lesser allowance for depreciation for such property under section 167 in the year of change and the taxpayer secures the Commissioner's consent to the change in accordance with the procedures of section 446(e) and § 1.446-1.

(2) *Placed in service.*— For purposes of this section, property is placed in service on the date on which the period for depreciation begins under section 167. See, for example, § 1.167(a)-10(b) and proposed § 1.167(a)-11(c)(2). If under an averaging convention, property which is placed in service (as defined in § 1.46-3(d)(ii)) by the taxpayer on different dates is treated as placed in service on the same date, then for purposes of section 167(l) the property shall be treated as having been placed in service on the date the period for depreciation with respect to such property would begin under section 167 absent such averaging convention. Thus, for example, if, except for the fact that the averaging convention used assumes that all additions and retirements made during the first half of the year were made on the first day of the year, the period of depreciation for two items of public utility property would begin on January 10 and March 15, respectively, then for purposes of determining the property of the same (or similar) kind most recently placed in service, such items of property shall be treated as placed in service on January 10 and March 15, respectively.

(3) *Certain section 1250 property.*— If a taxpayer is required under section 167(j) to use a method of depreciation other than its applicable 1968 method with respect to any section 1250 property, the term "applicable 1968 method" means the method of depreciation allowable under section 167(j) which is the most nearly comparable method to the applicable 1968 method determined under subparagraph (1) of this paragraph. For example, if the applicable 1968 method on new section 1250 property is the declining balance method using 200 percent of the straight line rate, the most nearly comparable method allowable for new section 1250 property under section 167(j) would be the declining balance method using 150 percent of the straight line rate. If the applicable 1968 method determined under subparagraph (1) of this paragraph is the sum of the years-digits method, the term "most nearly comparable method" refers to any method of depreciation allowable under section 167(j).

(4) *Applicable 1968 method in certain cases*

(i)

(a) Under section 167(l)(3)(E), if the taxpayer evidenced within the time and manner specified in (*b*) of this subdivision (i) the intent to use a method of depreciation under section 167 (other than its applicable 1968 method as determined under subparagraph (1) or (3) of this paragraph or a subsection (l) method) with respect to any public utility property, such method of depreciation shall be deemed to be the taxpayer's applicable 1968 method with respect to such public utility property and public utility property of the same (or most similar) kind subsequently placed in service.

(b) Under this subdivision (i), the intent to use a method of depreciation under section 167 is evidenced—

(1) By a timely application for permission for a change in method of accounting filed by the taxpayer before August 1, 1969, or

(2) By the use of such method of depreciation in the computation by the taxpayer of its tax expense for purposes of reflecting operating results in its regulated books of account for its July 1969 regulated accounting period, as established in the manner prescribed in subparagraph (g)(1)(i), (ii), or (iii) of this section.

(ii)

(a) If public utility property is acquired in a transaction in which its basis in the hands of the transferee is determined in whole or in part by reference to its basis in the hands of the transferor by reason of the application of any provision of the Code, or in a transfer (including any purchase for cash or in exchange) from a related person, then in the hands of the transferee the applicable 1968 method with respect to such property shall be determined by reference to the treatment in respect of such property in the hands of the transferor.

(b) For purposes of this subdivision (ii), the term "related person" means a person who is related to another person if either immediately before or after the transfer—

(1) The relationship between such persons would result in a disallowance of losses under section 267 (relating to disallowance of losses, etc., between related taxpayers) or section 707(b) (relating to losses disallowed, etc., between partners and controlled partnerships) and the regulations thereunder, or

(2) Such persons are members of the same controlled group of corporations, as defined in section 1563(a) (relating to definition of controlled group of corporations), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a) and the regulations thereunder.

(5) ***Same or similar.—*** The classification of property as being of the same (or similar) kind shall be made by reference to the function of the public utility to which the primary use of the property relates. Property which performs the identical function in the identical manner shall be treated as property of the same kind. The determination that property is of a similar kind shall be made by reference to the proper account to which expenditures for the property are chargeable under the system of regulated accounts required to be used by the taxpayer for the period in which the property in question was acquired. Property, the expenditure for which is chargeable to the same account, is property of the most similar kind. Property, the expenditure for which is chargeable to an account for property which serves the same general function, is property of a similar kind. Thus, for example, if corporation X, a natural gas company, subject to the jurisdiction of the Federal Power Commission, had property properly chargeable to account 366 (relating to transmission plant structures and improvements) acquired an additional structure properly chargeable to account 366, under the uniform system of accounts prescribed for natural gas companies (class A and class B) by the Federal Power Commission, effective September 1, 1968, the addition would constitute property of the same kind if it performed the identical function in the identical manner. If, however, the addition did not perform the identical function in the identical manner, it would be property of the most similar kind.

(6) ***Regulated method of accounting in certain cases.—*** Under section 167(l)(4)(B), if with respect to any pre-1970 public utility property the taxpayer filed a timely application for change in method of accounting referred to in subparagraph (4)(i)(*b*)(*1*) of this paragraph and with respect to property of the same (or similar) kind most recently placed in service the taxpayer used a flow-through method of regulated accounting for its July 1969 regulated accounting period, then for purposes of section 167(l)(1)(B) and paragraph (c) of this section the taxpayer shall be deemed to have used a flow-through method of regulated accounting with respect to such pre-1970 public utility property.

(7) ***Examples.—*** The provisions of this paragraph may be illustrated by the following examples:

Example (1). Corporation X is a calendar-year taxpayer. On its Federal income tax return for 1967 (the latest taxable year for which X, prior to August 1, 1969, filed a return) X used a straight line method of depreciation with respect to certain public utility property placed in service before 1965 and used the declining balance method of depreciation using 200 percent of the straight line rate (double declining balance) with respect to the same kind of public utility property placed in service after 1964. In 1968 and

1970, X placed in service additional public utility property of the same kind. The applicable 1968 method with respect to the above described public utility property is shown in the following chart:

Property held in 1970	***Placed in service***	***Method on 1967 return***	***Applicable 1968 method***
Group 1	Before 1965	Straight line	Straight line
Group 2	After 1964 and before 1968.	Double declining balance.	Double declining balance.
Group 3	After 1967 and before 1969.	.....	Do.
Group 4	After 1968	.....	Do.

Example (2). Corporation Y is a calendar-year taxpayer engaged exclusively in the trade or business of the furnishing of electrical energy. In 1954, Y placed in service hydroelectric generators and for all purposes Y has taken straight line depreciation with respect to such generators. In 1960, Y placed in service fossil fuel generators and for all purposes since 1960 has used the declining balance method of depreciation using a rate of 150 percent of the straight line rate (computed without reduction for salvage) with respect to such generators. After 1960 and before 1970 Y did not place in service any generators. In 1970, Y placed in service additional hydroelectric generators. The applicable 1968 method with respect to the hydroelectric generators placed in service in 1970 would be the straight line method because it was the method used by Y on its return for the latest taxable year for which Y filed a return before August 1, 1969, with respect to property of the same kind (i.e., hydroelectric generators) most recently placed in service.

Example (3). Assume the same facts as in example (2), except that the generators placed in service in 1970 were nuclear generators. The applicable 1968 method with respect to such generators is the declining balance method using a rate of 150 percent of the straight line rate because, with respect to property of the most similar kind (fossil fuel generators) most recently placed in service, Y used such declining balance method on its return for the latest taxable year for which it filed a return before August 1, 1969.

(f) ***Subsection (l) method.***— Under section 167(l)(3)(F), the term "subsection (l) method" means a reasonable and consistently applied ratable method of computing depreciation which is allowable under section 167(a), such as, for example, the straight-line method or a unit of production method or machine-hour method. The term "subsection (l) method" does not include any declining balance method (regardless of the uniform rate applied), sum of the years-digits method, or method of depreciation which is allowable solely by reason of section 167(b)(4) or (j)(1)(C).

(g) ***July 1969 regulated accounting period***

(1) ***In general.***— Under section 167(l)(3)(I), the term "July 1969 regulated accounting period" means the taxpayer's latest accounting period ending before August 1, 1969, for which the taxpayer regularly computed, before January 1, 1970, its tax expense for purposes of reflecting operating results in its regulated books of account. The computation by the taxpayer of such tax expense may be established by reference to the following:

(i) The most recent periodic report of a period ending before August 1, 1969, required by a regulatory body described in section 167(l)(3)(A) having jurisdiction over the taxpayer's regulated books of account which was filed with such body before January 1, 1970 (whether or not such body has jurisdiction over rates).

(ii) If subdivision (i) of the subparagraph does not apply, the taxpayer's most recent report to its shareholders for a period ending before August 1, 1969, but only if such report was distributed to

the shareholders before January 1, 1970, and if the taxpayer's stocks or securities are traded in an established securities market during such period. For purposes of this subdivision, the term "established securities market" has the meaning assigned to such term in § 1.453-3(d)(4).

(iii) If subdivisions (i) and (ii) of this subparagraph do not apply, entries made to the satisfaction of the district director before January 1, 1970, in its regulated books of account for its most recent accounting period ending before August 1, 1969.

(2) ***July 1969 method of regulated accounting in certain acquisitions.***— If public utility property is acquired in a transaction in which its basis in the hands of the transferee is determined in whole or in part by reference to its basis in the hands of the transferor by reason of the application of any provision of the Code, or in a transfer (including any purchase for cash or in exchange) from a related person, then in the hands of the transferee the method of regulated accounting for such property's July 1969 regulated accounting period shall be determined by reference to the treatment in respect of such property in the hands of the transferor. See paragraph (e)(4)(ii) of this section for definition of "related person."

(3) ***Determination date.***— For purposes of section 167(l), any reference to a method of depreciation under section 167(a), or a method of regulated accounting, taken into account by the taxpayer in computing its tax expense for its July 1969 regulated accounting period shall be a reference to such tax expense as shown on the periodic report or report to shareholders to which subparagraph (l)(i) or (ii) of this paragraph applies or the entries made on the taxpayer's regulated books of account to which subparagraph (l)(iii) of this paragraph applies. Thus, for example, assume that regulatory body A having jurisdiction over public utility property with respect to X's regulated books of account requires X to reflect its tax expense in such books using the same method of depreciation which regulatory body B uses for determining X's cost of service for ratemaking purposes. If in 1971, in the course of approving a rate change for X, B retroactively determines X's cost of service for ratemaking purposes for X's July 1969 regulated accounting period using a method of depreciation different from the method reflected in X's regulated books of account as of January 1, 1970, the method of depreciation used by X for its July 1969 regulated accounting period would be determined without reference to the method retroactively used by B in 1971.

(h) ***Normalization method of accounting***

(1) ***In general***

(i) Under section 167(l), a taxpayer uses a normalization method of regulated accounting with respect to public utility property—

(a) If the same method of depreciation (whether or not a subsection (l) method) is used to compute both its tax expense and its depreciation expense for purposes of establishing cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, and

(b) If to compute its allowance for depreciation under section 167 it uses a method of depreciation other than the method it used for purposes described in (*a*) of this subdivision, the taxpayer makes adjustments consistent with subparagraph (2) of this paragraph to a reserve to reflect the total amount of the deferral of Federal income tax liability resulting from the use with respect to all of its public utility property of such different methods of depreciation.

(ii) In the case of a taxpayer described in section 167(l) (1)(B) or (2)(C), the reference in subdivision (i) of this subparagraph shall be a reference only to such taxpayer's "qualified public utility property." See § 1.167(l)-2(b) for definition of "qualified public utility property."

(iii) Except as provided in this subparagraph, the amount of Federal income tax liability deferred as a result of the use of different method of depreciation under subdivision (i) of this subparagraph is the excess (computed without regard to credits) of the amount the tax liability would have been had a

subsection (l) method been used over the amount of the actual tax liability. Such amount shall be taken into account for the taxable year in which such different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (l) method for purposes of determining the taxpayer's reasonable allowance under section 167(a) results in a net operating loss carryover (as determined under section 172) to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under section 167(a) using a subsection (l) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

(2) *Adjustments to reserve*

(i) The taxpayer must credit the amount of deferred Federal income tax determined under subparagraph (l)(i) of this paragraph for any taxable year to a reserve for deferred taxes, a depreciation reserve, or other reserve account. The taxpayer need not establish a separate reserve account for such amount but the amount of deferred tax determined under subparagraph (l)(i) of this paragraph must be accounted for in such a manner so as to be readily identifiable. With respect to any account, the aggregate amount allocable to deferred tax under section 167(l) 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 under subparagraph (l)(i) of this paragraph. An additional exception is that the aggregate amount allocable to deferred tax under section 167(l) may be properly adjusted to reflect asset retirements or the expiration of the period for depreciation used in determining the allowance for depreciation under section 167(a).

(ii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Corporation X is exclusively engaged in the transportation of gas by pipeline subject to the jurisdiction of the Federal Power Commission. With respect to its post-1969 public utility property, X is entitled under section 167(l)(2)(B) to use a method of depreciation other than a subsection (l) method if it uses a normalization method of regulated accounting. With respect to such property, X has not made any election under § 1.167(a)-11 (relating to depreciation based on class lives and asset depreciation ranges). In 1972, X places in service public utility property with an unadjusted basis of $2 million, and an estimated useful life of 20 years. X uses the declining-balance method of depreciation with a rate twice the straight line rate. If X uses a normalization method of regulated accounting, the amount of depreciation allowable under section 167(a) with respect to such property for 1972 computed under the double declining balance method would be $200,000. X computes its tax expense and depreciation expense for purposes of determining its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account using the straight line method of depreciation (a subsection (l) method). A depreciation allowance computed in this manner is $100,000. The excess of the depreciation allowance determined under the double declining balance method ($200,000) over the depreciation expense computed using the straight line method ($100,000) is $100,000. Thus, assuming a tax rate of 48 percent, X used a normalization method of regulated accounting for 1972 with respect to property placed in service that year if for 1972 it added to a reserve $48,000 as taxes deferred as a result of the use by X of a method of depreciation for Federal income tax purposes different from that used for establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account.

Example (2). Assume the same facts as in example (l), except that X elects to apply § 1.167(a)-11 with respect to all eligible property placed in service in 1972. Assume further that all property X placed in service in 1972 is eligible property. One hundred percent of the asset guideline period for such property is 22 years and the asset depreciation range is from 17.5 years to 26.5 years. X uses the double declining balance method of depreciation, selects an asset depreciation period of 17.5 years, and applies the half-year convention (described in § 1.167(a)-11(c)(2)(iii)). In 1972, the

depreciation allowable under section 167(a) with respect to property placed in service in 1972 is $114,285 (determined without regard to the normalization requirements in § 1.167(a)-11(b)(6) and in section 167(l)). X computes its tax expense for purposes of determining its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account using the straight-line method of depreciation (a subsection (l) method), an estimated useful life of 22 years (that is, 100 percent of the asset guideline period), and the half-year convention. A depreciation allowance computed in this manner is $45,454. Assuming a tax rate of 48 percent, the amount that X must add to a reserve for 1972 with respect to property placed in service that year in order to qualify as using a normalization method of regulated accounting under section 167(l)(3)(G) is $27,429 and the amount in order to satisfy the normalization requirements of proposed § 1.167(a)-11(b)(6) is $5,610. X determined such amounts as follows:

(1)	Depreciation allowance on tax return (determined without regard to section 167(1) and § 1.167(a)-11(b)(6))	$114,285
(2)	Line (1), recomputed using a straight line method	57,142
(3)	Difference in depreciation allowance attributable to different methods (line (1) minus line (2))	$57,143
(4)	Amount to add to reserve under this paragraph (48 percent of line (3))	$27,429
(5)	Amount in line (2)	$57,142
(6)	Line (5), recomputed by using an estimated useful life of 22 years and the half-year convention	45,454
(7)	Difference in depreciation allowance attributable to difference in depreciation periods	$11,688
(8)	Amount to add to reserve under § 1.167(a)-11(b)(6)(ii) (48 percent of line (7))	5,610

If, for its depreciation expense for purposes of determining its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, X had used a period in excess of the asset guideline period of 22 years, the total amount in lines (4) and (8) in this example would not be changed.

Example (3). Corporation Y, a calendar-year taxpayer which is engaged in furnishing electrical energy, made the election provided by section 167(l)(4)(a) with respect to its "qualified public utility property" (as defined in § 1.167(l)-2(b)). In 1971, Y placed in service qualified public utility property which had an adjusted basis of $2 million, estimated useful life of 20 years, and no salvage value. With respect to property of the same kind most recently placed in service, Y used a flow-through method of regulated accounting for its July 1969 regulated accounting period and the applicable 1968 method is the declining balance method of depreciation using 200 percent of the straight line rate. The amount of depreciation allowable under the double declining balance method with respect to the qualified public utility property would be $200,000. Y computes its tax expense and depreciation expense for purposes of determining its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account using the straight line method of depreciation. A depreciation allowance with respect to the qualified public utility property determined in this manner is $100,000. The excess of the depreciation allowance determined under the double declining balance method ($200,000) over the depreciation expense computed using the straight line method ($100,000) is $100,000. Thus, assuming a tax rate of 48 percent, Y used a normalization method of regulated accounting for 1971 if for 1971 it added to a reserve $48,000 as tax deferred as a result of the use by Y of a method of depreciation for Federal income tax purposes with respect to its qualified public utility property which method was different from that used for establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account for such property.

Example (4). Corporation Z, exclusively engaged in a public utility activity did not use a flow-through method of regulated accounting for its July 1969 regulated accounting period. In 1971, a regulatory body having jurisdiction over all of Z's property issued an order applicable to all years beginning with 1968 which provided, in effect, that Z use an accelerated method of depreciation for purposes of section 167 and for determining its tax expenses for purposes of reflecting operating results in its regulated books of account. The order further provided that Z normalize 50 percent of the tax deferral resulting from the use of the accelerated method of depreciation and that Z flow-through 50 percent of the tax deferral resulting therefrom. Under section 167(l), the method of accounting provided in the order would not be a normalization method of regulated accounting because Z would not be permitted to normalize 100 percent of the tax deferral resulting from the use of an accelerated method of depreciation. Thus, with respect to its public utility property for purposes of section 167, Z may only use a subsection (l) method of depreciation.

Example (5). Assume the same facts as in example (4) except that the order of the regulatory body provided, in effect, that Z normalize 100 percent of the tax deferral with respect to 50 percent of its public utility property and flow-through the tax savings with respect to the other 50 percent of its property. Because the effect of such an order would allow Z to flow-through a portion of the tax savings resulting from the use of an accelerated method of depreciation, Z would not be using a normalization method of regulated accounting with respect to any of its properties. Thus, with respect to its public utility property for purposes of section 167, Z may only use a subsection (l) method of depreciation.

(3) ***Establishing compliance with normalization requirements in respect of operating books of account.—*** The taxpayer may establish compliance with the requirement in subparagraph (l)(i) of this paragraph in respect of reflecting operating results, and adjustments to a reserve, in its operating books of account by reference to the following:

(i) The most recent periodic report for a period beginning before the end of the taxable year, required by a regulatory body described in section 167(l)(3)(A) having jurisdiction over the taxpayer's regulated operating books of account which was filed with such body before the due date (determined with regard to extensions) of the taxpayer's Federal income tax return for such taxable year (whether or not such body has jurisdiction over rates).

(ii) If subdivision (i) of this subparagraph does not apply, the taxpayer's most recent report to its shareholders for the taxable year but only if (*a*) such report was distributed to the shareholders before the due date (determined with regard to extensions) of the taxpayer's Federal income tax return for the taxable year and (*b*) the taxpayer's stocks or securities are traded in an established securities market during such taxable year. For purposes of this subdivision, the term "established securities market" has the meaning assigned to such term in § 1.453-3(d)(4).

(iii) If neither subdivision (i) nor (ii) of this subparagraph applies, entries made to the satisfaction of the district director before the due date (determined with regard to extensions) of the taxpayer's Federal income tax return for the taxable year in its regulated books of account for its most recent period beginning before the end of such taxable year.

(4) ***Establishing compliance with normalization requirements in computing cost of service for ratemaking purposes***

(i) In the case of a taxpayer which used a flow-through method of regulated accounting for its July 1969 regulated accounting period or thereafter, with respect to all or a portion if its pre-1970 public utility property, if a regulatory body having jurisdiction to establish the rates of such taxpayer as to such property (or a court which has jurisdiction over such body) issues an order of general application (or an order of specific application to the taxpayer) which states that such regulatory body (or court) will permit a class of taxpayers of which such taxpayer is a member (or such taxpayer) to use the normalization

method of regulated accounting to establish cost of service for ratemaking purposes with respect to all or a portion of its public utility property, the taxpayer will be presumed to be using the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes with respect to the public utility property to which such order applies. In the event that such order is in any way conditional, the preceding sentence shall not apply until all of the conditions contained in such order which are applicable to the taxpayer have been fulfilled. The taxpayer shall establish to the satisfaction of the Commissioner or his delegate that such conditions have been fulfilled.

(ii) In the case of a taxpayer which did not use the flow-through method of regulated accounting for its July 1969 regulated accounting period or thereafter (including a taxpayer which used a subsection (l) method of depreciation to compute its allowance for depreciation under section 167(a) and to compute its tax expense for purposes of reflecting operating results in its regulated books of account), with respect to any of its public utility property, it will be presumed that such taxpayer is using the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes with respect to its post-1969 public utility property. The presumption described in the preceding sentence shall not apply in any case where there is (*a*) an expression of intent (regardless of the manner in which such expression of intent is indicated) by the regulatory body (or bodies), having jurisdiction to establish the rates of such taxpayer, which indicates that the policy of such regulatory body is in any way inconsistent with the use of the normalization method of regulated accounting by such taxpayer or by a class of taxpayers of which such taxpayer is a member, or (*b*) a decision by a court having jurisdiction over such regulatory body which decision is any way inconsistent with the use of the normalization method of regulated accounting by such taxpayer or a class of taxpayers of which such taxpayer is a member. The presumption shall be applicable on January 1, 1970, and shall, unless rebutted, be effective until an inconsistent expression of intent is indicated by such regulatory body or by such court. An example of such an inconsistent expression of intent is the case of a regulatory body which has, after the July 1969 regulated accounting period and before January 1, 1970, directed public utilities subject to its ratemaking jurisdiction to use a flow-through method of regulated accounting, or has issued an order of general application which states that such agency will direct a class of public utilities of which the taxpayer is a member to use a flow-through method of regulated accounting. The presumption described in this subdivision may be rebutted by evidence that the flow-through method of regulated accounting is being used by the taxpayer with respect to such property.

(iii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Corporation X is a calendar-year taxpayer and its "applicable 1968 method" is a straight line method of depreciation. Effective January 1, 1970, X began collecting rates which were based on a sum of the years-digits method of depreciation and a normalization method of regulated accounting which rates had been approved by a regulatory body having jurisdiction over X. On October 1, 1971, a court of proper jurisdiction annulled the rate order prospectively, which annulment was not appealed, on the basis that the regulatory body had abused its discretion by determining the rates on the basis of a normalization method of regulated accounting. As there was no inconsistent expression of intent during 1970 or prior to the due date of X's return for 1970, X's use of the sum of the years-digits method of depreciation for purposes of section 167 on such return was proper. For 1971, the presumption is in effect through September 30. During 1971, X may use the sum of the years-digits method of depreciation for purposes of section 167 from January 1 through September 30, 1971. After September 30, 1971, and for taxable years after 1971, X must use a straight line method of depreciation until the inconsistent court decision is on longer in effect.

Example (2). Assume the same facts as in example (1), except that pursuant to the order of annulment, X was required to refund the portion of the rates attributable to the use of the normalization method

of regulated accounting. As there was no inconsistent expression of intent during 1970 or prior to the due date of X's return for 1970, X has the benefit of the presumption with respect to its use of the sum of the years-digits method of depreciation for purposes of section 167, but because of the retroactive nature of the rate order X must file an amended return for 1970 using a straight line method of depreciation. As the inconsistent decision by the court was handed down prior to the due date of X's Federal income tax return for 1971, for 1971 and thereafter the presumption of subdivision (ii) of this subparagraph does not apply. X must file its Federal income tax returns for such years using a straight line method of depreciation.

Example (3). Assume the same facts as in example (2), except that the annulment order was stayed pending appeal of the decision to a court of proper appellate jurisdiction. X has the benefit of the presumption as described in example (2) for the year 1970, but for 1971 and thereafter the presumption of subdivision (ii) of this subparagraph does not apply. Further, X must file an amended return for 1970 using a straight line method of depreciation and for 1971 and thereafter X must file its returns using a straight line method of depreciation unless X and the district director have consented in writing to extend the time for assessment of tax for 1970 and thereafter with respect to the issue of normalization method of regulated accounting for as long as may be necessary to allow for resolution of the appeal with respect to the annulment of the rate order.

(5) ***Change in method of regulated accounting.***— The taxpayer shall notify the district director of a change in its method of regulated accounting, an order by a regulatory body or court that such method be changed, or an interim or final rate determination by a regulatory body which determination is inconsistent with the method of regulated accounting used by the taxpayer immediately prior to the effective date of such rate determination. Such notification shall be made within 90 days of the date that the change in method, the order, or the determination is effective. In the case of a change in the method of regulated accounting, the taxpayer shall recompute its tax liability for any affected taxable year and such recomputation shall be made in the form of an amended return where necessary unless the taxpayer and the district director have consented in writing to extend the time for assessment of tax with respect to the issue of normalization method of regulated accounting.

(6) ***Exclusion of normalization reserve from rate base***

(i) Notwithstanding the provisions of subparagraph (1) of this paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's tax expense in computing cost of service in such ratemaking.

(ii) For the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i) of this subparagraph, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for the period is the amount of the reserve (determined under subparagraph (2) of this paragraph) at the end of the historical period. If solely a future period is used for such determination, the amount of the reserve account for the period is the amount of the reserve at the beginning of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during such period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period. The pro rata portion of any increase to be credited or decrease to be charged during a future period (or the future portion of a part-historical and part-future period) shall be determined by multiplying any such increase or decrease

by a fraction, the numerator of which is the number of days remaining in the period at the time such increase or decrease is to be accrued, and the denominator of which is the total number of days in the period (or future portion).

(iii) The provisions of subdivision (i) of this subparagraph shall not apply in the case of a final determination of a rate case entered on or before May 31, 1973. For this purpose, a determination is final if all rights to request a review, a rehearing, or a redetermination by the regulatory body which makes such determination have been exhausted or have lapsed. The provisions of subdivision (ii) of this subparagraph shall not apply in the case of a rate case filed prior to June 7, 1974, for which a rate order is entered by a regulatory body having jurisdiction to establish the rates of the taxpayer prior to September 5, 1974, whether or not such order is final, appealable, or subject to further review or reconsideration.

(iv) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Corporation X is exclusively engaged in the transportation of gas by pipeline subject to the jurisdiction of the Z Power Commission. With respect to its post-1969 public utility property, X is entitled under section 167(l)(2)(B) to use a method of depreciation other than a subsection (l) method if it uses a normalization method of regulated accounting. With respect to X the Z Power Commission for purposes of establishing cost of service uses a recent consecutive 12-month period ending not more than 4 months prior to the date of filing a rate case adjusted for certain known changes occurring within a 9-month period subsequent to the base period. X's rate case is filed on January 1, 1975. The year 1974 is the recorded test period for X's rate case and is the period used in determining X's tax expense in computing cost of service. The rates are contemplated to be in effect for the years 1975, 1976, and 1977. The adjustments for known changes relate only to wages and salaries. X's rate base at the end of 1974 is $145,000,000. The amount of the reserve for deferred taxes under section 167(l) at the end of 1974 is $1,300,000, and the reserve is projected to be $4,400,000 at the end of 1975, $6,500,000 at the end of 1976, and $9,800,000 at the end of 1977. X does not use a normalization method of regulated accounting if the Z Power Commission excludes more than $1,300,000 from the rate base to which X's rate of return is applied. Similarly, X does not use a normalization method of regulated accounting if, instead of the above, the Z Power Commission, in determining X's rate of return which is applied to the rate base, assigns to no-cost capital an amount that represents the reserve account for deferred tax that is greater than $1,300,000.

Example (2). Assume the same facts as in example (1) except that the adjustments for known changes in cost of service made by the Z Power Commission include an additional depreciation expense that reflects the installation of new equipment put into service on January 1, 1975. Assume further that the reserve for deferred taxes under section 167(l) at the end of 1974 is $1,300,000 and that the monthly net increases for the first 9 months of 1975 are projected to be

January	1-31	$310,000
February	1-28	300,000
March	1-31	300,000
April	1-30	280,000
May	1-31	270,000
June	1-30	260,000
July	1-31	260,000
August	1-31	250,000
Sept.	1-30	240,000
		$2,470,000

For its regulated books of account X accrues such increases as of the last day of the month but as a matter of convenience credits increases or charges decreases to the reserve account on the 15th day of the month following the whole month for which such increase or decrease is accrued. The maximum

amount that may be excluded from the rate base is $2,470,879 (the amount in the reserve at the end of the historical portion of the period ($1,300,000) and a pro rata portion of the amount of any projected increase for the future portion of the period to be credited to the reserve ($1,170,879)). Such pro rata portion is computed (without regard to the date such increase will actually be posted to the account) as follows:

$310,000	×	243/273	=	$275,934
300,000	×	215/273	=	236,264
300,000	×	184/273	=	202,198
280,000	×	154/273	=	157,949
270,000	×	123/273	=	121,648
260,000	×	93/273	=	88,571
260,000	×	62/273	=	59,048
250,000	×	31/273	=	28,388
240,000	×	1/273	=	879
				$1,170,879

Example (3). Assume the same facts as in example (1) except that for purposes of establishing cost of service the Z Power Commission uses a future test year (1975). The rates are contemplated to be in effect for 1975, 1976, and 1977. Assume further that plant additions, depreciation expense, and taxes are projected to the end of 1975 and that the reserve for deferred taxes under section 167(I) is $1,300,000 for 1974 and is projected to be $4,400,000 at the end of 1975. Assume also that the Z Power Commission applies the rate of return to X's 1974 rate base of $145,000,000. X and the Z Power Commission through negotiation arrive at the level of approved rates. X uses a normalization method of regulated accounting only if the settlement agreement, the rate order, or record of the proceedings of the Z Power Commission indicates that the Z Power Commission did not exclude an amount representing the reserve for deferred taxes from X's rate base ($145,000,000) greater than $1,300,000 plus a pro rata portion of the projected increases and decreases that are to be credited or charged to the reserve account for 1975. Assume that for 1975 quarterly net increases are projected to be

1st quarter	$910,000
2nd quarter	810,000
3rd quarter	750,000
4th quarter	630,000
Total	$3,100,000

For its regulated books of account X will accrue such increases as of the last day of the quarter but as a matter of convenience will credit increases or charge decreases to the reserve account on the 15th day of the month following the last month of the quarter for which suce reserve account on the 15th day of the month following the last month of the quarter for which such increase or decrease will be accrued. The maximum amount that may be excluded from the rate base is $2,591,480 (the amount of the reserve at the beginning of the period ($1,300,000) plus a pro rata portion ($1,291,480) of the $3,100,000 projected increase to be credited to the reserve during the period). Such portion is computed (without regard to the date such increase will actually be posted to the account) as follows:

$910,000	×	276/365	=	$688,110
810,000	×	185/365	=	410,548
750,000	×	93/365	=	191,096
630,000	×	1/365	=	1,726
				$1,291,480

(i) *Flow-through method of regulated accounting.*— Under section 167(I)(3)(H), a taxpayer uses a flow-through method of regulated accounting with respect to public utility property if it uses the same method of depreciation (other than a subsection (I) method) to compute its allowance for depreciation under section 167

and to compute its tax expense for purposes of reflecting operating results in its regulated books of account unless such method is the same method used by the taxpayer to determine its depreciation expense for purposes of reflecting operating results in its regulated books of account. Except as provided in the preceding sentence, the method of depreciation used by a taxpayer with respect to public utility property for purposes of determining cost of service for ratemaking purposes or rate base for ratemaking purposes shall not be considered in determining whether the taxpayer used a flow-through method of regulated accounting. A taxpayer may establish use of a flow-through method of regulated accounting in the same manner that compliance with normalization requirements in respect of operating books of account may be established under paragraph (h)(4) of this section. [Reg. §1.167(l)-1.]

□ [*T.D.* 7315, 6-6-74.]

STATE OF Kentucky)

COUNTY OF Fayette)

BEFORE ME, the undersigned, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Kurt A. Stafford, 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 duly sworn, verifies that the data requests and discovery responses are accurate to the best of his knowledge.

Kurt Stafford

Kurt A. Stafford

Sworn to and subscribed before me
this 13th day of Feb, 2020.

Notary Public

My Commission expires: 7/25/2020

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STATE OF Kentucky)

COUNTY OF Fayette)

BEFORE ME, the undersigned, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Elaine Chambers, being by me first duly sworn deposed and said that:

She is appearing as a witness on behalf of Tennessee-American Water Company before the Tennessee Public Utility Commission, and duly sworn, verifies that the data requests and discovery responses are accurate to the best of her knowledge.

Elaine Chambers

Elaine Chambers

Sworn to and subscribed before me
this 13th day of Feb, 2020.

Sharon Miller

Notary Public

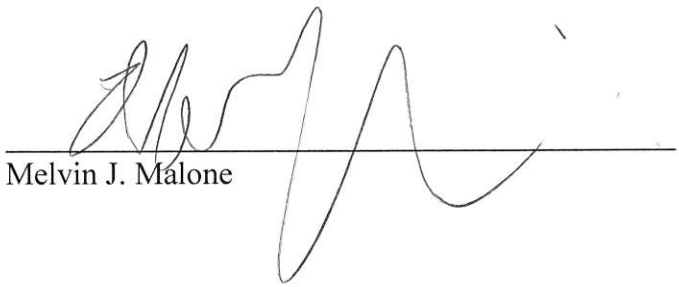
My Commission expires: 7/25/2020

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
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

This the 13th day of February, 2020.



Melvin J. Malone