BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Confluence Rivers Utility Operating Company, Inc.'s Request for Authority to Implement a General Rate Increase for Water Service and Sewer Service Provided in Missouri Service Areas	)	File No. WR-2023-0006

CHARLES HATCHER, Presiding
SENIOR REGULATORY LAW JUDGE

EVIDENTIARY HEARING
Friday, August 11, 2023
10:30 a.m. - 4:43 p.m.

Office of the Missouri Public Service Commission
200 Madison Street
Jefferson City, Missouri

Stenographically Reported by:
Jill Bleskey, CSR, CCR, RPR

I N D E X

(Exhibit retained by reporter to be attached.)

A P P E A R A N C E S

On behalf of the Public Service Commission:

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Commissioner Jason Holsman
Commissioner Glen Kolkmeyer
Commissioner Kayla Hahn
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(Hearing commenced at 10:30 a.m.)

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JUDGE HATCHER: Let's go on the record. Today is Friday, August 11th. This is the second day of the time that the Commission has set aside for the general rate increase case of Confluence Rivers Operating Company filed under WR-2023-0006.

With me today are Commissioner Glen Kolkmeyer, Commissioner Jason Holsman, Commissioner Maida Coleman is on WebEx. And I expect to be joined later by the other two Commissioners.

We do have a couple of announcements before we get into today's events. Which, for the benefit of those listening, I understand our first issue will be coming up as income taxes. I do want to, like I said, make two quick announcements. The first is to ask the parties, Staff Counsel, would you please tell me what further issues have settled.

THE REPORTER: And could you identify yourself too, please.

MR. PRINGLE: Yes, yeah. For the record, this is Travis Pringle from Staff Counsel. Actually Judge, if it's a little easier, I was just going to give you the issues that are still live.

JUDGE HATCHER: Perfect.

MR. PRINGLE: So we have income taxes. And this is going off the amended list that was filed on August 8th. So that's Issue 4, income taxes. Issue 6, acquisition related costs. Issue 8, time sheets. Issue 13, cost of capital. Issue 16, advanced meter infrastructure. Then in Issue 17 only Subissues C and D, and that is operation. Issue 21, corporate allocations. And Issue 25, capital verse expense. Those are the only live issues remaining.

JUDGE HATCHER: Twenty-five was capital expense?

MR. PRINGLE: Capital v -- capital verse expense, correct. One moment, Judge.

JUDGE HATCHER: Yes.

COMMISSIONER KOLKMEYER: Would you read those numbers down again, please?

MR. PRINGLE: And sorry, Judge, I did miss one other live issue. That is going back to Issue 5, rate design, Subissue A, A1, what is the appropriate amount of uses for purposes of establishing water rates. But the parties have agreed to waive cross-examination on that issue and just resolve it via the briefs.

JUDGE HATCHER: Please inform -- first,

let's note for the record the arrival of our Chairman Scott Rupp. S-C-O-T-T, R-U-P-P.
Counsel.
MR. PRINGLE: Yes.
JUDGE HATCHER: Go ahead.
MR. PRINGLE: Oh. And that's it pretty much for now. Those are the issues that are still live. Looking at the schedule, as it stands right now, time sheets is scheduled to end today. But we currently have no live issues scheduled for Monday, only cost of capital and advanced meter infrastructure scheduled for Tuesday. The Subissues C and D for operations and corporate allocations for Wednesday, and then just capital verse expense on Thursday.
JUDGE HATCHER: Okay. Thank you. Don't go anywhere. I have questions. You kind of stepped on my toes with my second announcement which I have not made yet but we're there. Please fill me in on district consolidation without telling me the terms of the settlement as I believe those would still be confidential. A, have the parties agreed to some form of --
MR. PRINGLE: I'll tell you, Judge. The only remaining issue on there has to do with the

actual water uses amount, the 5,000 as Staff proposed or the -- what is it, 3,500?

JUDGE HATCHER: Twenty-seven was in testimony.

MR. PRINGLE: Twenty-seven fifty or something like that.

JUDGE HATCHER: Yeah.

MR. PRINGLE: That's the only live issue left on the rate consolidation.

MR. WOODSMALL: And if you're inquiring -- I'm sorry. Dave Woodsmall on behalf of the Company. If you want to inquire about the nature of the settlement, it's not in writing but I have no problems either Counsel doing it or I'll put Mr. Cox up just to give whatever -- so while the Commissioners are here, if you want to know a little more substance around how we plan to resolve that I can put him up and you can ask him those questions.

JUDGE HATCHER: I would say yes, absolutely. That was my second announcement.

The Commission would like more information on additional district consolidation options.

MR. WOODSMALL: Okay. You want to do that before income taxes?

JUDGE HATCHER: Yes.

MR. WOODSMALL: The other thing I'll offer along those lines. This is obvious. This will all be memorialized into a stipulation. Consistent with past practice, I imagine there would be a stipulation presentation which you can ask further questions. But given the complexity of that issue I'll put him up right now. I'm sorry.

JUDGE HATCHER: And just a general announcement for those in the room. We do have people listening on WebEx which only picks up audio if you speak into a live microphone pretty directly.

MR. WOODSMALL: Understood.

MR. CLIZER: Your Honor, John Clizer on behalf of OPC. I apologize but I'm slightly confused. Is Mr. Cox standing up to discuss the terms of the stipulation or to answer Commission questions regarding possible other options? Because the latter would be more of an evidentiary point and we would at least like the opportunity to put on our other witnesses if that's what's going to happen.

JUDGE HATCHER: Yeah. No, I'm not ready for witnesses. I'm trying not to break confidentiality.

MR. CLIZER: Can I put forward potentially that I think the stipulation is going to be forthcoming relatively quickly.

MR. WOODSMALL: I doubt if it's today.

MR. CLIZER: Not today necessarily. But since we don't have anything Monday would it be possible to postpone that until we have the stipulation then we don't have to worry about confidentiality?

JUDGE HATCHER: Yes. Yes, I like that answer. Would --

MR. WOODSMALL: Your Honor.

JUDGE HATCHER: Go ahead, Mr. Woodsmall.

MR. WOODSMALL: The concern there, as Mr. Pringle said given the settled issues Monday would be empty. So there -- doing it on Monday would possibly cause witness availability concerns. If you want to do it Tuesday or whatever.

Honestly, I'll be real clear with you, the term of the settlement would provide for two districts water, two districts sewer not geographic. It would go along technology lines. Therefore, -- and Mr. Cox can explain this further. Therefore, waste water systems, several of them are lagoons. As lagoons they don't have blowers, aerators, and those types of things. Those are cost elements. So lagoons would be a lower cost 'cause they don't have those cost elements, and mechanical plants would be a higher cost. And there's a similar type of breakdown for water into two districts. And if you want to delve into that, he's available. Whatever the Commission wants.

MR. PRINGLE: And Judge, also Jim Bush, he's also happy to testify for Staff's perspective.

JUDGE HATCHER: Thank you. I appreciate that. I'm nodding my head not at approval of settlement but at the idea of checking witness availability. As I said, this has been one of the larger issues in the case. But yes, that was the answer I was looking for. I didn't want a witness, I just wanted a high level here's the direction we're going. That answers that question.

If Counsel, sometime through today, without me -- well, I'm sorry. The witnesses that I have are Lyons, Cox, Roth, Seiver, and Dr. Mark. I'm sure those are -- witnesses are listening or are in the room. If they would communicate with their counsel between now and the end of today. Just tell me what day all of them are available as a group and that will be the day, regardless of Counsel's schedule. Not -- I don't want to step on your schedule but this is a large and important issue that we want to make sure gets covered.

MR. WOODSMALL: Understood.

MR. PRINGLE: And I have one more update for that list of live issues right now, Judge. I have been informed that when it comes to the AMI investments issue also that that cross will be waived and that will also be argued in the briefs.

JUDGE HATCHER: Okay. I'm going to repeat this list by number and Commissioners and advisers I will e-mail this out subsequently later this morning. The issues by number in order. Number 4, income tax. Number 5, only the amount of water to be used in the calculation. And the two positions of the parties are 5,000 gallons and 2,750 gallons, and the parties have waived cross-examination on those witnesses so but for Commissioner questions that issue would be submitted on the pre-filed testimony.

MR. WOODSMALL: The only other complication on that is if the Commission has questions our witness Tim Lyons is testifying virtually so I need to, if you can, let me know if you have questions for him and I'll make sure that happens.

JUDGE HATCHER: Will do.

MR. WOODSMALL: Thank you.

JUDGE HATCHER: Number 6, acquisition costs. Number 8, I can't read my writing.

MR. PRINGLE: Time sheets.

JUDGE HATCHER: Thank you. It seems very clear now that you've said it out loud. Number 8, time sheets. Number 13, cost of capital. Number 16, advanced metering infrastructure, commonly called AMI. And this is another waiver of cross-examination by the parties. So absent Commissioner or Bench questions the parties will submit this issue for Commission decision on the pre-filed testimony. Issue 17, only Subparts C and D, this is operations and maintenance. Issue 21, corporate allocations. And Issue 25, capital v. expense.

MR. PRINGLE: That is correct, Judge. And parties, please let me know if I was wrong on any of that.

JUDGE HATCHER: I see no disagreement by the parties. And I thank you, Mr. Pringle. Go ahead and have a seat.

MR. PRINGLE: Thank you, Judge.

JUDGE HATCHER: Let's get started with our issue. If I can get a nod of heads. We are ready to go to income taxes. I am confirmed in my assumption. Many opening statements before we -- Mr. Clizer.

MR. CLIZER: Judge, do you want to do entries of appearance? We all kind of said our name at this point, so...

JUDGE HATCHER: Yes. Let's keep with our current ad hoc system and we will just make sure and introduce the first time when anybody is speaking. Many opening statements. I just want to remind Counsel that time is precious here. The Commissioners have all -- oh, and I also would like to make sure that all Commissioners have joined including making sure for the record -- oh, good, I'm on camera again. Commissioner Kayla Hahn has joined us. We have all five Commissioners now in attendance.

Just to remind Counsel once again, time is precious. The Commissioners and myself, we've read the pre-filed testimony, are familiar with the issue, we are really just looking for a summary from Counsel on these many openings. Let's get started. This is Confluence's rate case. Mr. Woodsmall.

CHAIRMAN RUPP: No two hours.

MR. WOODSMALL: I promise you. Possibly two minutes.

CHAIRMAN RUPP: Key word is many.

MR. THOMPSON: And time is precious. Good morning, Commissioners. Nice to see you again. I realize that when I did my opening statement yesterday that I probably complicated income taxes much more than it needed be. It's really a simple issue. You just need to keep your mind focused on how rate making's done. Rate making, just like your other tax -- your personal taxes. If you have any type of business rate making looks at expenses and revenues and it looks at your capital structure so that the amount of return that you have on equity is factored up for income taxes. That's it. You don't factor up the return on debt because that's not income, that's covering debt expense.

So rate making, very simple. In any case you've seen ever, I promise you, ever, every case you've done, Ameren, Evergy, Empire, Spire, income taxes were simply factoring up the return on equity. And that's what we seek in this case, just give us the income taxes that would derive from rates.

This has been complicated by Staff and Public Counsel who want to bring in the concept of net operating losses. Don't let that complicate things. I'll tell you what the net operating losses are, plain and simple. In the past the Company has covered losses. As I mentioned, when we buy a system rates are deflated. Some of these systems haven't had a rate increase for 30 years. We buy systems with depressed rates and we adopt those for the convenience of the customer.

So what happens. We go in and we do all the triage work that I talked about. I showed you the work that's done within 50 days. Rates are now here, costs are here. The Company covers all that lost, the Company covers all that loss and the ratepayers got the benefit of that loss. We covered it.

Now, Public Counsel and Staff says, well, thank you very much but please, sir, may I have another. I not only want the fact that you covered those losses, I want the tax benefit from you covering those losses. And that's where this gets complicated. We simply ask you to do it like you've always done it in every other case, how FERC does it, how everybody does it, you factor up the return on the equity component or taxes.

Available for any questions. Two minutes.

JUDGE HATCHER: Are there any Commissioner questions for Mr. Woodsmall? Thank you, Mr. Woodsmall.

MR. WOODSMALL: Thank you.

THE COURT: Move on to Staff.

MR. THOMPSON: Thank you, Judge. Do I have my visual? There we go.

THE REPORTER: Mr. Thompson, right?

MR. THOMPSON: What's that?

THE REPORTER: Mr. Thompson?

MR. THOMPSON: Yes. I'm Kevin Thompson and I represent the Staff. Post Office Box 360, Jefferson City, Missouri, 65101.

I was impressed yesterday that Mr. Woodsmall recruited Benjamin Franklin to his team on the income tax issues so I have recruited Plato and Aristotle. And the reason I have recruited them, the fathers of logic, is because Mr. Woodsmall's position, the Company position is absolutely illogical. Absolutely illogical. Let me explain it to you. And I'm going to do this in two minutes too.

Take a minute at some point to read the position statement of the Company on this issue because you will notice it has absolutely nothing whatsoever to do with what Mr. Woodsmall stood here talking about. Because perhaps they have realized that their original argument is a loser and so they're trying to shift to something else.

So how does this work? They buy systems

with rates that are inadequate and they're stuck with inadequate revenues until such time as they have a rate case like this one and raise the rates to a level that is adequate, right? So they have lost that money. Remember that one of the primary principles of rate making is you cannot have retroactive rate making, you cannot go back and recover what was lost, that's gone, that's gone, okay. So they don't get to recover that through income taxes or anything else. So they say we're trying to steal, bad Staff; bad, bad Staff, we're trying to steal the benefit of the income tax issue from them.

Let me explain that to you. Cost of service rate making means the rates will make the Company whole for the cost of service, for what it costs them to provide the service. That includes whatever income taxes they actually pay. Not the income taxes they don't pay but the income taxes they do pay.

So how does that work with net operating losses? You understand, I know, that a business is taxed on its net income, right. To the extent that revenue exceeds expenses that's what they pay taxes on. To encourage business, the federal government, the Internal Revenue Code, gives business a benefit. The benefit is they can use that loss, if they have a loss year, right, the net operating loss, they can use that to shield income from taxes in a later year. And after the Tax Cut and Jobs Act that benefit lasts forever. Used to expire after 20 years, no, now it's forever. Those losses can be used at anytime in the future to shield positive income from taxes, okay. That's the benefit. The federal government has given that benefit. It applies when there is positive income to shield.

They want a second benefit. They want the ratepayers to pay as though there was no net operating loss shielding the positive income from taxes. In other words, put into rates what we would have paid had we not had net operating losses.

That is a violation of two important principles, as I've told you. Number 1, it's making the ratepayers pay more than the actual cost of providing the service, Number 2, it's a sneaky way to try to recover money that was lost because prior rates were inadequate. Both of those are principles that would be violated.

I urge you to stand firm on those principles. Thank you. Any questions, I'll be happy to try to answer.

JUDGE HATCHER: Are there any Commissioner questions? Yes, Chairman.

CHAIRMAN RUPP: Showing your archaeological background with the --

MR. THOMPSON: Yeah.

CHAIRMAN RUPP: -- Aristotle and Plato.

MR. PRINGLE: Greeks.

CHAIRMAN RUPP: The Greeks, that's right. So two questions. First one. When I read everything, the analogy I was coming up in my head, and I'm going to give you how my brain worked at it and I want you to -- 'cause I think it's the same thing what you were saying. Is if on my personal income, you know, I earn an income and I am at this income bracket and I would pay X amount of dollars on that. But with the home mortgage deduction and the standard deduction and everything of that nature it lowers me down to my adjusted gross income and then that's what I pay tax on. Is the way I'm understanding it is they are asking for the amount of tax that they would have been taxed on their gross income and then in addition to what they actually paid based off their net income, they're asking for that difference even though they did not pay it?

MR. THOMPSON: That's absolutely right.

CHAIRMAN RUPP: Okay. Wanted to make sure I understood that. Second thing is we heard the Company's counsel talk about how this is a deviation from how the Staff has done all of other water and sewer cases, American Water, and this is how different and how FERC does that. Can you speak to that ascertation?

MR. THOMPSON: I think my witness will be much better able to speak to that than I can. But I will tell you that because this is such a blatant violation of rate making principles I would be very surprised if the witness were to tell you that, why, yes, he was correct, FERC and other states do it the way that Mr. Woodsmall has described.

CHAIRMAN RUPP: I will ask the witness. Thank you.

MR. THOMPSON: Thank you.

JUDGE HATCHER: Commissioner Holsman.

COMMISSIONER HOLSMAN: Thank you. From the macro perspective, do you think that the signals that the Commission would potentially set here would disincentivize future purchases of distressed systems knowing that the revenue is not there to essentially cover your cost and then knowing that you can't retroactively rate make to get that back should I guess -- let me ask it this way. Should there be an inventive for companies to rescue distressed systems from a macro perspective?

MR. THOMPSON: That's a very good question and it -- there's a way for the Commission to do that. And the way to do that is not by making ratepayers pay for an expense that doesn't exist. Instead what you can do is give them a higher return on equity than you otherwise have. If you want to incentivize them for buying bad systems then give them some basis points, that's how you can do it because you have absolute discretion in where you set the return on equity.

COMMISSIONER HOLSMAN: Would you oppose then the amount of cost that's being argued over here if it were shifted into return on equity as, you know, the same amount versus it being from a mechanism standpoint not captured by deferred taxes but through return on equity, would you oppose that shifting?

MR. THOMPSON: I don't have -- I have not conferred with any of my, you know, fellow Staff members on that and I haven't talked to our ROE expert. I would have to say that I think Staff would be reluctant to say yes on that but I think I'm telling you the absolute truth that that is the best mechanism with which to do that if you decide you want to do that.

COMMISSIONER HOLSMAN: Okay. Thank you. Thank you, Judge.

JUDGE HATCHER: Thank you, Commissioner. And Commissioner Kolkmeyer.

COMMISSIONER KOLKMEYER: Thank you, Judge. Good morning, Mr. Thompson.

MR. THOMPSON: Good morning, sir.

COMMISSIONER KOLKMEYER: Has Staff ever recommended offsetting income taxes on net operating loss amounts in any other rate case?

MR. THOMPSON: I think we let the Internal Revenue Code do what it does and I believe that in rates we put whatever the actual tax burden is going to be, the actual tax liability, that's what we stick into rates. It's unusual to have a situation where you have a lot of net operating loss with a utility company. You know, utility companies have captive customers, they have a monopoly, they're selling a necessity of life. So they're not typically operating at a loss, right.

We have a company here that has a very

unusual business plan. Let's buy decrepit loser systems and we're going to make money off of it. Okay. We're happy to have them do that because we'd like to have someone responsible buy those systems and fix them up and make them work. That's a great thing. And that's why our engineering department really likes this company. But our accountants on the other hand, they make them crazy because of the way they keep, or should I say don't keep their records. So it's a difficult pickle for us. But it's also an unusual situation because, you know, Ameren and those companies they don't have net operating losses.

COMMISSIONER KOLKMEYER: Thank you.

MR. THOMPSON: Thank you, sir.

COMMISSIONER KOLKMEYER: Thank you, Judge.

JUDGE HATCHER: Thank you, Commissioner. And thank you, Mr. Thompson. The spelling of Holsman is H-O-L-S-M-A-N, spelling of Kolkmeyer is K-O-L-K-M-E-Y-E-R.

And we go to Mr. Clizer, C-L-I-Z-E-R, for the Office of the Public Counsel, commonly abbreviated to OPC. Mr. Clizer, the floor's yours.

MR. CLIZER: Give me one second, Judge. Can you tell me whether or not that's in frame? All right. Now, I know that you're probably scared up here because you're thinking I'm going to take forever. I'm not, I'm going to keep this as short as possible but you guys asked some really good questions so I want to hit some of those things.

First of all, to answer sort of and address what you said, this is very similar to how you would actually file your own tax returns, right. You have your income, that's your wages, you take off your available deductions, that gives you your taxable income. Same thing has happened with the Company. You have your revenues, you take your expense deductions, what's left over is the taxable income.

Now, for individuals it's really pretty hard for you to actually have deductions in excess of your income, not so much for companies, they can do that and when that happens you have a net operating loss. What that means is that your expenses, your deductions have exceeded your income. Now, there are two things that happen when you have NOL, and you keep them separate.

First, in the year that you have the NOL your taxable income is zero because your expenses have exceeded your income. So you have no taxes in that year. That's benefit one to the Company. The Company does not pay tax in the year that they generate the net operating loss. But they get a second benefit. The net operating loss gets carried forward into the future and it gets used to offset your income in future years.

What has happened in this case is Staff has simply recognized the fact that the Company has net operating loss carryforwards and that those carryforwards is going to reduce what the Company is actually going to remit to the IRS. And if you don't take those into account the Company will collect more money from customers than it's going to remit.

What's going to happen to the excess? That's an important question, I'm going to come back to that. But after anything else that's just going to be pure profit for the Company, they're going to stick it in their pocket and they're going to walk away.

Now, I echo what Mr. Thomas (sic) said regarding what Mr. Woodsmall's opening about is not at all consistent with what their actual witnesses have argued and I'm a bit confused by that. I'm going to address something -- what their actual witnesses have argued. Because what their witnesses are trying to convince you is that an NOL generates a tax liability. There is several points where their witness Mr. Seltzer states it generates a tax liability. And what they're trying to do is they're trying to get you to think that this is like accelerated depreciation. I don't want to go too much into detail there. But at a minimum, what accelerated depreciation does is it creates a tax liability on a company's books which means they're going to have increased taxes later on.

So the IRS has created what's called the normalization rules and what the normalization rules say is we're going to force the company -- I'm going to have to actually explain a little bit about accelerated depreciation, I apologize. I just want to make sure this is really clear. Let's keep it simple.

A company has something called depreciation expense. For depreciation expense you have a book version and a tax version. For the book version in Missouri we use straight line depreciation so we depreciate by the exact same amount every single year. You have an asset that lasts ten years you depreciate it ten percent each year, at the end of the ten years it's done. For tax purposes you can take accelerated depreciation. What that means is you get to take more depreciation in the front end. Let's say you take 20 percent depreciation. You do 20 percent for year one, two, three, four, five but then you're fully depreciated. So for years six, seven, eight, nine, ten you lack the depreciation expense for tax purposes and your taxes are actually higher than they would normally be. Does that make sense?

So if you are a regulator and you were saying how do I set income taxes if a company's doing accelerated depreciation? You might say I'm going to set the income taxes at exactly what the company is actually going to pay. But the company says, hold up, there's a problem with that. If you don't -- if you set us -- give us exactly what we're going to pay we're going to be able to pay our taxes for the first five years but then as soon as our depreciations run out we're not going to have taxes to pay what we actually owe.

So instead what the IRS has said is for accelerated depreciation you have to give the company the amount of tax that they would have with straight line depreciation. Now that results in the company collecting more taxes than what it remits in the first five years of my hypothetical but it takes that money and it uses it to pay the extra taxes it ends up paying on the back five years. In other words, it defers those taxes through time. And we call that deferred income tax liability. And the company books those into its accounts where they accumulate and we call it accumulated deferred income tax liability.

Now, the logic here, which is what I want you to focus on. The logic is you are giving the company money up front to pay for its future tax liability, the taxes that are going to become due once the company has exhausted taxable depreciation. That is the logic of why we do that. And the IRS has told us we have to do that.

Why am I talking about this? This case has no accelerated depreciation, this case doesn't concern the normalization rules, none of that's at issue. But the Company is trying to trick you into thinking that an NOL is a tax liability and therefore you have to give them money up front to pay for some future tax. But that's not the case. An NOL is actually a tax asset. It generates a future deduction. So you don't have to give the Company a big pile of money up front to pay for that future deduction. Anybody understand? If you can figure out, if you can see how it's a tax asset and not a tax liability it no longer makes sense to give them this big pile of money up front because they're not going to have the future tax burden they need to pay for that.

On that note, ADIT, accelerated depreciation -- accumulated deferred income tax, this Commission includes that in rate base as an offset to rate base because what it functionally represents is a loan from the customers to the Company, a temporary loan that they are going to use to pay their taxes in the future.

In this case what the Company wants is they want to have you force the customers to pay all that money up front but then never do anything with it, they want to make it a permanent tax benefit to the Company. If you are going to do a normalization, if you are going to force the Company -- sorry, force customers to pay more than they're actually going to remit what you need to do is you need to order the Company to book those deferred taxes that you've created into an account that will offset rate base.

And the reason I bring all this up is because you asked has this happened before. In all the other cases that have come before this Commission what's happened is they've created -- the issue has always been the company is in a net operating loss position because of accelerated depreciation. This is the first time that we are aware of where a company who doesn't use accelerated depreciation has created a net operating loss, that's where things are slightly different. But the underlying logic has been consistent with past cases and I believe Ms. Bolin can speak on that. I also believe that you also should ask Mr. Riley.

So to summarize, this is a tax asset. The Company will have a future deduction, the Company received a benefit in the year that it was created because they didn't have to pay income taxes. The Company will receive a future benefit because they are not going to have to pay income taxes in the future, or at least they will pay a lesser amount. The Company is asking for a third benefit which is for you to give them the income tax expense that they otherwise wouldn't have had to pay. And then they're going to get a fourth benefit in the form of they're not going to have pay income taxes on that because they're going to use the NOL to reduce the tax that will be owed on the income tax expense you're going to give them that they're not going to remit which is going to give them profit.

There's no reason to do this. The IRS doesn't require this, the Commission has never required this, and as far as compensating the utility, this utility is being fully compensated for -- and I just want to throw this out there -- for the systems that have come in in the past Mr. Murray's evaluation has shown that if you use e-stas EMS run those systems have been getting an ROE of up to 30 percent. This company has been heavily compensated. They've hit a not (sic) operating loss for the systems they've acquired but for the systems they've had come in they've been making 30 percent returns. You don't need to give them more money.

Are there any questions?

JUDGE HATCHER: Chairman Rupp.

CHAIRMAN RUPP: Thank you. That was helpful. They are choosing straight line depreciation so all of their tax liability -- all of the deferred tax -- they are going to be able to reduce their operating income with this deferred tax through the straight line ten percent every year?

MR. CLIZER: You reduce your income tax by your available deductions.

CHAIRMAN RUPP: Right.

MR. CLIZER: Depreciation expense is an available deduction whether you use straight line or accelerated. The Company is choosing to use straight line depreciation for tax purposes as well as book purposes which is fairly unique. I'm not sure that there's any other utility -- actually I can't say, I'm not sure about all small water utilities. But it's fairly unique in my experience. The Company is already -- so the Company is not generating an accelerated depreciation tax liability.

CHAIRMAN RUPP: Right. They're straight line?

MR. CLIZER: Yeah. They're straight line depreciation.

CHAIRMAN RUPP: So they will receive the benefit of the net operating loss spread out over the ten years of the depreciation -- of the straight line depreciation?

MR. CLIZER: They will receive the benefit of the net operating loss carryforward.

CHAIRMAN RUPP: Carryforward.

MR. CLIZER: Again, we've got to be careful here.

CHAIRMAN RUPP: I can't say -- yeah, that's what I mean.

MR. CLIZER: The second they come in to pay income taxes and they have any taxable income they will be able to reduce that taxable income in an amount up to 80 percent. There's a limit that was put on it by the Tax Cuts and Job Acts. But the second they have taxable income they can use their net operating losses to reduce it. If not over the ten year period that they take the depreciation, those are separate concepts. The net operating loss carryforward is going to sit on their books until it is used to reduce their taxable income.

CHAIRMAN RUPP: So the net operating loss is reducing the income of the Company in future years which is lowering whatever that years's tax liability for that year?

MR. CLIZER: Correct. And when we say reduce the income of course we mean the taxable income, they're not actually losing -- they're not having less money, it's for tax purposes it's reducing income.

CHAIRMAN RUPP: Yes. So the less tax that they would have to pay. So the net operating loss is reducing the tax liability of the Company in the future up until the point of which they have exhausted that amount?

MR. CLIZER: Correct.

CHAIRMAN RUPP: And they are -- can they -- assuming that they're not expending the amount of money on the higher tax level amount in this year because they're deferring it to a future year but they are receiving money from ratepayers to pay that, are they allowed to earn their rate of return on that amount of money from the ratepayers until they exhaust the life?

MR. CLIZER: So let's break it down. If the Commission were to say normalize the taxes, meaning effectively put into rates the amount of taxes that we expect to be paid without considering the NOL they're going to have more income tax expense built into their rates than they're actually going to remit. Now, absent anything else, no, what's going to happen is that's just going to be straight profit.

Now, if you choose to order them to defer that excess, which is the recommendation of both Staff and OPC, you can have them defer that into a tax deferred account where you can then have that reduce rate base, which is effectively getting to the same point that you're saying. I mean, because rate bases then get -- you multiply that by the weighted average cost of capital. I mean, do you --

CHAIRMAN RUPP: Yeah. I'm following, I'm just...

MR. CLIZER: And that -- that is exactly consistent with how we've always treated ADIT, or accumulated deferred income tax. See, the problem here is two fold. First, they want to defer an asset, which makes very little sense because why not flow that through immediately; and then second, they don't want the taxes to actually be booked anywhere. At least one of those should be wrong. Both of them -- well, in my opinion you shouldn't allow deferral of an asset because they can -- customers -- sorry, customers can receive the benefit of that immediately. But if, if you're going to book the deferral of an asset you should require them to book that in their accounts as a deferred taxable offset rate base.

And again, both Ms. Bolin and Mr. Riley have independently recommended that in surrebuttal.

CHAIRMAN RUPP: Thank you. Thank you, Judge.

JUDGE HATCHER: Commissioner Holsman.

COMMISSIONER HOLSMAN: Thank you. We talked a little earlier about how this is done in other rate cases with other companies. Is net operating loss not a factor because most of those companies do not have net operating loss and so it doesn't come in or is it a policy issue that you don't do it?

MR. CLIZER: The companies that come in with net operating losses outside of Confluence come in because the accelerated depreciation is driving them below their taxable income. But remember, accelerated depreciation allows you to forefront your expense. So the company isn't actually -- I'm just going to use as an example Missouri American Water, they were in this situation.

The company isn't -- it's not like the company is having less income than they have expenses it's just that for tax purposes the accelerated depreciation is driving you below your -- below your taxable income. And because it's the accelerated depreciation you start putting things in ADIT. And ADIT is what we call a protected tax timing difference. That's where the IRS literally says to you you have to normalize it. This is explained in Ms. Bolin's testimony.

This is not accelerated depreciation, there is no ADIT, there is no normalization rule. So what you do in other situations is regulate it by the

IRS normalization rules that say you have to normalize accelerated depreciation, create a tax deferred liability.

I feel like -- I'm not sure that completely answered your question so please feel free to re-answer -- re-ask it.

COMMISSIONER HOLSMAN: I'm just talking about historically with other rate cases. Mr. Smallwood (sic) said that we don't -- that net operating losses are not a part of the tax discussion in previous rate cases. And my question to you is is that true and is that because most companies who come in for a large rate case don't have any net operating losses or is it a matter of policy that it wasn't included in that as a choice?

MR. CLIZER: You know, I would absolutely love to answer that question. I think I probably could but I'm a little bit treading on thin ice here. So I'm going to say that the -- probably the best answer to either Ms. Bolin or Mr. Riley. I believe that it has always been Staff's policy to attempt to flow-through non-protected, which would include NOL in most cases, deductions. But from what I understand of what Ms. Bolin has testified it's been a Commission on a case-by-case basis whether or not non-protected tax deferrals, which would include NOLs in this case, are normalized or not.

COMMISSIONER HOLSMAN: In this case is the NOL a confidential number? Would we have to go en camera to talk about --

MR. CLIZER: I believe that it is listed as confidential in Ms. Bolin's testimony and so I am going to say yes unless somebody tells me that the amount of existing NOLs is not.

MR. WOODSMALL: You can make it public. It's nine million dollars.

COMMISSIONER HOLSMAN: Okay.

JUDGE HATCHER: For the record, and those listening on WebEx, Counsel Woodsmall indicated it was nine million dollars. Thank you.

COMMISSIONER HOLSMAN: And so that nine million dollars of net operating loss, in laymen's understanding, would be the amount of expenses that exceeded revenue over the period of time that they operated before they have closed that period to come in for this rate case?

MR. CLIZER: That net operating loss represents the accumulation of the expenses over income for each taxable year that they had a net operating loss. So the general answer to your question I think is probably somewhere in a yes but I would be hesitant to absolutely say that with conviction because I would need to kind of figure out whether or not they have net operating loss in each year for example or if they had net operating losses carried forward from other years, I'm not entirely sure what the situation is there.

COMMISSIONER HOLSMAN: And you said they're going to use the book line, right, they're not going to use accelerated depreciation they're going to take in ten percent or --

MR. CLIZER: They are currently using straight line depreciation.

COMMISSIONER HOLSMAN: Straight line depreciation. And do we know how long that nine million will stretch out over time at their current revenues?

MR. CLIZER: So -- this comes back to you. I want to make sure this is very clear. The straight line depreciation versus accelerated depreciation does not in anyway affect the timetable for when NOLs are spent down. The reason I was bringing that up was to explain to you what accelerated depreciation is, why an accelerated depreciation tax deferred liability is created, and how that's different from

NOL.

How long that nine million lasts, right, is purely dependent on the future tax income they can deduct, currently under the existing law, up to 80 percent of positive tax income using any NOL carryforward. Which under the Tax Cuts and Jobs Act now extends indefinitely. So what's going to happen is that nine million dollars is going to sit there and for every single future year if they have taxable income they're going to deduct up to 80 percent using some portion of that. And whatever portion is obviously going to then reduce the nine million.

COMMISSIONER HOLSMAN: So if they had 12 million in the following year they could blow all nine million of it on a reduction?

MR. CLIZER: If they had 12 million dollars --

COMMISSIONER HOLSMAN: Eighty percent.

MR. CLIZER: If they had 12 million dollars in taxable income.

COMMISSIONER HOLSMAN: Right.

MR. CLIZER: They could use up to 80 -- they could deduct up to 80 percent. Again, unless I am corrected by a witness.

COMMISSIONER HOLSMAN: Okay. And so the

difference here is their position is we should be able to put the amount of money that we would have paid on that nine million into rates. And you're saying that because you're going to spread this out over the course of however long you need it for then it should not be recouped in the rate side, right, is that -- I'm trying to find the crux of the difference between your two positions on why you can't get together?

MR. CLIZER: The crux of the position is that Staff and OPC says that that deduction should be recognized when setting the Company's rates and the Company says it should not be recognized, we should pretend like it doesn't exist and have tax -- ratepayers pay the amount of taxes if it didn't exist. And we are saying we should have ratepayers pay taxes as -- we should set rates to collect taxes based on what is actually going to be paid in taxes.

COMMISSIONER HOLSMAN: And we have the ability, through our order, to let them collect that as if they were going to pay it but then put it into a deferred account so that as it comes in it could then be used to reduce rates once it's been exhausted? Help me further understand that mechanism 'cause it sounds like the Commission may have some tools to maybe get to a compromise here.

MR. CLIZER: I want to start off by saying that this is the recommendation of both Ms. Bolin and Mr. Riley. So to the extent that I screw anything up here direct that question to them to make sure it gets right. I'm going to tell you what I understand it to be and I'm hoping I'm correct.

If the Commission orders these rates -- sorry, these taxes to be normalized then the Commission should order the difference between what is included in income tax expense and what is actually remitted or paid to the IRS. That difference should be booked into a deferred tax account which can then offset rate base in future cases until it is used at some long point in the future to pay down actual taxes.

COMMISSIONER HOLSMAN: But then it would show up in the existing rate increase as ordered when this is completed? They would start collecting that from the ratepayers? Because that deferred account would have to be filled, right?

MR. CLIZER: No. I don't -- I don't think so. What we're saying is that what would be booked to that account would be the difference between income tax expense and what's remitted to the IRS moving forward. The existence of the net operating losses would just be there, they would only generate into that account as they actually pay taxes and didn't remit all of their money to the IRS.

So it would start off at zero and then each year, if they paid income taxes -- sorry, when they paid income taxes if there was anything different between what they had in rates and what they actually paid they would put it into that account and it would have no effect on ratepayers until the company came in for the next rate case and there was actually money in there. So it would have zero impact right now.

COMMISSIONER HOLSMAN: I guess.

MR. CLIZER: I'm genuinely trying to do my best.

COMMISSIONER HOLSMAN: I'm trying -- I'm doing my best to try to understand. Truly I am. All right. Thank you. I mean, I...

MR. CLIZER: Again, this is the recommendation in surrebuttal of both Ms. Bolin and Mr. Riley. Have them explain it to you if I'm not making sense.

COMMISSIONER HOLSMAN: So back to the last question I asked. If, from a macro perspective --

and I heard from Staff's position. You know, do you think there should be incentives for rescuing of these distressed systems?

MR. CLIZER: The Company earns a profit off of the investments it makes to save these systems. I understand that it is not --

COMMISSIONER HOLSMAN: Well, apparently not with a net operating loss of nine million.

MR. CLIZER: Because it hasn't come in for a rate case. Once they come in for a rate case they have been earning massive profits on their systems. And they're going to earn a profit on these systems now that they've come in for a rate case. The fact that regulatory lag has occurred, as always happens. You can't base your entire decision on the fact that we have regulatory lag, you need to acknowledge the Company makes money by making the investments necessary to rehabilitate these systems. And if you look at their entire business model do you really think they're about to stop? They've been expanding like crazy, they are making money.

They were bought out by a large firm because it was recognized how profitable this entire enterprise could be. You are going to increase their rates by some amount presumably in order to make sure that they are being incentivized to continue doing this just on what's in rate base. You don't need to give them additional money. You don't need to incentivize a company to do its job.

COMMISSIONER HOLSMAN: Thank you, Judge.

JUDGE HATCHER: Before -- excuse me. Before I forget, I do have a quick announcement. I'd like the record to reflect the attendance of Commissioner Maida Coleman, she has joined via WebEx. All five Commissioners are in attendance. Commissioner Hahn.

MR. CLIZER: Oh, I have more questions. I apologize. I was about to step away.

COMMISSIONER HAHN: Thank you, Mr. Clizer. Given that this is a very unique company that buys distressed systems and repairs them, do you anticipate that the future -- in the future they would continue to experience significant net operating losses?

MR. CLIZER: That's honestly hard to say because it would be dependent on the rate of expansion and the rate of rate cases. If they come in regularly for rate cases and they get -- no, I mean, it's not guaranteed that they're going to experience net operating losses. Now, if they continue to expand extremely rapidly and they're not coming in for rate cases regularly then yes. I mean, that's simple, right. If you don't take the time to come in and deal with the regulatory lag you're going to suffer for it. But it's not a guarantee.

COMMISSIONER HAHN: Thank you.

CHAIRMAN RUPP: Judge, I have one more.

JUDGE HATCHER: Chairman.

CHAIRMAN RUPP: Thank you. I was going to save this for Kim just so she would have some questions but I figured since Commissioner Hahn just kind of jumped on I'm going to follow up.

What is the incentive to not just this company, any utility company? Is there a better incentive for them to take all of their net operating loss and take it off all of their tax liability if they can outside of a test year or is there a better incentive for them to have a bigger net operating loss and collect -- during a test year?

MR. CLIZER: That's probably something you should probably ask Ms. Bolin.

CHAIRMAN RUPP: I will ask.

MR. CLIZER: I would ask Mr. Riley too.

CHAIRMAN RUPP: Okay.

MR. CLIZER: That's a -- I would need to think through that one exactly.

CHAIRMAN RUPP: Thank you.

MR. CLIZER: Sorry about that.

CHAIRMAN RUPP: No. No. Appreciate it.

JUDGE HATCHER: Seeing no more Commissioner questions. Thank you, Mr. Clizer.

Let's start with our first witness. Confluence, go ahead and call your first witness.

MR. WOODSMALL: Thank you. And some preliminary matters. First thing, there were a lot of questions that went naturally far afield from taxes. There were questions about incentives and whether someone --

JUDGE HATCHER: Mr. Woodsmall, you've had your opening statement. Can you call your witness?

MR. WOODSMALL: Yes. But I'd like to call Mr. Cox so you guys could ask your questions about incentives and whether companies will continue to invest.

JUDGE HATCHER: No, sir. I would like Mr. Seltzer or Mr. Thies, please.

MR. WOODSMALL: Okay. If the Commissioner doesn't want to hear from the guy that knows then we will --

JUDGE HATCHER: No. The Commissioner

doesn't want it hear it out of order. Can we please proceed with the issue at hand.

MR. WOODSMALL: I am proceeding. So given that, we would call Mr. Thies.

JUDGE HATCHER: Mr. Thies, go ahead and have a seat. You've already been sworn in. I just remind you that you are still under oath.

Go ahead. Your witness.

* * * * *

BRENT THIES,

The witness, having been recalled upon his oath, testified as follows:

* * * * *

EXAMINATION CONDUCTED

BY: MR. WOODSMALL

Q. Would you state your name for the record?

A. Brent Thies.

Q. And you're the previous Brent Thies that testified yesterday; is that correct?

A. Yes, sir.

MR. WOODSMALL: And at that time, your Honor, you admitted the direct, rebuttal, and surrebuttal testimony, Exhibit 17, 18, and 19. I'd ask for indulgence here. In -- as Staff and Public

Counsel acknowledged in their surrebuttal testimony, they raise a new position. It wasn't in their direct. They raised the idea that you could put this into a deferred account. Because it was surrebuttal we never got to respond so I'd like to ask him one question.

MR. CLIZER: Yeah, I object absolutely. It was in surrebuttal because it was response -- I'm sorry, I didn't wait for you to ask if there were objections.

JUDGE HATCHER: You're fine. Go ahead.

MR. CLIZER: I was hot on the gun. It was proper surrebuttal. It was responding directly to the recommendations made by Brad Seltzer. We don't have an opportunity to respond to what he's going to say at this point. You can't get into this back and forth situation here. We have written testimony for a reason.

MR. WOODSMALL: Your Honor.

JUDGE HATCHER: Mr. Clizer, what's the reason then for this live testimony?

MR. CLIZER: To cross-examine. Which is why we always just do direct of, introduce it, and tender.

MR. WOODSMALL: Your Honor, just to

complete the thought very quickly. This was an issue introduced in surrebuttal, it clearly got Commissioner Holsman's attention. I'd like one question just to acknowledge the fact that it was done in surrebuttal.

MR. CLIZER: Your Honor, if you have that issue in front of you, Bench can ask questions. Mr. Woodsmall doesn't need to open this up. If the Bench wants to know I'm sure the Bench will ask.

MR. WOODSMALL: And if -- that's what I'm asking. Will the Bench allow me to do that for them?

MR. CLIZER: Does the Bench really need Mr. Woodsmall to be their lawyer on this?

MR. WOODSMALL: It's a matter of getting to the truth.

THE COURT: You guys have a lot of loaded questions today. Okay. The Commission is interested in these answers. Mr. Thies's testimony has already been introduced. While traditionally the Commission does have the counsel for the witness simply tender them, in this situation, anticipating the interest in this matter and wanting to make sure that, A, it gets covered, and B, that the other parties have an opportunity to respond, because they will be following Mr. Thies and also available to cross-examine Mr. Thies on Mr. Woodsmall's question. Mr. Clizer.

MR. CLIZER: On that note then -- and I'm just going to ask it now and I'll bring it up later. Are the witnesses by OPC and Staff going to be permitted to be asking the same question to their witness as part of their direct?

MR. WOODSMALL: If you want to ask the same exact question.

MR. CLIZER: Response to.

JUDGE HATCHER: Mr. Woodsmall, what's your question?

MR. WOODSMALL: First off I'm going to ask --

JUDGE HATCHER: No, to me. What's your question? No, no. What is your question going to be?

MR. WOODSMALL: Okay. I was going to first ask him their surrebuttal, establish that foundation. What is your response to their proposal as contained in that surrebuttal.

MR. CLIZER: We'd like the opportunity to respond to his response.

JUDGE HATCHER: I think that's all fair game. Go ahead.

BY: MR. WOODSMALL

Q. Okay. Mr. Thies, did you review the surrebuttal testimony of Ms. Bolin and Mr. Riley on the issue of income taxes?

A. Yes.

Q. And did you see there a proposal that any taxes collected in rates here be deferred into a liability?

A. Yes.

Q. And what is your response to that?

A. I think that makes some sense in terms of what we're doing here, that effectively gives the concept we're talking about here of net operating losses a similar treatment to accumulated deferred income tax as Mr. Clizer described in his opening.

I think the issue that wasn't dealt with that maybe is in the Company's view is we have this nine million dollar number and there's no asset treatment for that in rate base so we would reduce rate base on one side and not get any credit in rate base for the history of losses there. So it feels a little unbalanced but as stated there with a deferred tax liability that part makes some sense to the Company.

Q. Thank you.

MR. WOODSMALL: I tender the witness for cross.

JUDGE HATCHER: Thank you, sir. I believe we go to Staff.

MR. THOMPSON: No questions at this time, Judge. Thank you.

JUDGE HATCHER: Thank you. Mr. Clizer.

MR. CLIZER: No questions.

JUDGE HATCHER: Thank you. Are there any Commissioner questions? Commissioner Holsman.

COMMISSIONER HOLSMAN: Do you got one, Mr. Chairman?

CHAIRMAN RUPP: I do, but...

COMMISSIONER HOLSMAN: Well, you're the Chairman.

CHAIRMAN RUPP: You're very kind.

COMMISSIONER HOLSMAN: Defer to the Chairman.

JUDGE HATCHER: Chairman Rupp, you have a question.

EXAMINATION CONDUCTED

BY: CHAIRMAN RUPP

Q. Based off of your answer to your attorney, --

A. Uh-huh.

Q. -- are you in agreement with Staff and OPC's position for this tax liability treatment?

A. I think it's half of the solution. I think their solution to allow the taxes in rate making, which we believe is consistent with the rate making that we've done in the State of Missouri in our other five rate cases and that we're doing in other parts of the country, other states, it's consistent with all of that to allow taxes based on the return that's granted in this rate case. And so to book that into a deferred tax liability because there is this another issue of NOLs makes some sense.

I think the part that isn't clear to the Company is what -- is there fairness. We haven't asked for some kind of treatment in rate base for this nine million dollar number. And so conceptually we would be reducing our rate base later for this liability and get no credit in it now or in the future for whatever is there in terms of the net operating losses. So it feels like a one-sided solution but that one side makes sense, if I can say it that way.

CHAIRMAN RUPP: Okay. Thank you. Appreciate it.

JUDGE HATCHER: Mr. Holsman.

COMMISSIONER HOLSMAN: Thank you.

EXAMINATION CONDUCTED

BY: COMMISSIONER HOLSMAN

Q. So what would be -- first off, part of the solution that you agree with is -- would that then moot the Staff and OPC's point that the taxes would then be pure profit for the Company if they're being booked for later deployment?

A. Yes. I mean, from a cash perspective, the cash would be here now but a liability would be booked that would reduce rate base in the future. So yes.

Q. So what would your recommendation be then for the other part of the equation? You say this is one-sided, how would you then reflect the nine million dollar net operating loss in some sort of asset or some way to recognize that in the process?

A. Sure. So we have -- excuse me -- a mechanism in some other states to book the net operating losses on acquired systems as an asset for consideration in future rate cases. And so that's all part of the state's determined incentivization for us to continue to buy these distresses systems.

So something like that that could recognize a net operating loss as an asset. Then it effectively removes it from the consideration -- removes that loss from the consideration of taxes in the current year and so that would be the balancing piece. So think we buy a system and maybe it loses $10,000 per year. If we could book that $10,000 as an asset to be considered in the future in rate base then the liability makes some sense as the balance. And as I said, we have that in a couple of other states currently.

Q. And so your testimony is that in other states they have taken that net operating loss and booked it as an asset in the overall case?

A. Correct.

Q. Is that something that you're aware that the State of Missouri has a practice of doing or --

A. Not to my knowledge.

Q. So this would be a departure from the way that normal rate cases are proceeded?

A. It would be. And I would also offer that, you know, this whole, you know, net operating loss issue seems to be a departure as to what to do with it. But that part would be new and novel in

Missouri, yes.

COMMISSIONER HOLSMAN: All right. Thank you, Judge.

JUDGE HATCHER: Thank you, Commissioner. Are there any other Commissioner questions? The Bench has no questions. That takes us to re-cross examination. Mr. Thompson.

MR. THOMPSON: No questions, Judge. Thank you.

JUDGE HATCHER: Mr. Clizer.

MR. CLIZER: Yes.

EXAMINATION CONDUCTED

BY: MR. CLIZER

Q. In response to one of the questions from Mr. Holsman, you said that the deferred tax liability would reduce rate base in the future?

A. Uh-huh.

Q. How would that happen?

A. If we -- excuse me. If we were -- so the way I understand it is -- and let's say we were collecting ten dollars of income tax in the rates currently. The amount that we don't actually pay in cash would be booked into a liability that in the future could reduce rate base.

Q. When would it start reducing rate

base?

A. Next rate case.

Q. So you agree that it should reduce rate base in the next rate case?

A. I'm suggesting that as a part of a balanced solution it makes some sense to have a mechanism like that.

Q. Okay. But, to make sure I understand this correctly, you are proposing to create a deferred tax liability that would offset rate base in the future?

A. I'm responding to a proposal someone else made. But what you're saying I think is my suggesting that it would be for a future rate case, yes.

Q. Okay. So you would agree that it makes sense if you were going to book the excess income tax expense that's not remitted to the IRS into a deferred tax liability that that offset rate base in the future case?

A. That makes sense from the Company's perspective only when a company buys some sort of asset treatment. But that part, yes.

Q. All right. So with regard to recognizing the NOL. Let me make sure I understand this correctly. The net operating losses that we're talking about here. And for the record, NOL, net operating loss, I'm going to use them interchangeably. Those were generated, per the Company's statement, because the Company purchased systems with existing rates, correct?

A. Correct.

Q. And those rates -- sorry. The Company then invested in those systems, correct?

A. Correct.

Q. And your argument is that the rates that were currently in effect didn't cover the investments, right?

A. It didn't cover the full cost of operations which includes more than investments, it's operational costs as well.

Q. So what your goal is is to allow the Company some kind of asset to recognize the fact that those rates weren't covering what you needed to; is that right?

A. Yes.

Q. Right. So it's to go back and say we need to get the money that we should have been charging in order to cover these investments, correct?

A. Going back would obviously be in the Company's interest. I think a proposal like this that starts today and it is booked concurrently with the deferred tax liability makes sense as well.

Q. But to make sure I understand it correctly, I just want to understand the argument correctly. What you're proposing would be to have an asset to allow you to go back and recover what you should have recovered in order to make these improvements?

A. What do you mean go back?

Q. Well, it would allow you to recover what you needed to have recovered, what the rates should have been in order to make the money necessary to cover the improvements?

A. I still don't know what you mean by go back in terms of an actual timeline. Are you talking about going back to 2015, are we talking about going back between rate cases, what's the phrase?

Q. Okay. Let's simplify and make sure we're trying to be clear here. The NOL was created because the rates that were in effect weren't sufficient to cover the improvements made, correct?

A. To cover the cost of service.

Q. Cost of service. I'm sorry, let me try to make sure that's clear. You're saying that this asset would allow the Company to effectively have the income that would have been the case if those rates had been set at what they needed to to cover the cost of service?
A. It's a little bit nuanced. I'm not suggesting -- so the mechanism could work and does work in other states such that you establish a formula, you know, revenues minus operating expenses and whatever the negative number is there goes into a regulatory asset. So it's not a recovery of depreciation and it's not a recovery of any lost return on equity or interest kind of expense, it's simply the operational cost.
Q. I understand that. But as far as the operational costs go it would effectively allow the Company to recover what they would have recovered if the rates had been changed to allow them to meet those operational costs; is that accurate?
A. Yes. If you -- the same thing could be accomplished by changing rates during an acquisition case, yes.
Q. Okay. So the goal of your recommendation is to allow the Company to operate as

if they had changed the rates during an acquisition case, is that what you just said? It would put you in the same position?

A. Mathematically that's the equivalent, yes.

Q. Thank you.

MR. CLIZER: I have no further questions.

JUDGE HATCHER: Thank you. And re-direct.

MR. WOODSMALL: Thank you, your Honor.

EXAMINATION CONDUCTED

BY: MR. WOODSMALL

Q. Let's talk about some of these other states. CSWR has affiliates in 13 states; is that correct? Twelve?

A. Twelve, yes.

Q. Okay. Twelve. And in all those states you use the same business model; is that correct?

A. That's correct.

Q. In that you go in, you acquire distressed systems and you adopt the rates; --

A. That's correct.

Q. -- is that correct?

A. Uh-huh.

Q. And similar to here, the rates do not

cover operating costs; is that correct?
A. That's correct.
Q. And that's because the rates are dated, sometimes decades, as well as the fact as operating costs are going up?
A. Correct.
Q. Okay. So in all these states, you incur a net operating loss?
A. Yes.
Q. Okay. Let's start first off. In all these states that you've incurred a net operating loss and you had a rate case, have any of those states sought to recognize that net operating loss that was incurred by the investors for the benefit of the customers?
MR. CLIZER: I'm going to object as to relevance. This case concerns Missouri. We do not concern ourselves with the laws of other states. There may be statutory requirements, rule requirements, et cetera, at play in other states and is misleading the Commission to suggest what other states do is what Missouri must do.
MR. WOODSMALL: Your Honor, Mr. -- I'm sorry. Commissioner Holsman was asking about other states and incentives and how things are done. So I

think -- I think clarifying that as to how other states operate is directly responsive to his question.
JUDGE HATCHER: I agree. The objection's overruled.
BY: MR. WOODSMALL
Q. In all these other states, first off, has any Commission attempted to use those net operating losses that the investors incurred for the benefit of customers?
MR. CLIZER: I object to the form of the question. That is not consistent with what the OPC or Staff is recommending.
THE WITNESS: Can you re -- can you ask again?
BY: MR. WOODSMALL
Q. Okay. The investors incur net operating losses; is that correct?
A. Yes.
Q. And those net operating losses, the customers benefit from the investors incurring those net operating losses?
A. That's correct.
Q. Okay. And so while they benefit from the net operating losses up front, are you aware of

any state commissions that then try to give those customers the benefit of the net operating losses again through a reduction in rate making?

A. No.

Q. Okay. Let's move to the second part, what the other states do. Let's talk Mississippi. You're familiar with the recent Mississippi rate case?

A. Yes.

Q. Okay. And there, can you tell me -- well, explain first what the mechanism is? You said a regulatory asset. But can you tell us more about what that is?

A. Sure. It's a System Acquisition Regulatory Asset is the -- SARA is the acronym. And it effectively does what I was explaining to Mr. Clizer. For newly acquired systems it tracks revenue less expenses and whatever that negative number is is moved to the balance sheet for consideration in future rate proceedings.

Q. And because that's put on the balance sheet it's included in rate base in those other states?

A. Correct.

Q. And the company is allowed to earn a

return?

A. Correct.

Q. Okay. Despite that, those regulatory assets in both -- first off, that mechanism is done in Mississippi and Louisiana; is that correct?

A. Correct.

Q. Okay. And that mechanism, taking those losses and hanging them on the balance sheet as a regulatory asset, is from X date going forward; is that correct?

A. Correct.

Q. Okay. The past net operating losses are not included in that regulatory asset, are they?

A. Correct. Only from the date of Commission approval of booking that asset and moving forward. Nothing historically.

Q. Okay. So while you've gone through rate cases and that regulatory asset would effect losses going forward, how have those Commissions handled the past net operating losses?

A. No consideration given to them either to reduce anything in current rate making or any kind of asset from the historical standpoint.

Q. Okay. Would you believe -- we were talking incentives again. Would you believe that relative --

MR. CLIZER: Your Honor, I don't believe that incentives were brought up as part of the cross-examination. I thought it was brought up during the openings.

MR. WOODSMALL: There were questions about other states and relative to other states.

MR. CLIZER: Nobody mentioned incentives.

COMMISSIONER HOLSMAN: Do we have a chance to ask questions once this is concluded?

JUDGE HATCHER: I can make it happen.

COMMISSIONER HOLSMAN: Okay.

JUDGE HATCHER: I'm of the belief that we're going to have --

MR. CLIZER: Additional questions from the Bench.

JUDGE HATCHER: We'll go back through re-cross and re-direct. When you say incentives, are you using that as a term of art reference to a statutory or regulatory scheme or are you using that as language?

MR. WOODSMALL: Let me clarify that with a question and then you can take that up, if that works for you. It's not a question to you but let me rephrase the question.

BY: MR. WOODSMALL
Q. Given that Mississippi and Louisiana have this regulatory asset treatment would acquisitions in those states be viewed more favorably than acquisitions in Missouri if Missouri doesn't have it?
A. Absolutely.
MR. WOODSMALL: I have no further questions. Thank you.
JUDGE HATCHER: Thank you. That was the end of re-direct. However, as announced, we do have further Commissioner questions. Commissioner Holsman.
COMMISSIONER HOLSMAN: Thank you.
EXAMINATION CONDUCTED
BY: COMMISSIONER HOLSMAN
Q. So my first question is the SARA that you mentioned. Was that a -- was that a product of a statute that had to be passed in Mississippi and Louisiana to allow those Commissions to book that as a regulatory asset?
A. I don't think it had anything to do with existing statutes. It was part of a conversation with those Staffs about how to continue to do what we had been doing in those states.

Q. So it's your testimony that that was -- that scheme, as it were, --
A. Yeah.
Q. -- was a product of the Commissions and not a product of requiring statute to allow that to occur?
A. That's correct.
Q. Okay. And you view that as -- we use the term incentive -- but as a signal for investors to rescue distressed systems?
A. Absolutely. And certainly in our investor context it is viewed favorably.
Q. Do you think that it would create a prolonging of return for a rate case if the Company knows that they're able to take this net operating loss and book it as an asset, that it would keep them out of a rate proceeding longer than normal without an absence of being able to book that as an asset?
A. That's a good question. I don't think so. Because it is a -- you know, effectively an accounting trick, it has nothing to do with real cash. So, you know, you're able to, you know, protect your income statement and have some future consideration for those losses. But it still does nothing to sort of eliminate the cash reality that's

happening when we buy those systems.

Q. Is it your experience in these other circumstances that the taxes then are deferred and that this is a two part approach to the net operating loss and the tax collection issue? Like are they normally paired together?

A. They are not. We have not experienced a deferred liability alongside this. We've only experienced the regulatory asset.

Q. So in the other states that you're citing, they provide the regulatory asset and they provide the taxes to flow-through as if there wasn't a net operating loss?

A. They do. And it's important to note that this regulatory asset eliminates expense and so would therefore increase your taxable income. And that's just the accounting mechanics. I don't want to get incredibly technical because it is -- or it could be. But this is effectively saying, you know, I didn't have enough revenue and whatever that number is I'm going to reduce my expenses for so that my taxable income is zero there so I'm not incurring that net operating loss that can be used in the future.

COMMISSIONER HOLSMAN: Okay. That's all

the questions I have, Judge.

JUDGE HATCHER: Thank you. Are there any other Commissioner questions? The Bench has at least one.

EXAMINATION CONDUCTED

BY: JUDGE HATCHER

Q. Would you offer your response to the following statement. Confluence knew the rules of Missouri when it purchased its systems, why is it now asking for a change? I guess that was the question, sorry.

A. Sure. I don't think Confluence is asking for a change. You know, we came into the state with the understanding that there was going to be a period of net operating losses. Then in rate making, in our first Staff assisted rate cases income taxes were recognized there. And so this removal of income tax expense from the rate making equation would be the departure not what the Company has requested. Now, that's prior to today.

Q. I want to clarify that. And I'm sorry to interrupt. Was that system earning revenue or was that system earning a loss?

A. Which system?

Q. The one that you were referencing

early on. Because that seems to be the difference here.

A. Well, so everything that we have purchased initially loses money, right. And so as we have, you know, taken some of the -- gone through some of the Staff assisted rate cases there is one of those companies, Hillcrest, that prior to consolidation, which the Commission approved, it actually was earning some income. But other than that one, we -- none of our six companies that became one had ever earned income -- taxable income.

Q. Okay. I do have a follow-up question. If I understand what the situation is, similar to deferred acceleration, which is not this case, but similar to that case where with an accounting mechanism the Company is allowed a -- I believe the phrase is a no interest loan to operate. And I believe Confluence has acknowledged that's not our situation, however that is the treatment we're asking for because of these distressed systems we're purchasing.

How should the Commission distinguish Confluence's position essentially asking for, I think what Mr. Clizer had referenced Ms. Bolin as stating as a per situation solution. How are you going to distinguish that from every other water company that, as your counsel pointed out, might come in and purchase any of the 3,000 small sewer districts in Missouri, or whatever the appropriate number is, and those companies then saying, hey, we also would like our net operating loss for that system recognized in our income taxes in order to take advantage of the accounting mechanism in a similar manner of accelerated depreciation and get our interest free loan?

A. There's a significant policy question there that is clearly, you know, a bigger concern for the Commissioners, I think. For -- in our experience we have, you know, sought to have conversations with state commissioners -- state commissions in other places to try to understand how we can acquire the systems that are most distressed and do that well and where Commissions have desired us to do that there are certainly times when we've been incentivized. And so the statutory policy making piece of that makes me very nervous to sort of comment on because I can't possibly know all of the component pieces of that.

But I think as we're talking about it today, without a statute in place, it should be viewed in the light of what the Company has done and would like to continue to do in the future and how that benefits the people of Missouri and the people served by these distressed systems.

Q. I didn't hear an answer to my question though.

A. I'm trying not to answer like telling you what policy to make. And I apologize for, you know, being a little dodgy.

Q. I'm asking you to distinguish Confluence Rivers from the competitor that may be listening to this hearing and saying, a-ha, --

A. Sure.

Q. -- I am going to start my own utility operating company, I'm going to go out and purchase distressed systems for low investment money and then as long as I can float the expense for X number of years to a rate case --

A. Uh-huh.

Q. -- I will then get the rate increase to cover my expenses plus they are going to ask, hey, I bought this distressed system, I'd like my income tax treated like Confluence. Can you distinguish Confluence Rivers from that situation?

A. So I think pragmatically, especially

on the lowest quality systems, we're the only ones in the state who are doing this type of work. So can -- you know, I don't know of an analog to us, especially on the extremely small sized systems. And so I don't know that that exists.

I think the other piece of that is wouldn't it be a good thing, from a Commission perspective, if there were incentives to fix problems. And so, you know, I don't know that I can offer anything that would say we are this and we should get special treatment. I think I'm suggesting this is a potential incentive for the problem in the State of Missouri. And currently I don't know that anyone else is doing it, especially at the extremely small level -- small system size that we are.

JUDGE HATCHER: I'm just going to note it's 11:58. I have gone in a unique direction. Are there any Commissioner questions? Okay. Let's go back to re-cross. We'll start with Staff.

MR. THOMPSON: Thank you, Judge.

EXAMINATION CONDUCTED

BY: MR. THOMPSON

Q. To follow up on the line of questioning from Commissioner Holsman and also from the Judge. You would agree with me that a net operating loss is a concept that comes from the tax code?

A. Yes.

Q. And the way it's treated is a tax issue; isn't that correct?

A. Certainly there are ways -- and as we described, accumulated deferred tax that makes its way into rate making. But it does come from the tax code initially, yes.

Q. But A-D-I-T is something different than what we're talking about here today, isn't it?

A. It is.

Q. In fact, care has been taken to make it clear that this case has nothing do with A-D-I-T; isn't that correct?

A. That's correct.

Q. Okay. So a net operating loss you have agreed is a tax concept. And isn't it true that the prohibition on retroactive rate making means there cannot be anything like a net operating loss carryforward with respect to rate making?

MR. WOODSMALL: Your Honor, I would object to the extent it's asking for a legal conclusion, for him to make any type of legal conclusion that this is retroactive rate making certainly if they want to talk accounting. But whether there's a prohibition against retroactive rate making, we should probably handle that in the briefs.

JUDGE HATCHER: No. I'd like to hear the witness's answer on this. He is an expert in the utility industry, I'm sure he has some familiarity with that. He's expressed familiarity with other states on other administrative issues.

THE WITNESS: I am unfortunately not an expert on the history of retroactive rate making and the rules around that. I would suggest though that retroactive rate making in this case could be happening with past net operating losses being applied to current rates. So -- and again, I'm not an expert but the term retroactive feels as if it's cutting both ways here.

BY: MR. THOMPSON

Q. You acknowledge that when you purchase these systems that have inadequate rates that the rates can be reset as part of the acquisition case?

A. They have not been historically. I guess that's possible though from a Commission perspective.

Q. And do you have any explanation for

why the Company has not pursued seeking a reset of those rates upon acquisition?

A. I know that -- excuse me. I know that we preferred to keep the rates as they are for public relations and customer service purposes and, you know, if there were Commission policy around setting those rates in acquisitioning cases we certainly would pay attention to this. But our preference would be to allow the customers a period of time to get to know us before we raise their rates which, as we know in this case, is not popular.

Q. And in your testimony you have raised the operating losses as the justification for the income tax treatment you seek, haven't you?

A. I'm not sure I follow.

Q. Well, let me take a look at your position statement which was written by your attorney; is that correct?

A. Yes.

Q. Based upon your testimony; is that correct?

A. I don't know exactly what you're referring to.

Q. You don't know where it came from, okay. "In the process of acquiring distressed systems, Confluence Rivers adopts the current rates charged by those systems. In many cases these rates are years or even decades old. As such, those rates do not reflect the cost of service at the time of acquisition and certainly do not reflect the increased costs associated with the capital investment and professional operations provided by Confluence Rivers. Until Confluence Rivers files a rate case and rates are increased to reflect operational costs Confluence Rivers incurs a net operating lot. Effectively, this net operating loss is a quantification of the benefit that ratepayers receive from Confluence Rivers providing service at a below cost rate."

Skipping down to the next paragraph. "Contrary to other states, Staff and Public Counsel seek to use this net operating loss to reduce the rates resulting from this case epitomizing the notion of looking a gift horse in the mouth. Staff and Public Counsel believe that ratepayers should not only receive the benefit of both low cost initial rates but also receive the tax benefit resulting from those below cost rates."

Do you have any reason to disagree that that's what the position statement filed by this

Company says?
A. No.
Q. Okay. And do you hear any echoes of your testimony in that language?
A. Some. Certainly not all. Some.
Q. Okay. So you would agree with me then that your attorney at least has linked operating losses to the tax treatment the Company is seeking as the justification for that favorable rate making treatment of the tax issue; isn't that correct?
A. Can you say that again? Linked? I'm not sure what you mean there.
Q. Well, when I read the position statement it wasn't saying anything about tax law, was it?
A. No.
Q. It was instead talking about Confluence Rivers' losses because the rates are inadequate in the systems it purchases?
A. Uh-huh.
Q. That those rates do not, in fact, cover operating costs?
A. Correct.
Q. So you would agree then that the favorable tax treatment that the Company is seeking

is in fact a way of recovering money lost because rates were inadequate for past services?

A. I would not frame it that way, I don't think that's a -- I don't think that's a way we have framed it. I think the Company is seeking consistent rate making math, if you will, you know, the operating costs plus depreciation, amortization, taxes and return are what make up the rate making equation. That's what the Company's seeking. I understand the connection that can be made there but I don't think that's the way the Company views that initially.

Q. And a net operating loss reflects losses that occurred in a prior taxable year; isn't that correct?

A. That's correct.

MR. THOMPSON: No further questions, Judge. Thank you.

JUDGE HATCHER: Thank you. Mr. Clizer.

MR. CLIZER: Yes.

EXAMINATION CONDUCTED

BY: MR. CLIZER

Q. I'd like to start with a line of questioning focused on the incentive conversation you were having with Commissioner Holsman.

A. Okay.
Q. Before I wanted to kind of level set. You would agree with me that the purpose of this rate case in general is to bring Confluence's rates in line with its cost of service?
A. Correct.
Q. And by cost of service, just to make sure everybody's on the same page, we're talking about the cost required to meet its operation costs to continue serving customers, correct?
A. Correct.
Q. And in addition -- well, the issue at hand here is income tax expense, correct?
A. Correct.
Q. And the improper amount of income tax that needs to be put into rates, correct?
A. Correct.
Q. And the issue at hand is is the Company going to collect more income taxes than it actually remits to the IRS?
A. Correct.
Q. Would you agree with me that any amount of income taxes that are collected but not paid to the IRS aren't being used to pay to the IRS?
A. Sure.

Q. And -- okay. Would you agree with me that that money is therefore no longer being used to serve customers?

A. No.

Q. Fine. Moving on, 'cause I am just trying to level set. The Company is also seeking a return on equity in this case, correct?

A. Correct.

Q. Would you agree with me that return on equity is roughly analogous to profit, we can call that profit?

A. Sure.

Q. And that's what we're going to pay to our shareholders and justifies their investment?

A. Sure.

Q. Now, the incentive conversation that was had focused on the idea that other states are giving preferentially more beneficial treatment, right?

A. Correct.

Q. So am I correct to understand that the Company's concern is unless Missouri gives the same treatment we get from other states we're going to go build in other states; is that right?

A. When you say same, you know, there's

not a lot of binary switches for us. I mean, like we're -- let me say that differently. We did not come in with an ultimatum, right. But what we are saying is changing the rate making formula for us is a disincentive in the State of Missouri as compared to states that have used the standard rate making formula.

Q. But it's not an ultimatum?

A. No.

Q. So you're not saying you won't come into Missouri?

A. I mean, that is not a question for me, I'm the accountant, that be would a question for Mr. Cox.

Q. Fair enough. Well, let's think. Does this mean that Missouri is effectively bidding against other states for your services?

A. I mean, that's a strange way of saying that. I think, you know, you'd be better off to talk to Mr. Cox about incentivization across the industry and in other states.

Q. Well, you're the one who had the conversation with Mr. Holsman and I want --

A. Sure, sure.

Q. -- to make sure we get down to this

right now. As I understand it what the Company is saying is if we don't get this tax treatment we are disincentivized from doing stuff in Missouri?

A. That's absolutely true.

Q. Okay. So what you're trying to say, hey, you have to give us as good as we're getting in other states or we're just going -- we have less of a reason to do things here, right?

A. I mean, that's not the way the Company's framing it. We are not bringing an ultimatum. We are suggesting this is a disincentive, full stop.

Q. I'm really not sure I'm seeing the difference. Let me make sure I'm getting this down. You're saying that, again, unless you get the same treatment that other states are giving you you have a disincentive to continue operation or to expand operations probably, expand, in Missouri?

A. That's correct.

Q. So again, basically if another state does something beneficial Missouri has to match them in order to get you to stay in Missouri? Or continue to expand in Missouri -- I'm going to keep -- you're using expand. Let me restate that question because it's getting confused. You're telling me that if another state gives you something more beneficial you say Missouri has to match that if you want us to expand operations in Missouri?

A. So I'm not the one making decisions about state expansion so that would be Mr. Cox for sure.

Q. You did testify though it's a disincentive?

A. Absolutely. It's simple math.

Q. Again, --

A. It's a disincentive.

Q. So I don't understand how you can say it's a disincentive but then also turn around and say you're not the one making decisions. I mean, you clearly at some level are aware of the decision making process?

A. It's a conceptual disincentive when you have a different rate making treatment in one state versus another.

Q. Right. And you're saying to avoid that disincentive Missouri has to be as good as all the other states, we have to give you the same treatment?

A. I think by definition to avoid a disincentive you can't disincentivize, right.

Q. Right. So again, if another state is not giving as good as Missouri is you're saying we have a disincentive to expand operations?
A. Correct.
Q. And you want Missouri's existing ratepayers, your existing ratepayers to continue to fund that expansion, that's that incentive to expand?
A. I'm not sure how you -- how you get there. You know, from net operating loss position customers aren't funding any expansion that would still have to be investors.
Q. Well, you're saying that the customers have to pay you income tax above what you're going to remit?
A. I'm saying that's consistent with regulatory rate making.
Q. Okay. So we're in agreement, you are asking customers to pay more than you are going to remit to the IRS?
A. I'm asking the Commission to give me consistent rate making. That's the ask.
Q. Can we agree that the consistent rate making that you're asking for is for customers to pay more than you're going to be remitting to the IRS? I feel like that's a very simple standard, I don't know

why we're arguing about this.

A. Because it's two separate issues and it goes back to a similar concept to accumulated deferred income tax. Because I'm not paying it, there are regulatory rate making treatments for whether I'm paying it or not. And so I'm asking for the Commission to provide consistent rate making treatment as to what they've done in this state for our group of companies before.

Q. And that consistent rate making treatment, according to you, is to allow the Company to collect more than it's going to ultimately remit to the IRS?

A. The consistent rate making treatment would be to allow the Company to base income taxes on the return granted in this case.

Q. And the effect of that would be to collect more than they're going to remit, correct?

A. Yes.

Q. Thank you. I don't know why we had to go to such lengths to get --

MR. WOODSMALL: Objection, your Honor.

MR. CLIZER: -- to the point.

JUDGE HATCHER: Mr. Clizer.

MR. CLIZER: Sorry.

BY: MR. CLIZER
Q. And you are saying that Missouri needs to do that or else you'll have a disincentive?
A. Yes.
Q. Okay. Are you aware that there's a statute that allows the Commission to order a company to acquire a distressed system?
A. I am not aware of a statute at all, no.
Q. So you wouldn't happen to know why the Commission's never utilized that statute?
A. No.
MR. CLIZER: I have no further questions. Thank you.
JUDGE HATCHER: Thank you. We will be adjourning for lunch after this witness. We do have re-direct to finish off Mr. Thies's testimony regarding income taxes. Mr. Woodsmall.
MR. WOODSMALL: Thank you, your Honor.
EXAMINATION CONDUCTED
BY: MR. WOODSMALL
Q. Let's work backwards. First off, you were asked questions about whether -- if you're not provided the same treatment in other states whether you would quit investing in Missouri, something along

those lines. You recall that?
A. Yes.
Q. Does the Company have unlimited capital?
A. No.
Q. Okay. And would you agree with the statement that capital will necessarily follow, will go to the states where it provides the best overall return including consideration of income taxes?
A. Yes.
Q. Okay. Lot of questions that talked about standard rate making formula, end quote, and, quote, regulatory rate making, do you recall those?
A. Yes.
Q. Okay. Would you explain to me, in rate making, the difference between normalization of taxes and flow-through of taxes?
A. That's a good question. It's a technical issue and I am not a tax expert. But the best of my understanding, normalization would be setting the amount of taxes based on all the components in the rate making equation. Flow-through would be setting taxes based on what is actually going to be paid in that period.
Q. Okay. And to put this in

perspective. The Company's position is a normalization of taxes; is that correct?
A. Correct.
Q. And Staff and Public Counsel want to look at the actual taxes that may or may not be paid and flow that through to the rate making formula; is that correct?
A. That's correct.
Q. Would you agree that in virtually every other aspect of cost of service we don't include the actual amount, rather we go in and we look and we normalize and we annualize and we make adjustments to try to look at what the normal amount of that cost is, would you agree with that?
A. I agree that we seek to adjust, annualize, normalize, as much as necessary.
Q. So while we normalize every other component of cost of service, here Staff and OPC want to turn its back on norm -- on normalization and use flow-through; is that correct?
A. That's my understanding, yes.
Q. I was going to get into ADIT but let's let that go. Going back to the very beginning -- this is my last question. There were comments -- or questions to you from the Bench based

upon Ms. Bolin's surrebuttal using the quote interest free loan?

A. Uh-huh.

Q. Is this an interest free loan? And you can --

A. Is what an interest free loan?

Q. Is it a gift or an interest free loan for the Commission to normalize income taxes?

A. Gosh, I've never thought about it that way. I think the context of that conversation was it is reduced from rate base because it's a source of capital that doesn't have -- that was not supplied by investors or supplied through debt. So in that sense this would be similar, yes.

Q. But it is not a gift because it's more recognition of the losses the Company has previously incurred?

MR. CLIZER: I'm going to object. I feel like he's attempting to get his witness to change his answer.

MR. WOODSMALL: I'm asking for a clarification.

JUDGE HATCHER: I'll allow it. I'll allow it. Go ahead. Overruled.

THE WITNESS: Could you ask the question

again, I'm sorry?

BY: MR. WOODSMALL

Q. Is this a gift or is this more recognition of the past losses the Company has incurred?

A. Which part? The -- income tax and the rate or the reduction based on --

Q. Income taxes.

A. I mean, I wouldn't think about it as a gift as much as I'm thinking about it as standard rate making that offers certainty and reliability as we plan the next rate case and the rate case after that. So I never considered the option that -- or the thought that it's a gift.

Q. Okay. And again, to try and put a bow on all this. Under normalization of taxes and any other cost of service, basically it normalizes, it flattens out that cost component, it tries to eliminate fluctuations, would you agree with that?

A. I would.

Q. And under flow-through however, if you pass through the amount that is actually paid, that can fluctuate rapidly over time, would you agree with that?

A. I would agree with that, yes.

Q. Okay. I have no further questions.

MR. WOODSMALL: Thank you, your Honor.

JUDGE HATCHER: Thank you. Mr. Thies, you are excused from the stand. I understand you will be back later on --

THE WITNESS: Uh-huh.

JUDGE HATCHER: -- for other issues. I intend to adjourn in the next few minutes. Are there any issues before we adjourn for lunch? We are on income taxes and we have three witnesses, Seltzer, Bolin, and Riley to go. Any corrections, any announcements?

MR. WOODSMALL: No corrections. Simply just a reminder, and we'll try and take care of this before we come back from break, that Mr. Seltzer will be appearing virtually.

JUDGE HATCHER: Let's come back at 1:30. 1:30. That's an hour and 10 minutes.

MR. THOMPSON: Thank you, Judge.

JUDGE HATCHER: We are off the record and adjourned.

(At this point in the proceedings, a short recess was taken.)

JUDGE HATCHER: Okay. Let's go back on the record, the time of recess having expired. The

Commission will now resume the evidentiary hearing of the water and sewer general rate case of Confluence Rivers. That file number is WR-2023-0006.

We are on the issue of income taxes and we are ready to begin with the Company's second witness. Confluence Rivers.

MR. WOODSMALL: Before I lay the foundation, let me just inquire. Mr. Seltzer, are you on the phone?

MR. SELTZER: I am.

MR. WOODSMALL: Okay. Thank you. Your Honor, call Mr. Seltzer to the phone -- or to the stand.

JUDGE HATCHER: Mr. Seltzer, you are on our virtual witness stand, so to speak. Please raise your right hand, I'll swear you in.

* * * * *

BRADLEY M. SELTZER,

The witness, having been first duly sworn upon his oath, testified as follows:

* * * * *

JUDGE HATCHER: Thank you. And Counsel, your witness.

MR. WOODSMALL: Thank you, your Honor.

EXAMINATION CONDUCTED

BY: MR. WOODSMALL
Q. Mr. Seltzer, would you state and spell your name, please?
A. My name's Bradley M. Seltzer, S-E-L-T-Z-E-R.
Q. And by whom are you employed and in what capacity?
A. I'm an equity partner at Holland and Knight.
Q. And have you been retained to provide testimony on the issue of income taxes in this case on behalf of Confluence Rivers Utility Operating Company?
A. Yes, I have.
Q. And do you have a copy of what's been marked as Exhibit 16, your rebuttal testimony, in front of you?
A. I do.
Q. And do you have any changes to that testimony?
A. No.
Q. And if I were to ask you those same questions today as contained therein would your answers be the same?
A. Yes.

MR. WOODSMALL: Your Honor, I'd move for the admission of Exhibit 16 and tender the witness for cross-examination.

JUDGE HATCHER: You've heard the motion of the Counsel. Are there any objections to the admission of Exhibit 16?

MR. THOMPSON: No objection from Staff, Judge.

JUDGE HATCHER: Hearing none, Exhibit 16 is so admitted onto the record.

Did you tender the witness?

MR. WOODSMALL: I did, your Honor.

JUDGE HATCHER: The witness is tendered and we go to cross-examination. Looking for a little assistance. We'll go to Staff.

MR. THOMPSON: Thank you, Judge.

EXAMINATION CONDUCTED
BY: MR. THOMPSON

Q. Mr. Seltzer, you are an attorney, are you not?

A. Yes.

Q. And you have been practicing law for a good many years; isn't that correct?

A. Yes.

Q. And you specialize in tax law of

public utilities; is that correct?
A. Amongst other things, yes.
Q. And you have previously testified here in Missouri?
A. Yes.
Q. And are you familiar with rate making in Missouri?
A. Yes. As it relates to the treatment of taxes in rate making, yes.
Q. Are you aware that there is a prohibition on retroactive rate making in Missouri?
A. Yes.
Q. Now, looking at your testimony, I'm on Page 5 at Line 4, the proposed disallowance of any tax expense in cost of service fails to appreciate that the NOLs in this case reflect actual increased operating expenses attributable to the distressed assets acquired by Confluence Rivers that have been borne by Confluence Rivers but have adhered to the benefit of its customers. Do you see that?
A. I do.
Q. Now, those NOLs reflect operating expense losses incurred in previous tax years; isn't that correct?
A. At least in part, yes.

Q. And their recovery in this rate case would in fact violate the prohibition on retroactive rate making; isn't that true?

A. I don't believe so. I don't believe that the Company is seeking to recover the costs. What I believe the Company is seeking to recover is the carrying costs attributable to spending the money for expenses which were deductible for rate making purposes -- for book purposes but which they could not claim a tax deduction until a future year. It's the carrying cost of the deferred tax deduction.

Q. And those tax deductions in a future year, that is a benefit, is it not, that is conferred on businesses by the Interstate -- excuse me, the Internal Revenue Code?

A. It is a benefit that will be received in the future, yes.

Q. If my living expenses exceed my income am I able to deduct that on my individual tax return?

A. Define living expenses. Some of them you can, some of them you can't.

Q. Okay. But a business can deduct all of its business operating expenses to the extent that they exceed its income; isn't that correct?

A. Eventually I guess that's true.
Q. Depending on when they happen to have positive income, correct?
A. And again, as you mentioned earlier, subject to the 80 percent limitation, yes.
Q. Thank you. I have no further questions.
JUDGE HATCHER: Mr. Clizer.
MR. CLIZER: I have no questions. Thank you.
JUDGE HATCHER: Thank you. Are there any Commissioner questions for Mr. Seltzer? The Bench does have a few questions.
EXAMINATION CONDUCTED
BY: JUDGE HATCHER
Q. Do you know if Confluence Rivers or any of the holding companies affiliated with Confluence Rivers that are filing federal tax returns, do any of those companies issue financial statements in compliance with FAS 109?
A. Honestly I've never seen their financial statements.
Q. Okay. Do you know if FERC has any jurisdiction over Confluence or any water or sewer utility in Missouri?

A. They clearly do not.

Q. Does the NARUC USOA, that's the Uniform System of Accounts, for Class A3 water utilities, does that USOA have an Account 190?

A. Could you repeat that question?

Q. Does the NARUC, that's the National Association of Regulatory Utility Commissioners, does the NARUC USOA for Class A3 water utilities have an Account 190?

A. I believe so.

Q. And I'd like to turn to your rebuttal testimony. And I'm going to be looking at Pages 5, 6, and 8.

A. Okay.

Q. Can you provide a copy and the authoritative source of the actual tax doctrine and/or principle that you refer to on Pages 5, 6, and 8?

A. Are we talking about the actual tax document?

Q. Yes.

A. It's discussed at length in Water 144 by FERC, it's discussed to some extent in one of the two leading treatises on accounting for public utilities which was written by Richard Matheny, it's referred to from time-to-time in cases. But those are the two leading authorities on the actual tax doctrine.

It might be a helpful time to clarify one thing 'cause it's -- there's been a lot of references to, you know, how you go about calculating tax expense. When you calculate tax expense, the way the Internal Revenue Service looks at it, and we all agree that the Internal Revenue Service only has jurisdiction over accelerated depreciation as it pertains to this net operating loss. But when you compute tax expense and you basically take your rate base and multiply it by your rate of return and you apply a tax rate you only apply the statutory rate. It doesn't care what your effective tax rate is even if it's less than the statutory rate. You compute tax expense under normalization for federal tax purposes at the statutory rate. I just want to be clear. And that is regardless of what you currently pay to the Internal Revenue Service.

Q. Thank you.

JUDGE HATCHER: I'll ask once again if there's any Commissioner questions? No. And we will go to re-cross. Mr. Thompson.

MR. THOMPSON: Thank you, Judge.

EXAMINATION CONDUCTED
BY: MR. THOMPSON
Q. Is the Commission required to normalize in this case?
A. As my testimony stated, no.
Q. Thank you. No further questions.
JUDGE HATCHER: Mr. Clizer.
MR. CLIZER: I guess just very briefly.
EXAMINATION CONDUCTED
BY: MR. CLIZER
Q. In response to the clarification you stated, that would be the definition of normalization, correct?
A. The definition of normalization is longer than that but it does embrace that principle, yes.
MR. CLIZER: All right. Thank you. That was all I had.
JUDGE HATCHER: And re-direct from Confluence?
MR. WOODSMALL: Just one question, your Honor.
EXAMINATION CONDUCTED
BY: MR. WOODSMALL
Q. Mr. Seltzer, do you recall the

question from Mr. Thompson about retroactive rate making?

A. Yes.

Q. And when you were asked that, you said that the Company's trying to seek recovery of the net operating losses, simply the carrying cost of those net operating losses, do you recall that response?

A. Yes.

Q. And would you agree that the carrying costs on those net operating losses is a current expense to the Company?

A. Yes. Until we can use the losses, yes.

MR. WOODSMALL: No further questions. Thank you.

JUDGE HATCHER: Thank you. And Mr. Seltzer, you are excused from the stand on this issue, subject to any callback. Where are we at?

MR. CLIZER: The Staff's first witness.

JUDGE HATCHER: I think we're moving to Staff's first witness. Thank you. Ms. Bolin, please raise your right hand. Last name is spelled B-O-L-I-N.

* * * * *

KIM BOLIN,

The witness, having been first duly sworn upon her oath, testified as follows:

* * * * *

JUDGE HATCHER: Thank you. Please, have a seat. Mr. Thompson, your witness.

MR. THOMPSON: Thank you, Judge.

EXAMINATION CONDUCTED

BY: MR. THOMPSON

Q. Please state your name.

A. My name is Kim Bolin, and Bolin is spelled B-O-L-I-N.

Q. And how are you employed?

A. I'm a division director for the financial and business analysis division.

Q. And by profession, are you an accountant?

A. Yes.

Q. And how long have you practiced accountancy?

A. I have worked in the regulatory arena for over 25 years.

Q. Okay. Did you prepare or cause to be prepared direct and surrebuttal testimony, both public and confidential, which has been designated

Exhibits 101 and 123?

A. Yes.

Q. Do you have any corrections to that testimony?

A. Yes. I have a correction on my direct testimony, Page 4, Line 11. The number 1,153,219 should read 1,198,879.

JUDGE HATCHER: Before you get to what I expect is your next correction, that includes a confidential number that is included in Exhibit 133 and it is available to be seen by all of the parties and the Commissioners and the Bench but will not be repeated by Ms. Bolin as she testified today. Go ahead, Ms. Bolin.

THE WITNESS: Okay. So --

JUDGE HATCHER: So I'll paraphrase what I believe is your next correction on Page 4, Line 13.

MR. CLIZER: Correct.

JUDGE HATCHER: Delete that confidential number and replace it with -- that's a public number?

THE WITNESS: That's a public number. 9.77 million. And then the Footnote Number 2 on that page should read, Response to Staff Data Request Number 0120.1.

BY: MR. THOMPSON

Q. Do you have any other corrections, Ms. Bolin?

A. No, I do not.

Q. With those corrections in mind, is your testimony true and correct to the best of your knowledge and belief?

A. It is.

Q. If I were to ask you those same questions today would your responses be the same?

A. They would.

MR. THOMPSON: At this time, Judge, I move for the admission of Exhibits 101 and 123, both public and confidential as corrected.

JUDGE HATCHER: You've heard the motion of Counsel. I'll take both together at once. Are there any objections to the admission of Exhibit 101 or 123? Seeing none they are so admitted. Counsel, your witness.

MR. THOMPSON: Thank you, Judge. I tender the witness for cross-examination.

JUDGE HATCHER: Mr. Clizer. Thank you.

EXAMINATION CONDUCTED

BY: MR. CLIZER

Q. Good afternoon, Ms. Bolin.

A. Good afternoon.

Q. Do you happen to have a copy of Mr. Seltzer's rebuttal testimony with you?
A. Yes, I do.
Q. Do you have a copy of your own testimony with you?
A. Yes, I do.
Q. I'll probably be bouncing back between the two. Starting with Mr. Seltzer's testimony, could you turn to Page 5 for me. And I will clarify, he only filed rebuttal testimony, that's why I'm not specifying it.
A. Okay. I'm there.
Q. You would agree with me that starting on Pages 2 through 4 -- well, actually starting on Line 1, Page 5, my apologies, and I'm going to try and paraphrase this, he accuses Staff of misrepresenting or misapplying the actual taxes doctrine by failing to acknowledge the deferred tax liability?
A. Yes, that's what it says.
Q. That's what NOL represents. And again, I've omitted some there, trying to keep it simpler. And at the same time, on Line 17 through 19 -- again, I'm not going to read the entire line, trying to keep things a little bit quicker. He

references the deferred tax liability inherent in the NOL; is that correct?
A. He refers to that, yes.
Q. And if you'll turn to Page 8 for me. He accuses you of attempting to exclude a future tax liability; is that correct?
A. Yes, he does.
Q. And would your understanding be that he is referring to the NOL in that case as well?
A. I believe that's what he's referring to, yes.
Q. So we can assume then that Mr. Seltzer's testimony is referring to an NOL as creating a tax liability; is that correct?
A. That's what one could assume from his testimony, yes.
Q. You would agree with me that an NOL carryforward results in a deduction in future tax years?
A. Yes, it does.
Q. You would agree with me that an NOL is a -- sorry. You would agree with me that an NOL results in carryforward for future tax years?
A. Yes.
Q. And you would agree with me NOL does

not result in new taxes in a future year?
A. It reduces the taxes for future years.
Q. It does not increase taxes in future years?
A. Correct.
MR. CLIZER: Your Honor, I'd like to mark an exhibit. This should be 215.
JUDGE HATCHER: So marked. And can you give me the five word description?
MR. CLIZER: Yeah. Okay. I would go with the title Statement of Financial Accounting Standards 109.
MR. THOMPSON: Thank you, sir.
MR. CLIZER: I am going to run out of numbers if I -- I'm going to give yours after the fact. My apologies. Oh, wait.
JUDGE HATCHER: Okay. And for those listening this is marked, not yet admitted. It is marked as Exhibit 215, Statement of Financial Accounting Standards Number 109.
BY: MR. CLIZER
Q. Are you familiar with this document?
A. Somewhat.
Q. Would you agree with me that this is

a document referenced in Mr. Seltzer's testimony?
A. I believe it is, yes.
Q. Could you turn to Page 5 for me. Would you agree with me that the line under deferred tax liability reads, "A deferred tax liability is recognized for temporary differences that will result in taxable amounts in future years?"
A. That is what it says.
Q. You would agree with me that the deferred tax asset is recognized in the next paragraph as, "A deferred tax asset is recognized for temporary differences that will result in deductible amounts in future years and for carryforwards?"
A. That's what it says.
Q. Based on these definitions you would agree with me that an NOL would be at most creating a deferred tax asset, correct?
A. I would agree.
Q. You would agree with me that therefore the statements made in Mr. Seltzer's testimony claiming the deferred tax liability is contrary to the sources upon which he relies, correct?
A. It is contrary to this document.
Q. I'm going to press forward.

MR. WOODSMALL: John, did you offer that document?
MR. CLIZER: Not yet.
MR. WOODSMALL: Okay.
BY: MR. CLIZER
Q. You have a copy of Mr. Thies's testimony?
A. Rebuttal and surrebuttal both.
Q. Could you turn to the surrebuttal for me. Specifically Page 10. I'm sorry, I forgot to tell you what page.
A. Okay.
Q. Again, I don't want to have to read a whole bunch into the record so I'm simply going to ask you to read that first Paragraph 1 through 11 for a second. Not out loud, just read it to yourself and let me know when you're finished.
A. I'm finished.
Q. Sorry. Thank you. You would agree with me that this testimony is at most, or in essence attempting to claim that you needed to calculate NOLs on an individual system basis?
A. For the Confluence River systems, yes.
Q. And your understanding that

Confluence filed a consolidated tax return?

A. They -- my understanding is they will file a consolidated tax return for 2022, they have not yet filed it.

Q. Would you expect an NOL to be reported in a consolidated tax return on individual system basis?

A. No, it will not be.

Q. I believe you were in the room earlier when there was a discussion with Mr. Seltzer regarding what a normalization is?

A. Yes.

Q. Would you agree with him that that's a fair characterization of normalization for tax purposes?

A. Yes.

Q. Would you agree with me that normalization for tax purposes and normalization for bookkeeping purposes are very different things?

A. They are different, I would agree with you.

Q. Were you in the room earlier when Mr. Thies was testifying?

A. Yes, I was.

Q. Do you remember questions coming from

Mr. Thies's attorney suggesting that Staff was turning its back on normalization rules in this case?

A. I remember some questions concerning normalization from his --

Q. You would agree with me that your recommendation is not a departure from the Staff's existing normalization rules with regard to normalizing book accounts?

A. As you mean normalizing other expenses?

Q. Correct.

A. That is correct.

Q. Much has been said that this is a novel approach. In your opinion, is what you are proposing inconsistent with the Staff position taken in past cases?

A. In past cases we have not had NOLs that have not have occurred due to accelerated depreciation.

Q. If in past cases you had had situations similar to this one where you had NOLs generated that were not caused by accelerated depreciation would you have taken the same position?

A. We probably would have. I'd have to review all circumstances, see how large the NOL was, and see if it would be continuing in the future.

Q. I believe earlier you indicated that you were in the room during the testimony of Mr. Thies; is that correct?

A. That is correct.

Q. Do you recall his recommendation to the Commission regarding the creation of an asset to account for funds -- sorry, account for the difference between rates and what the actual operating costs and required systems are? I'm trying my best to keep that consistent with what you recommended.

A. I remember the discussion on creation of an asset.

Q. Would you agree with me that that asset would constitute retroactive rate making?

A. I believe it would.

Q. Are net operating losses, again potentially referred to as NOLs, capable of being booked into a water company's accounts? Actually, let me try and clear that up.

A. Not sure I understand your question.

MR. CLIZER: Your Honor, the Bench asked previously a question regarding Account 190? Was it 190 or 109, I have dyslexia sometimes?

JUDGE HATCHER: 109.
MR. CLIZER: It was 109.
BY: MR. CLIZER
Q. Are you familiar with Account 109?
A. I thought it was 190, but...
JUDGE HATCHER: Oh, gosh dang it. It was FS 109 and Account 190. Yes, thank you.
THE WITNESS: I did not bring up my NARUC chart of accounts with me and I cannot tell you right now what Account 190 is.
BY: MR. CLIZER
Q. Are you requesting that Confluence book NOLs to its accounts?
A. I don't think I am.
Q. Is it correct to say that your request is solely for net operating losses that are being experienced for tax purposes to be reflected in income tax calculations?
A. That is correct.
Q. So there is no request to change how things are being booked in Staff's -- sorry, Confluence's accounts?
A. Now, under our alternative we are asking that if -- our alternative of setting -- of including the income taxes and then tracking the

difference between what is paid and what is billed into rates, we would be setting up an account for that, having them book that amount in an account.

Q. But only under that circumstance?

A. Under that circumstance.

Q. I believe in your surrebuttal testimony you described the situation analogous to ADIT -- not analogous to. You described the situation with ADIT which is analogous to what you're proposing here, do you recall that conversation?

A. In my surrebuttal?

Q. Yes. Specifically on Page 6, Lines 7 through 13.

A. Yes. That's analogous, yes.

Q. And you state, "Because the amounts paid in by customers for deferred income tax expense represents capital paid by the ratepayers that the utilities can use for a period of time it is appropriate to provide customers a return on this capital contributed by reducing utility's rate base by the balance of its net collection of accumulated deferred income taxes at a point in time customers can see a return on capital contribution;" is that correct?

A. That is what I wrote, yes.

Q. And you would agree with me that if the Commission were to order rates in this case where income tax expense was set such that it was greater than the amount that the Company expected to remit, that Company would be receiving, in the same manner that you described here, what amounts to an interest free loan?

A. Yes.

Q. It would be an amount of capital that the Company would be allowed to use?

A. That is correct.

Q. And under the same logic that the Commission has employed in the past with ADIT it is reasonable that that amount should offset rate base?

A. That is my opinion, yes.

Q. And if the Commission were to allow the Company to collect income tax expense greater than what it was going to remit and not book that into ADIT, you would agree that that would create a permanent tax bonus for the Company, correct?

A. Yes.

Q. It would effectively be free money for the Company?

A. That is correct. Then they'll have to pay that back.

Q. Would the systems that are being acquired by Confluence that are currently regulated by the Commission -- well, actually let me back up. It is the practice of Staff to include the amount necessary to pay income taxes when setting ratings for all utilities, correct?

A. That is correct.

Q. So for the systems being acquired by Confluence that are currently under the jurisdiction of the Commission that have had their rates set by the Commission an amount for income tax would be included for those rates, correct?

A. Yes, it should be.

Q. And if the Company is in a net operating loss position after acquiring that system the amount that is currently in rates to pay taxes for that system will ultimately be profit for the Company?

A. The Company will be able to use it, yes.

Q. And that would constitute a benefit to the Company, correct?

A. Correct.

Q. And you would agree with me that a taxpayer not having to pay taxes is a benefit to the taxpayer, correct?

A. Could you repeat that question?

Q. Would you agree with me that a taxpayer not have to pay taxes is a benefit to the taxpayer?

A. Yes.

Q. And you would agree with me that a taxpayer in a net operating loss position does not have to pay taxes?

A. I would agree with you.

Q. So you would agree with me that a taxpayer in a net operating loss position receives an immediate tax benefit in the form of not having to pay taxes?

A. That is true.

Q. Are you familiar with the actual tax doctrine?

A. I have seen a data request where that was requested by Office of the Public Counsel and what was provided. I don't know that it's an actual tax doctrine. It outlines normalization.

Q. Because of the name, let's make sure we got that clear. When you say you're not sure it's an actual tax doctrine, what did you mean by that, 'cause the name is Actual Tax Doctrine?

A. I don't know that the document I provided said anywhere that it was an actual tax doctrine.

Q. Do you understand my point of confusion 'cause I want to try and clarify -- okay. You think -- okay. I'm just going to move on. So you're not sure if it's a real doctrine, let me put it that way?

A. That's correct.

Q. Okay. That's what I was trying to get to. The Commission is setting rates prospectively, correct?

A. That is correct.

Q. So the income tax expense included in this case is to pay future taxes, correct?

A. Correct.

Q. And the taxes coming due in the future will be able to make use of any existing net operating loss carryforward?

A. Yes.

Q. So the taxes -- sorry, the rates -- the taxes paid on rates set in this case will immediately be able to make use of the benefit of net operating loss carryforwards, correct?

A. For a certain period of time, yes.

As long as the NOLs are still available.

Q. So when you say for a certain period of time, you mean --

A. Until they --

Q. -- for as long as the net operating loss carryforwards exist?

A. Correct.

Q. Until they are fully used up?

A. Correct.

Q. And the Company will be able to receive that benefit immediately?

Let's talk very briefly regarding census. Are you familiar with the fact -- well, did you work on any recent acquisition case by Missouri American Water?

A. If you could give me an exact case number.

Q. How about -- and I'm just going to list these off and you can tell me. WA-2021-0376, Eureka; WA-2022-0049, City of Orrick; WA-2022-0293, City of Purcell; WA-2022-022, I think that's a 9, Monsees Lake Estates; and WA-2022-0311, Stewartsville?

A. I did not work any of those cases. I am somewhat familiar with them but I did not work them.

Q. You caught -- you described Confluence's request in this case as creating a phantom tax; is that correct?

A. That is correct.

Q. Is it your -- you would agree with me that such a phantom tax is not necessary to incentivize acquisitions of systems, correct?

A. I would agree.

Q. You would agree with me that other utilities in the state are acquiring small systems without the need of such a phantom tax, correct?

A. That is correct.

Q. And to your knowledge, does any of the other systems that are acquired by other utilities, do those utilities request this phantom tax treatment?

A. Missouri American pays taxes, so no.

Q. Are there carrying costs on a net operating loss?

A. Not on the net operating loss.

Q. So a net operating loss generated for tax purposes does not have any carrying costs associated with it?

A. Correct.

Q. And that's because it is effectively just a thing that the IRS has created for the benefit of a taxpayer when filling out their tax forms?

A. That is correct.

Q. All right.

MR. CLIZER: I believe that is all the questions I have. I did not move for the admission and honestly I'm just going to ask, does the Commission request it be admitted?

MR. THOMPSON: No objection. If he's not going to move for it to be admitted, I will.

JUDGE HATCHER: Okay.

MR. CLIZER: In that case then I will move and I'll use my number.

JUDGE HATCHER: Okay. Any objection?

MR. THOMPSON: No objection.

JUDGE HATCHER: No objection. It is so admitted as Exhibit 215, Statement of Financial Accounting Standards Number 109. Mr. Woodsmall, your witness.

MR. WOODSMALL: Thank you.

EXAMINATION CONDUCTED

BY: MR. WOODSMALL

Q. Let's start at a higher level. You're -- what's your current position?

A. Division director.
Q. Of which division?
A. The financial and business analysis division.
Q. Okay. And relative to the witness that -- witnesses that have appeared in this case, you would supervise all those auditors; is that correct?
A. The auditors, yes.
Q. Okay. So Mr. Majors, Ms. Lyons, Amenthor, Dougherty, Sarver, all of those; is that correct?
A. That is correct.
Q. And would you review their testimony?
A. I do review their testimony.
Q. Okay. And so you're -- you are familiar with the positions in that testimony?
A. Yes, I am.
Q. Do you consider how those positions may reflect on a bigger policy of trying to encourage acquisition of distressed systems?
A. I do not.
Q. Okay. So in this case, for Staff, who would consider how auditing positions may impact acquisition or non-acquisition of distressed systems?

A. I don't know that anybody on Staff would be concerned with what auditing's positions are and how they would impact future acquisitions.

Q. In your role reviewing all this testimony, did you go back to look at how Staff handled certain issues in Staff assisted rate cases for Confluence River?

A. I talked with witnesses from those previous cases, yes.

Q. Okay. And so you're familiar with the positions in that case?

A. Somewhat familiar, yes.

Q. Okay. Do you believe that Staff's position on preliminary legal costs are in this case consistent with that done in previous cases?

A. Not for the Confluence River case. We have a little different position and further review of this case made it so.

Q. But it is different?

A. It is different.

Q. Okay. Preliminary engineering costs are different than how it was handled in a previous case?

A. I'm not exactly sure on the preliminary engineering costs because I do believe some engineering costs, if they're tied to construction, are capitalized.

Q. Okay.

MR. CLIZER: Your Honor, I'm only making this objection to the extent that these are issues which are being brought up later in the case so I'm not sure why the cross of those issues are being done right now.

MR. WOODSMALL: Because Ms. Bolin, as the supervisor for all those, is only scheduled to appear once. So this is my only time to ask her about how Staff's position has changed or how it fits the bigger picture.

MR. CLIZER: Okay.

JUDGE HATCHER: I've -- go ahead.

MR. WOODSMALL: Sorry. I saw you nod your head but I think you want to make a ruling, so...

JUDGE HATCHER: I understand that the objection was withdrawn.

MR. CLIZER: I guess my concern is that I wasn't aware that we were supposed to be crossing Ms. Bolin on those issues. If that was the case, I probably would have had additional cross. It seems -- and again, I apologize to Ms. Bolin. But wouldn't it make more sense to bring her back for that issue?

MR. WOODSMALL: Your Honor, Rules of Evidence say that I can cross-examine on anything relevant. I knew the Rules of Evidence, I knew that she -- this was her only time and I'm crossing on things that are relevant.

JUDGE HATCHER: Okay. I can certainly see both sides. The Commission operates by breaking down large rate cases into issues. Those issues that you're cross-examining on are going to be raised next week if -- well, today is Friday. So yes. Ms. Bolin, are you going to be in the office next week?

THE WITNESS: I guess I will. I will.

JUDGE HATCHER: Okay.

MR. WOODSMALL: Okay. So she will appear on those issues?

JUDGE HATCHER: I'm going to ask Staff right now. Staff counsel.

MR. THOMPSON: Yes, sir.

JUDGE HATCHER: Would you please make Ms. Bolin available at whichever day happens to be -- Mr. Woodsmall will contact you with when --

MR. THOMPSON: As part of what issue exactly?

MR. WOODSMALL: Preliminary legal costs, preliminary engineering costs. We're handling NOLs here today. Classifying --

MR. THOMPSON: Are you talking about the acquisition costs issue?

MR. WOODSMALL: It is --

MR. THOMPSON: It's scheduled --

MR. WOODSMALL: It's wrapped up in there.

MR. PRINGLE: Well, that's scheduled for today.

MR. WOODSMALL: So he'll be -- Dean will be able to handle that. And then the issue for next week regarding the reclassification of capitalized --

MR. THOMPSON: Got it.

MR. WOODSMALL: -- cost as repairs.

MR. THOMPSON: That is currently set for Friday -- or Thursday, I believe, of next week.

MR. WOODSMALL: Okay. So we will then limit your cross here solely to net operating losses. I'm sorry, did you have something? Okay.

BY: MR. WOODSMALL

Q. Did you go back to look at how Staff previously handled net operating losses in Staff assisted Confluence River cases?

A. Yes, I did.

Q. And did you include income taxes in those cases?

A. We did.
Q. Okay. So your treatment here today is a departure from your typical -- your treatment in those previous cases?
A. It is. We look at things on a case-by-case basis.
Q. Okay. And would you agree that your treatment in previous Confluence River cases is more consistent with the treatment that you have done for Ameren, Spire, Evergy, Missouri American?
A. Those entities use accelerated depreciation so that's why this situation is different than that.
Q. Okay. Putting aside the ADIT issues resulting from accelerated depreciation, your tax calculation in those previous Confluence Rivers cases is consistent with Ameren, Evergy, and those type of cases?
A. We did not apply an NOL to those --
Q. Okay. And you cal --
A. -- Confluence cases.
Q. I'm sorry for interrupting for you.
A. That's all right.
Q. You calculated taxes in those previous cases simply by looking at the equity

component and the cost of that equity in applying just an income tax factor?

A. That is correct.

Q. And that's different than what you're doing today?

A. That is correct.

Q. Okay. Do you know if any of the CS -- have you looked at how any other states handle these net operating losses for CSWR affiliates?

A. I have not reviewed that.

Q. Okay. So you haven't reviewed how other states handled it, you didn't look at how the Staff's positions affect the bigger picture, and you made a departure from how Staff did it in previous cases?

A. Yes.

MR. THOMPSON: Objection, asked and answered.

BY: MR. WOODSMALL

Q. Okay. You said yes?

A. Yes. Based upon the large amount of --

MR. THOMPSON: Can I get a ruling here?

MR. WOODSMALL: Or the answer.

JUDGE HATCHER: Mr. Woodsmall, do you have a response to the objection?

MR. WOODSMALL: No. I think I got the answer I wanted so I'm ready to move on.

JUDGE HATCHER: Okay. Objection seems moot.

MR. THOMPSON: I move to strike the answer, Judge.

JUDGE HATCHER: Mr. Woodsmall?

MR. WOODSMALL: I was simply summarizing what her testimony was and making sure the record was clear. I'm ready to move on.

JUDGE HATCHER: You may be. But we have a motion to strike the witness's answer.

MR. THOMPSON: He already got answers to each of those three questions.

MR. WOODSMALL: Your Honor, I'll withdraw it. If he wants to strike it, strike it.

JUDGE HATCHER: Okay. The question and answer for the summary is withdrawn. Now the motion is moot. Mr. Woodsmall.

MR. WOODSMALL: Thank you.

BY: MR. WOODSMALL

Q. You were asked some questions by Mr. Clizer about some other acquisition cases, do you recall that?

A. Yes, I do.
Q. And I believe his point was to show that there are other entities besides Confluence Rivers making acquisitions in Missouri?
A. I don't know if that was the point of his question or not.
Q. Okay. Do you agree that there are at least Missouri American making other acquisitions?
A. I am aware of Missouri American filing for acquisition cases in the State of Missouri recently, yes.
Q. Okay. Do you know if any of those are distressed water systems as in they are not compliant with environmental regulations?
A. The City of Orrick may have been a distressed system, if I remember right.
Q. So maybe one of the cases?
A. I'm not familiar with all of them but I do remember hearing something about the City of Orrick.
Q. Okay. Let's talk size. Are you familiar with the City of Eureka?
A. Somewhat, yes.
Q. Okay.
A. I know where it's at, yes.

Q. Significant size city, would you agree?

A. Depends on how you define significant.

Q. Okay. Let's say more than 20,000 people?

A. I'm assuming.

Q. Okay. And that was a Missouri American acquisition; is that correct?

A. That is correct.

Q. Have any reason to believe that they weren't in compliance at the time?

A. I am not aware of any compliance issues.

Q. Okay.

A. But I'm not not aware either.

Q. Okay. So to put it in perspective, do you know of anybody else out there acquiring small distressed systems?

A. In the State of Missouri?

Q. Correct.

A. Maybe other public water supply districts which we don't regulate and we don't approve.

Q. Point taken. Okay. But other than

that, you're not aware of anybody else --
A. Any other regulated.
Q. Okay. Thank you. Let's talk about the A-D-I-T analogy that Mr. Clizer was making. A-D-I-T, can you tell me first what it stands for?
A. Accumulated deferred income taxes.
Q. And would you agree that in large part A-D-I-T balances stem out of the practice of allowing accelerated depreciation?
A. For the most part, yes.
Q. Okay. And can you tell me in an A-D-I-T, accelerated depreciation environment, who provided the ability for the utility to take accelerated depreciation? Would you agree that it was a governmental code or governmental statute regulatory provision?
A. The IRS code.
Q. Okay.
A. Yeah.
Q. Let's analogize that to now. The net operating losses. What are the genesis of those net operating losses, are they some type of governmental rule or policy change or anything the government did?
A. I don't know if I understand your question.

Q. Let's get at it this way. Would you agree that the net operating losses here are not the result of governmental action but the fact that this company was buying systems where rates were below cost?
A. I don't know that I would attribute it to them buying systems. I would probably attribute it to they have more expenses than revenues.
Q. Okay. It was an operational not the acquisition is the point you're taking?
A. Yes.
Q. Okay. That's fair. What happens to rates if -- let's say the Company has an NOL balance of nine million dollars. They have a net operating balance of nine million dollars, right?
A. Correct. Well, they will after they file their '22 -- 2022 tax return, that is correct.
Q. Okay.
A. Projected.
Q. And let's say next year they magically made ten million dollars. They would then apply that net operating loss against those earnings; is that correct?
A. That is correct. But in this

situation we're nowhere near --
Q. True.
A. -- ten million dollars --
Q. Hypothetical.
A. -- taxable income. We're closer to one million.
Q. Okay. But just hypothetically, they would use those to the extent of the 80 percent limiter; is that correct?
A. Yes. Anything after 2018 -- any NOLs after 2018 only 80 percent can be applied in one year.
Q. Okay. So in -- for tax purposes, taxes can change -- fluctuate over time?
A. Yes.
Q. Okay. What would happen -- absent a rate case what would happen to rates because of those tax changes?
A. Rates do not change in between rate cases.
Q. Okay. So if -- let's say rates -- okay. So regardless of what happens with taxes rates will not change?
A. Correct. Unless the Company comes in for a rate case.

Q. Okay. And finally, there were some questions -- well, let's go to this. Your experience is solely limited to rate making in Missouri; is that correct?
A. That is correct.
Q. Have you ever done a FERC rate case?
A. No, I have not.
Q. You're not familiar with how FERC handles this issue?
A. Not at all.
Q. Or you haven't done cases in any other jurisdiction?
A. Correct. No, I have not.
Q. So you're not familiar with how it's handled there?
A. No.
Q. Okay. Staff set rates on an individual system -- or they did a cost of servicing calculation on an individual system basis; is that correct?
A. That is correct.
Q. Okay. And how did you then handle, if you -- if you calc -- if you calculated a cost of service on an individual system basis, how did you handle the application of net operating losses to

each system then?

A. This is kind of a lengthy discussion on this. But I looked at the NOLs based on each utility holding company that filed tax returns. 2002 they'll file one -- 2021 they'll file one tax return for the whole company. But some of these systems were the only systems in the utility operating company so I applied that NOL to that system. Some of the systems, like Confluence Rivers, has several systems within the utility holding company. I allocated the NOL based on what their taxable income would be using a composite tax rate of 24.13 percent.

Q. Okay. So you didn't try in any way to attribute the NOL balance to the losses that were incurred at each individual system?

A. If the system was the only system in the utility holding company I did do that.

Q. Okay.

A. But for the ones that were within Confluence Rivers, I did break it out by systems.

Q. Okay. So let's take as an example, are you familiar -- have you heard of the Glen Meadows system?

A. Yes, I have.

Q. And it was acquired in December

of 2022?
A. I'm not sure the exact date but yes.
Q. Okay. And so the test year in this case ended January 31st of 2023; is that correct?
A. I don't know if it was the test year or the update year was January 2023.
Q. Update period, would you accept that?
A. Yes.
Q. So if Glen Meadows was acquired in December and if the update period ended in January, there was only one month of opportunity to incur net operating losses there; is that correct?
A. The tax return will be filed as one entity, Confluence Rivers Utility Holding Company. So they will get the full use of the NOL going forward.
Q. Okay. But even though they didn't -- they didn't help to create the net operating losses you assign to them some of the benefit of the net operating losses?
A. Yes. Because taxes going forward, they will be able to benefit from the NOL.
Q. Okay. So there was no attempt to actually have rates for those systems strictly follow costs of service, you assigned, to some regard, these

net operating loss balances?
A. I would disagree on the following cost of service. We set rates prospectively and they will not be paying any taxes.
Q. Okay.
A. So I set it to that level.
Q. Even though the net operating losses were the result of other systems those other systems didn't get the full -- the full effect of the net operating losses, it's being attributed to other systems as well?
A. It's being attributed to every system that's in the utility holding company of Confluence Rivers.
Q. Okay. I have no further questions. Thank you.
JUDGE HATCHER: Thank you. Are there any Commissioner questions for Ms. Bolin? Chairman Rupp.
CHAIRMAN RUPP: Thank you, Judge.
EXAMINATION CONDUCTED
BY: CHAIRMAN RUPP
Q. Do you remember the question that I asked --
A. Unfortunately, yes.
Q. Okay. Can you walk me through --

what is the incentive there for a company to not take -- or to carryforward the net operating loss and then have it appear in a test year versus not?
A. I wouldn't think they would want to do that because they would want to take advantage of not paying income taxes. We would see -- even if they did pay taxes in test year we would still look at the NOL balance and what they would pay in taxes in the future.
Q. So if a company exhausts all of their net operating loss, they choose to do it in 2024, then in 2025 they would not have -- be able to count that on their -- deduct that off of their taxes and they were to come in for a rate case in that year. How would that -- how would the rates be different if it -- if they had have come in the year that they had taken the deduction versus the year that they had not, is there any difference on rates?
A. We would set -- if they exhausted all their NOLs we would then set -- create tax -- income tax, we would generate an amount in there, the full amount.
Q. So is there -- is there an incentive for a company to -- like to utilize all of their tax deduction in a year so that it would show a tax

liability in a future year which they plan to come in for rates?

A. I don't know that there is an incentive that way.

Q. Is the amount in rates going to be relatively insignificant or do you think the amount of rates -- so how would a nine million dollar net operating loss affect the revenue requirement in the rate -- in the rate base?

A. I don't know if I understand your question.

Q. I'm trying to understand -- I'm trying to theorize. How would a utility plan in the future if they know they're coming in for a -- you know, 'cause utilities talk. I think I'm coming in in 18 months, I think I'm coming in in 16 months. What is the incentive for them, when they are looking at should I exhaust all -- use all of my net operating loss from the previous year to yes, I'm going to get the tax benefit now but how -- will that hurt me if it's a test year and are they having those conversations internally to anticipate what will show up in a test year?

A. We ask for several previous year's tax returns and review those balances. If we would see that that may flag something that we would have to take into consideration if they did not happen to use their NOLs for a tax year and still had them sitting out there. Or if they exhausted all of them.

Q. Does that not violate the test year of this is the information the test year, if you're going back and looking at previous years?

A. Well, all these NOLs were generated from year 2000 -- let's see here.

Q. They're generated from previous years?

A. Previous years. So, you know. I looked at all those tax returns, watched the balance. One of the operating companies did start to eat into their NOL so I reduced their NOL on the balance just like they did on their tax return. What I saw was going forward and setting rates you want to set rates for what's going to occur in the future and it does not appear they're going to be paying taxes for a couple years. I don't know, I think maybe we've got a disconnect here.

Q. I'm just -- I'm thinking more big pause why and stuff not as much on the numbers on -- I guess I'm just trying to understand the incentive. Is there an incentive, is there not an incentive, how

do utilities approach this issue?
A. I mean, I would think they would want to pay income taxes. So I would think they would utilize their NOL regardless of if it was a test year or not.
Q. All right. Thank you.
JUDGE HATCHER: Commissioner Kolkmeyer then Commissioner Holsman.
COMMISSIONER KOLKMEYER: Thank you, Judge.
EXAMINATION CONDUCTED
BY: COMMISSIONER KOLKMEYER
Q. Good afternoon.
A. Good afternoon.
Q. I think you said in past Confluence Rivers' rate cases that you said that Staff did not recommend offsetting income tax with NOL amounts; is that right?
A. That is correct. We did not pass small Staff assisted cases.
Q. So then what was the change in position for this case?
A. We got to reviewing it a little more and we noticed the large amount of NOLs and did a little more digging. You find things in different cases that you missed in previous cases. It's just

part of the audit. Sometimes you see things you don't see in one audit, you see it in the other.
Q. When was the last time, are you aware, that Confluence Rivers came in for a rate case?
A. The Confluence River Utility Holding Company came in in 2020.
Q. Okay.
A. I think Elm Hills was in 2020 also. They've had different rate cases over the years.
Q. Okay. I was appointed in 2020 -- no, 2021 and I didn't remember --
A. Right.
Q. -- Confluence Rivers having a rate case since I've been here. This is the first one that I remember.
A. Yeah. And that was -- those were all small Staff assisted cases in the past.
Q. All right. They've grown dramatically since then, --
A. Yes.
Q. -- since their last rate case?
A. Yes.
Q. Is probably where a lot of this is coming from?

A. I don't know about the growth on the -- impacting the NOLs. It would be they have more expenses than they do revenues.

Q. Okay. Thank you.

COMMISSIONER KOLKMEYER: Thank you, Judge.

JUDGE HATCHER: Mr. Holsman.

COMMISSIONER HOLSMAN: Thank you.

EXAMINATION CONDUCTED

BY: COMMISSIONER HOLSMAN

Q. Hello.

A. Hello.

Q. So I want to drill in just a little bit deeper on what Commissioner Kolkmeyer was talking about. So when you're dealing with the small rate cases, Staff assisted in the past, you basically treated them the same way that the precedent had been in the other rate cases on how to deal with taxes. Now you've got a departure. And what I heard you just testify was is it was the amount of the net operating loss that got your attention which put it into a different classification, or category in your estimation which then created a different approach than what you have done previously; is that accurate?

A. And the fact that they do not use accelerated depreciation.

Q. And the fact they do not use --
A. Yeah. To separate them from the other utilities that do use accelerated depreciation for tax purposes.
Q. Okay. Okay. So then the answer to the question of why are Ameren and Evergy and Spire and American Water and everybody else treated differently, because they use accelerated depreciation?
A. Yes.
Q. That's what --
A. Yes.
Q. -- your position is?
A. Yes. And so we have to normalize on that per IRS code.
Q. Okay. What, in your estimation, would be the reason why the Company would choose to not use accelerated depreciation? What's the benefit to them if we're now in this conflict over how to approach the taxes if they would get the same treatment -- well, let me back up. Would you treat them the same as the rest if they did use accelerated depreciation?
A. We would have to.
Q. You would have to. So then there

must be some benefit to the Company for them not using accelerated depreciation causing this departure from normal practice. What do you think that that benefit would be?

A. If they used accelerated depreciation their NOL would be even larger.

Q. Okay. And so then by that token, the effort, or the hope would be is that they could spread that NOL out longer and offset future revenues that might be greater as opposed to taking it up front when the revenues may not be as great to offset. Would they then lose that -- if they had to accelerate the depreciation would they lose that if they didn't have the revenue to offset it? Does that make sense? Let me give you an example.

A. Yeah.

Q. So if you had a hundred dollars and you were going to do ten years and you did ten dollars a year and you thought that in years seven, eight, and nine you're going to have revenue that that ten dollars is going to be able to be applied to but in year one and two you don't have that much revenue. But if you accelerated that hundred dollars into 80/20 in the first two years but you didn't have that revenue would you then lose the ability to apply that 80 dollars and that 20 dollars in year one and two in years six, seven, and eight when you might have the revenue to offset, is that a loss?

A. I think they would have the NOL they could apply still.

Q. Even if it was accelerated?

A. Even if it was accelerated, yes.

Q. Okay.

A. In rate making though they would have to offset rate base with that deferred income tax that is related to the accelerated depreciation.

Q. Okay.

A. So that would be an offset to rate base.

Q. Earlier we talked a little about other states and I know that we deal in our sandbox and the state laws that we have. But we also deal with precedents and the traditions of process that we also have. And you've indicated that this is a departure from that traditional process treatment that other companies have had because of accelerated depreciation, or whatever the cause is, we are now approaching -- or you have taken a position that is different than what would have been in their Staff assisted cases and how it's treated with the other companies as well. Is this the first time that you're aware of that we are approaching this tax in this way?

A. I don't know how we handled it before I started this -- in the '90s. I think there may be sometimes where we did flow-through possibly in the '70s and '80s, but...

Q. But since you've been here --

A. But since I've been here --

Q. -- this is the first time that this approach --

A. Yes.

Q. -- has been employed?

A. Yes.

Q. Deployed. Okay. So when we look at other states, when we had earlier testimony that said other states will book that net operating loss as an asset, have you had -- do you have any experience or have you seen that in practice or are you familiar with any studies that have to do with taking that approach and what the results are on rates?

A. No, I do not.

Q. No?

A. No.

Q. Do you -- given that concept, do you

believe that this Commission would have the ability to execute a concept like that or do you think that we would be confined by statute of not being able to book that as an asset?

A. I think you could do it if you wish to.

Q. You think we could do it?

A. Uh-huh.

Q. Do you agree that if you take the approach of deferring --

A. Now, on the asset, are you talking about when they buy a small distressed system?

Q. Yes. The time -- the time period that they're operating at a loss on distressed systems to the time that they come into a rate case, we were testified earlier that in other states they will be allowed to book that as an asset. So as a balance to the fact that now the taxes are going to be deferred into another account to be deployed later on, that would not pass through as what is being considered just profit right now. So it's sort of like -- is the way I understood it being explained in testimony it would be a balance between those two factors. And so I'm curious to get your opinion on whether you think that that is equal weight?

A. I don't think it is because to me the looking at the expenses in the past kind of gets into retroactive rate making.

Q. Uh-huh.

A. And that's prohibited.

Q. When we talk about incentives and we look at it in a macro sense like why would a company take over a small distressed system when they know that the revenues are not going to be there to justify the capital expense on improvements, why would they do that? Now, OPC has testified that they're going -- as soon as they get it rate based and they get caught up then they're going to have their rate of return and they're going to make money on that once it's folded in --

A. Uh-huh.

Q. -- and that's why they would do it. But in the period of time between -- we heard yesterday in opening statements, we looked at how long -- I asked the question how long does it take to make these investments and one answer was, well, in the first 50 days we could potentially make an investment to improve water quality but most of the time it takes a year before the investment has, you know, fully been made to get that system back to, you know, at least DNA certifiable or, you know, healthy.

A. Uh-huh.

Q. So we know that there's going to be lag. And OPC said, well, you can't factor in regulatory lag in this. But as a company that's relying on return on investment those investors are figuring in the lag portion of it and the taxes are clearly a part of that forecast into why would I take over this system. Now, we have DNR, who's on record in an exhibit saying we're thankful that a company like Confluence is out there buying these small systems and refurbishing them and bringing them back up to code. So earlier Staff suggested that if taxes aren't the place to do that, you know, perhaps a larger ROE or in that portion of it you could make it -- this Commission has the ability to make it more incentivized to do that.

In your opinion, do you agree with the statement the Staff has made that taxes here -- because again, this is a departure from your statement of how it's normally treated. So you're treating them separately because of the NOL. Do you think that ROE would be the place to create an incentive to rescue distressed systems?

A. Many times when they buy these

systems they pay underneath the book value and then they get book value later on so they're paying less. So there is incentive there.

Q. Uh-huh.

A. I'm not a fan of this one but we do have a rule making that allows you to increase the ROR or do a debt acquisition adjustment to incentivize companies to buy small systems.

Q. Okay. Earlier testimony said that if the taxing -- that the way that we're approaching the taxing would be a disincentive for that. Do you agree that for the State of Missouri to treat the acquisitions of distressed systems in a manner that factors in NOL and that does not allow for that tax passthrough as we've been talking about, do you see that as a disincentive for investment in our state?

A. I'm not sure I do.

Q. No?

A. Uh-uh.

Q. Okay. My last question. From a macro perspective, you have said that other companies have potentially acquired distressed systems. You cited Orrick as an example?

A. Missouri American, yes. I think it was.

Q. We're not 100 percent sure?
A. Yeah.
Q. But that's the only one that came to your mind that has done. What percentage of systems are left out there right now that you're aware of that would fall into this category of being distressed, how many systems -- do we know how many systems there are in the entire state?
A. I don't know that number.
Q. Don't know that number?
A. That would be better addressed to Mr. Gaitley.
Q. Okay. So would it also be the question of what percentage of them are distressed left out there that need rescuing?
A. Yes.
Q. Okay. All right. Thank you very much.
COMMISSIONER HOLSMAN: Thank you, Judge.
JUDGE HATCHER: Any other Commissioner questions? Okay. Ms. Bolin, the Bench does have a few more questions.
EXAMINATION CONDUCTED
BY: JUDGE HATCHER
Q. First, I want to pick up on something

that Mr. Woodsmall had mentioned and Mr. Thies had mentioned. And I think it was glossed over a little bit. I want to talk about the carrying costs of the loss. The question that I heard asked previously was was there any carrying cost on the net operating loss. I would like to try and drill down into a little bit more detail. Are there carrying costs on the expenditures of the company -- yeah. Are there carrying costs on the expenditures?

A. There's always carrying costs on expenditures.

Q. Do you have any knowledge on how the Commission has historically viewed those carrying costs?

A. Through the CWC, the cash working capital.

Q. Okay. Do the NOL amount totals and total taxable income change depending on whether a consolidated tax return is filed for Confluence Rivers or multiple holding company tax returns are filed?

A. That will not change for Confluence Rivers going forward, they will be able to utilize the full amount of NOLs for each of their utility holding companies, past utility holding companies.

They were all merged into Confluence River Utility Holding Company in 2021, I believe.
Q. Doesn't sound right.
A. Somewhere in there.
Q. Okay. Are you aware, in your history of being with the Commission, of Staff, are you aware of the Commission ever authorizing a deferred liability or a deferred asset for net operating losses when it's determining rate base?
A. We have had net operating losses that offset the ADIT but they were all -- we had to do that due to the fact that it was accelerated depreciation was driving the --
Q. Just to clarify. The references to accelerated depreciation, underlying that is federal law. So when a company is taking that federal law says the treatment is thus?
A. IRS, yes.
Q. It's not a distinguishment between Staff likes to treat it this way when it's accelerated depreciation and likes to treat it this other way when it's not, it's a citation to a federal law?
A. That we must normalize, yes.
Q. Okay. I don't know if this next

question is or should be amended because of the pending settlement regarding the rate districts that are -- just summarizing, the attorney statements were two and two. That's two water systems and two sewer systems.

How does Staff allocate the income tax expense between the rate districts it proposed -- so I think this is probably referring to the original proposal by Staff of four -- I think it was four water, five sewer. How was Staff proposing to divvy up the income expense in that scenario?

A. I did it based on the 2021 income tax returns that were separated by each utility holding company. Now, if -- if two of the utility holding companies were merged then that amount was merged together. Say one had taxable income that wasn't offset by an NOL and one did not, the amount would be the same. It would be one merged amount. But going forward this company will file one income tax return.

Q. Are there other reasons -- besides the accelerated depreciation example, are there other reasons the Staff is recommending the flow-through method in this rate case?

A. When we look at the NOLs that they'll be able to utilize they will not be paying income tax expense for several years.

Q. Excellent. And that brought up -- I want to clarify that. You've said several just now, --

A. Uh-huh.

Q. -- in response to Chairman's question you said a couple. And by my non tax mind brain we were talking about a totally whole numbers, around a nine million dollar loss, something around a million dollar income. So just off the top of my head I'm thinking at least nine years. And I know that -- I know that that is impossible to put a definitive -- even a formula to apply to it. In your professional expert opinion, what do you think that longevity is? Because I'm having a problem reconciling two years and almost a decade.

A. In the data response to the Company -- from the data response to Staff from the Company, the Company has calculated that they believe the balance of net operating loss could potentially last for six or more tax years. They also answered us that they will have taxable losses in 2023 so that would increase the NOL and then they will have projected taxable income in 2024. That is their projection.

We don't know. It depends on the tax, you know, if they're going to pay taxes or not, it depends on the expenses they claim and the revenues they have.

Q. And the Company has a solution if that situation arises in six years to come in for a rate case?

A. Yes. They absolutely do.

Q. Okay. I'm going to reference your direct testimony on Page 5. That testimony gives an example of how the 80 percent NOL restriction from the Tax Cuts and Jobs Act would work leaving $10,000 of taxable income after applying $40,000 or 80 percent of a $50,000 net operating loss; is that correct?

A. That is correct.

Q. How is that example in agreement with your statement on the next page? That statement reads, "If there are enough NOLs to cover the taxable income Staff did not include any income tax in its cost of service."

A. That is -- I look at each individual utility holding company and if they had enough NOLs up to 2018 I applied it and it went zero. But if they had more taxable income than they had pre-2018 net operating losses then I applied the 80 percent to those amounts. So my -- our case does have about $31,000 worth of tax built into it to account for -- say Osage Water, if you'll look on Page 3 of my testimony, has no NOLs prior to 2018. So for that company I had to do the 80 percent for that. So I did build in an amount of tax for Osage Utility Operating Company.

Q. Wouldn't that always leave a remaining 20 percent of taxable income? I'm talking about that 80/20 percent split. Wouldn't there always be a 20 percent remainder similar to the $10,000 in the example on Page 5?

A. Once they exhaust any pre-2018, yes, they would. But total Company wise they have 1.9 million of pre-2019 net operating losses they can carryforward. And in this case taxable income is roughly a million dollars.

Q. Your surrebuttal testimony states that the Commission is not required to follow the Financial Accounting Standards, that's the FAS, and that is also what was introduced as Exhibit 215 by OPC. If Confluence booked deferred taxes and used accelerated depreciation for tax purposes would Staff recommend following Financial Accounting Standards for rate making purposes?

A. We don't have to follow them but we would include income tax in that case, if they had accelerated depreciation.

Q. Okay. I want to turn to Accounting Schedule 11. That was sponsored by you and was filed with Staff's rebuttal testimony?

A. I don't know if I have a copy of that with me.

Q. I'm trying to ask about Column E and the amount of $26,480 on Line 15, if that helps narrow things down. Otherwise let's all take a pause and we'll try and find that paperwork.

A. That is in the rebuttal?

Q. Yes.

A. Accounting Schedule?

Q. Accounting Schedule 11.

MR. CLIZER: I believe that we have a copy but it's marked on.

THE WITNESS: I have one just for Osage Utilities. I'm not sure if it's on rebuttal or not, a Schedule 11.

BY: JUDGE HATCHER

Q. Can you check Line 15, see if there's a number around 26,000 there?

A. Line 15?
Q. Yes.
A. No, there's not.
Q. Okay. That's not it.
A. And is that our combined accounting schedules or is that a certain individual one? If I can get on this computer -- I don't know if I can or not.
Q. I'm going to wait for further information and hopefully any of those that are listening that can give me further information will do so. Let's move on to the next question. That one's on -- gosh darn it. All of the next questions are on this schedule.
A. I brought one little one.
Q. Yes. Yes. Go ahead and try and open the browser on the witness computer.
COMMISSIONER HOLSMAN: Judge, I'll have one more follow up when you're done. Maybe. Maybe, maybe, maybe.
MR. THOMPSON: Judge, do you know what it says on the cover sheet of the one you want? We have quite a few here for individual systems.
JUDGE HATCHER: My question reads Accounting Schedule 11, sponsored by witness Bolin --

THE WITNESS: You said it was --
JUDGE HATCHER: -- in rebuttal testimony.
BY: JUDGE HATCHER
Q. So I'm going to head to your -- to your rebuttal testimony first and then work my way out from there.
A. I have two different accounting schedules, consolidated and individual runs. What was the number you were looking for?
Q. I'm looking for $26,480. And it appears on Line 15.
A. I have it -- yes. I have it here on the screen.
Q. Excellent.
MR. WOODSMALL: Your Honor, I'm sorry to interrupt your flow. I don't have a copy of it. But could you try to identify it for the clarity of the record?
JUDGE HATCHER: Yes. Please.
BY: JUDGE HATCHER
Q. First tell me the EFIS number or the date?
A. Of course. We don't have a back button. It is EFIS Item Number 85. Filed on June 29th, 2023.

Q. Oh, and at the bottom right corner they are labeled accounting schedule by number. And I'm going to scroll down. Accounting Schedule 11 which shows as Sheet 12 of 14 in the edge, Adobe Reader.

THE WITNESS: Is that on the screen up there, Mike?

JUDGE HATCHER: Oh, excellent. We have it on screen. Thank you.

THE WITNESS: It's the combined accounting schedules.

JUDGE HATCHER: Thank you.

THE WITNESS: Confluence consolidated it says.

JUDGE HATCHER: Okay. We have Counsel caught up.

BY: JUDGE HATCHER

Q. My question is Column E. And to read that out loud it says 8.05 percent return. Line 15 in Column E reads 26,480. My question is how did -- can you explain how that amount was calculated?

A. That amount was calculated with me applying the pre-2018 NOLs to each utility holding operating company. And if there was additional tax return -- taxable income beyond the NOL amount I then had to figure out what tax they would pay based on the 80 percent. So that should be the federal tax of 26,480 that we are building into our case for federal income tax. If you go down further, Line 34 is the state income tax. We also applied the same methodology to that and then it gives a total of $31,051 for current income tax.

Q. To rephrase and to make sure that I understand it, you took the pre-2018 net operating losses, applied them to this systems too -- that incurred them if there was -- I'm sorry to the accountants, if there was extra NOL that could be applied you then went up to the holding company level?

A. I used it at the past holding company levels. Those were what the most current income tax returns I have. For 2022 they should be filing one but for 2021 and previous they filed several income tax returns.

Q. Okay. I am tracking now.

A. And then this program, our accounting schedule just adds everything together for the combined run.

Q. Okay.

JUDGE HATCHER: And my intent here is to

finish with Ms. Bolin, including cross, re-cross, and re-direct, and then take a break.

BY: JUDGE HATCHER

Q. If you go to Page 2 of Schedule 11, so just the next line down, Line 51, that is the final line, and it reads total federal income taxes.

A. We should probably not include that because we do not use -- are you talking about the tax? It's got tax rights? Yeah.

Q. Yes. Why that amount is not reflected in the cost of service?

A. Those amounts pre the Thies -- were the amounts that they would have been pre the Tax Cut and Job Acts. Now corporate income tax is a flat 21 percent and Governor Parsons passed a flat four percent for state. So this table, in our accounting schedules, you can't see it here, but we have the ability to say disregard that tax table. And we should probably do away with that tax table, to be real honest with you, it doesn't apply anymore. 'Cause we used to have a graduated 34 percent, 39 percent, and it's just a flat 21.

Q. Understood. My next question. If Staff calculated the Federal and Missouri State income tax without consideration of any NOL or net operating loss carryforward, so if you calculated Federal and State income tax for Confluence not counting any NOL or NOLC what would the tax amounts be using Column E of Schedule 11?

A. As I stated in my sur -- in my rebuttal -- surrebuttal testimony it would be approximately $264,793. That amount may change, you know, depending on the case, how the outcome of this case is.

Q. Staff's final reconciliation on Line 32, which reads, summary of current income tax, lists the value of income tax issued to be $447,099. Can you provide the Confluence amount and the Staff amount used to calculate the $447,099 figure?

A. That is a very complicated calculation. The -- we have different taxable amounts, income -- yeah. Total taxable amounts are different based on each case. It also impacts the ROE when you apply the tax factors. So there's very -- there's several different variables. I don't know that I can give you that calculation.

Q. Okay. And where is Staff's treatment of Confluence's net operating losses or NOLCs reflected on Schedule 11?

A. We could not reflect them on Schedule

11. I had to do that calculation in my work paper and then for each individual run I had to come up with the tax rate to get the tax amount that you would need to pay. So if you would open up the individual runs on here you would see some have tax rates and some don't.

Q. Okay. Thank you. Last question from the Bench then we have a follow-up Commissioner question, then we will hit re-cross, re-direct, and take a break. The differences between Confluence and Staff's income tax amounts result from both differences in net income before taxes, that's Line 1 on Schedule 11, and the treatment of NOLs, correct?

A. Correct.

Q. Are there other cost of service items that affect the income tax differences between Confluence and Staff?

A. Yes. When you apply it to the certain ROE, we have different ROEs. So that would also impact the tax difference.

Q. I do remember reading about that. Thank you, Ms. Bolin.

JUDGE HATCHER: Any Commissioner questions? Commissioner Holsman.

COMMISSIONER HOLSMAN: One quick follow

up.

EXAMINATION CONDUCTED
BY: COMMISSIONER HOLSMAN

Q. As I was sitting here and thinking about this, we've established that this is a departure --

A. Yes.

Q. -- from the way it's been done. And you had said that one of the reasons it was a departure was because the amount of the NOL was up there. Can you tell me a little bit about what that threshold would be that if a Staff assisted was going to say -- or it's a million dollars, it's five million dollars, or nine million dollars. Like what all of a sudden can the next company that comes in with distressed rate cases consider their NOL to be too high to get normal treatment?

A. We would have to look at what their taxable income is going to be for the next several years and look at the level of NOLs. Now, if it was going to expire within a year --

Q. So who ultimately makes that decision?

A. It would be the individual working that case or they would have to --

Q. So would you suggest that that number is an arbitrary number?
A. Yes, it is.
Q. Okay. Thank you.
JUDGE HATCHER: Thank you. Any other Commissioner questions? And we'll go to re-cross.
MR. CLIZER: Yes.
JUDGE HATCHER: I got to think through this. Mr. Clizer.
MR. CLIZER: Yeah.
EXAMINATION CONDUCTED
BY: MR. CLIZER
Q. Good afternoon, again.
A. Good afternoon.
Q. I'm going to bounce around a little bit. You were asked a question from the Bench regarding the Statement of Financial Accounting, do you recall that. There were a lot of questions, I know.
A. Yes, I think I recall that.
Q. And you were asked if you would include income tax if there was accelerated depreciation following the Statement of Financial Accounting, do you recall that?
A. Yes.

Q. And to clarify, you would include income tax if it was accelerated depreciation because the normalization rules of the IRS require to you do so, correct?
A. Yes, that is correct.
Q. It has nothing to do with following the Statement of Financial Accounting?
A. Yes. We do not have to follow.
Q. It is the IRS rules that are driving that?
A. You are correct.
Q. Now, let's talk about -- there were several times where this was referred to as a departure. Let's break that down. We have two different possibles I think in my mind, situations where there is accelerated depreciation and situations where there aren't accelerated depreciation. Let's talk about the situations where there are accelerated depreciation.
Now again, the IRS rules absolutely mandate that you use straight line depreciation in those situations, correct, for rate making purposes?
A. We have to normalize for rate making.
Q. You have to normalize for those?
A. Yes.

Q. That's set by U.S. federal law?
A. Yes.
Q. So this situation where there is no accelerated depreciation is completely disanalogous to that?
A. That's correct.
Q. It's an apples to oranges comparison?
A. That's correct.
Q. So to call it a departure from something that's completely different from this doesn't really make a whole lot of sense, wouldn't you agree?
A. It is not a -- those situations were different where they can use accelerated depreciation.
Q. So it's not a departure from those situations because those were different?
A. That is correct.
Q. So the past situations where they have not used accelerated depreciation, those would be Confluence's prior case, was that it?
A. That is -- they did not -- I am not aware of them using it in prior cases, no.
Q. In the prior Confluence case?
A. Right.

Q. Was there any other case?
A. They have been in for several rate cases for different utility holding companies.
Q. For each of those cases, was that a Staff assisted rate case?
A. Yes, they were.
Q. And a Staff assisted rate case requires the Staff to effectively perform a large degree of the functions of bringing a normal rate case on its own, correct?
A. That is correct.
Q. And you would agree with me that in those cases obviously there's a higher level of workload for the Staff, wouldn't you?
A. It is done in a shorter time period.
Q. So it's much more likely that something could get missed, correct?
A. Things can get missed in any case.
Q. And you would agree with me also that these small rate cases are going to have a much lower income tax amount, correct?
A. They should.
Q. They should. In this case we have a much larger income tax amount than what we see in those past cases, correct?

A. I don't have a direct comparison, I don't have the numbers in front of me.

Q. You would agree with me that if it was a large much larger income tax -- income tax expense the affect of the NOL issue on this case would be much more dramatic in this case than in prior cases?

A. If the amount was lower, the taxable income.

Q. And earlier you were kind of talking down this idea that if in the past it looked like the NOL was going to expire in only a few years you wouldn't have included it. Do you recall saying that?

A. That is correct.

Q. And the reason for that, if I'm -- I'm going to guess, and I want to see if I'm correct, is that because you assume what the Company's going to do -- you don't assume the Company's going to come in the next year for a rate case, right?

A. I hope they don't.

Q. So if they're going to lose the NOL after maybe one or two years you're going to say, well, they're not going to come in for a rate case in those one or two years so we're not going to include

the NOL in that situation, correct?
A. Yes.
Q. But that's not the situation here, correct?
A. They appear like they can -- per their own answer in the DR, they will not exhaust these for six years.
Q. And just to reaffirm, when we talk about -- there was a question from the Bench, are there other reasons why the flow-through. Is it correct to understand that the central reason from Staff is that this amount constitutes free money for the Company, correct?
A. That is correct.
Q. And to the extent that we're including this to incentivize what that means is that Confluence's current customers are being expected to front free money to the Company in order to encourage the Company's continued expansion in Missouri?
A. That is -- yes.
Q. But if Confluence continues to expand and it takes those new systems at their existing rates the new customers won't be funding that continued expansion, correct?
A. Could you repeat that question?

Q. If Confluence buys a new system and it takes -- or sorry, it acquires a system and allows the rates that are in effect to in essence continue, those new customers will not be paying the free money generated by these rates?

A. If they -- if Confluence adopts the current rates the Company is charging, that is correct.

Q. If Confluence adopts the current rates of the company it's acquiring?

A. Acquiring, yes.

Q. Correct. So those customers won't be paying for the expansion but the current customers will be forced to pay for the expansion?

A. They will be paying income taxes, yes.

Q. They will be paying income tax expense that's not being remitted?

A. It is not being paid, correct.

Q. They will be paying the phantom tax you referred to?

A. Yes.

Q. Just one last thing. I know there's been discussion of, I think, exhausting the net operating loss -- actually I take that back, it's not going to be one last thing, sorry. I'll make it quick though. A company wants to use every availability to reduce its income tax each year, right?

A. One would hope, yes.

Q. You would agree that it would be imprudent for a company to not use an available deduction to reduce its income tax expense, correct?

A. Yes.

Q. To your knowledge, are there any other incentive mechanisms in place to encourage customers to -- sorry, not customers, companies to acquire distressed systems in the state?

A. I referred to the one rule we have.

Q. Are you familiar with the statute that allows companies to acquire distressed systems to take it at the value that an appraiser appraises it at?

A. I'm aware of the statute that allows a large utility to purchase a smaller utility using the appraisals value.

Q. I think that's all my questions. Thank you.

JUDGE HATCHER: Mr. Woodsmall.

MR. WOODSMALL: Thank you. I'll be brief, I hope.

EXAMINATION CONDUCTED

BY: MR. WOODSMALL

Q. You had some questions from Commissioner Holsman and he was asking why would any company come in and acquire. And you made the statement that there are times where Staff will allow a rate base associated with net book value that's greater than purchase price?

A. Yes.

Q. Do you recall that?

A. We always use net book value for the purchase.

Q. Even --

A. For the company.

Q. Okay. So if the company buys a distressed system for one dollar and it has a net book value of a thousand dollars you always use that thousand dollars?

A. We always use original cost.

Q. Okay. Just to clarify. Because -- I think you clarified it but the Bench's question may be different. I believe the question from the Judge said something like federal law dictates accelerated depreciation, do you recall that?

A. Dictates accelerated depreciation?
Q. I thought that was the question. I think you're going to clarify. Go ahead.
A. Yeah. It dictates that if you utilize accelerated depreciation we have to normalize taxes.
Q. Okay. And accelerated depreciation is an election by the company; is that correct?
A. That is correct.
Q. Okay. So there's nothing saying that anybody has to use accelerated depreciation in any particular time?
A. Correct.
Q. Okay. That clarified that. And to your knowledge, the Company, or any of its predecessor companies, they have never used accelerated depreciation?
A. Per the tax returns that I looked at, no.
Q. Okay. Lot of talk about the Staff's position here is a change from its position in the Staff assisted rate cases, do you recall that?
A. Yes, I do.
Q. Did -- after the last Staff assisted rate case, when the Company kept acquiring systems,

did you ever indicate to the Company, you guys might want to consider this, we're going to change our mind?

A. No, we did not.

Q. Okay.

A. This is something we discovered in this case.

Q. Okay. Do you understand the concept of regulatory certainty?

A. I've heard of it.

Q. Okay. Would you believe that at least for this company this introduces an element of regulatory uncertainty?

A. I'm not sure if it does for this company or not. I don't speak for the Company.

Q. Okay. There was some discussion about free money from Mr. Clizer. But earlier you said everything has a carrying cost?

A. I think I meant with expenses we measure a carrying cost through the cash working capital. If you have to pay up your expenses ahead of time then you -- the Company -- they pay -- before they get the revenue then we build that into rate base and they get a return on cash working capital.

Q. Okay. But that cash working capital

element never considers the operating losses that occur after rates are set; is that correct? It only changes going forward?
A. That is correct.
Q. So carrying costs on these past losses -- or let's say we acquire system X tomorrow and we start incurring cash losses, operating losses. There are carrying costs on that in reality, isn't there?
A. The --
Q. Money's not free?
A. The amounts that you book in your income tax return may not be the same that we would consider just and reasonable and prudent rates for the rate case.
Q. You establish cash working capital --
A. Going --
Q. -- forward looking; is that correct?
A. That is correct.
Q. So to the extent that tomorrow we make an acquisition and start having operating losses, there is no consideration of carrying costs for those operating losses?
A. That's retroactive rate making.
Q. Okay. But even going forward, you

don't say, wow, you're giving authority to acquire X, Y, Z system, going forward you can apply carrying costs for the losses, you don't do that?
A. We do not do that, no.
Q. Okay. So -- but there are -- to the Company there's a cost to that, would you agree?
A. Possibly to the company, yes.
Q. Okay. And there are carrying costs for other elements. Would you agree that when a utility builds a power plant you give what's called construction costs to carry that entity forward to the rate case to account for the cost of that capital that they've invested?
A. What do you mean by construction cost?
Q. Construction accounting.
A. We apply a rate -- a debt rate to the construction amounts for the amounts they have to expend.
Q. Okay. And so even though rates have been set, they come in and build a power plant, you give a carrying cost of some degree to account outside of rates for the carrying cost on that investment?
A. On the plant. But we don't on their

expenses. If they have more expenses we don't -- we don't apply a carrying cost to that.

Q. But you acknowledge that there is a cost for that money that the Company's invested that they're not getting in rates?

A. They get it through their equity and through their cost of debt.

Q. Did you -- or will you be willing to apply a debt carrying cost going forward for the net operating losses we incur after this case?

A. No.

Q. Okay. No further questions. Thank you.

JUDGE HATCHER: Thank you, Mr. Woodsmall. We will be in recess until 3:40. That gives everyone 20 minutes. Ms. Bolin, thank you for your testimony, you are --

THE WITNESS: Are we going to do re-cross, re-direct?

MR. THOMPSON: Yeah. We get re-direct, right?

JUDGE HATCHER: Oh, gosh.

MR. THOMPSON: 'Cause I have a few questions.

THE WITNESS: Sorry.

JUDGE HATCHER: No, no, no. Judge's error. My apologies. Let's do re-direct. Thank you. Mr. Thompson, you're up.

MR. THOMPSON: Thank you, Judge.

EXAMINATION CONDUCTED

BY: MR. THOMPSON

Q. First of all, Ms. Bolin, you were asked by Ms. Clizer about Staff's alternative. Now, did Staff make an alternative suggestion in case the Commission decided to go with the Company's treatment of income tax?

A. Yes.

Q. And could you briefly describe that suggestion?

A. The suggestion would be if the Commission decided to go with their income tax that the difference between what was built into rates and what they actually paid would be an offset in future rate cases in rate base.

Q. So it would lower rate base in future cases?

A. It would lower rate base in the return the Company would receive.

Q. And that would recognize, would it, the fact that this was capital provided to the

Company by the ratepayers?
A. Yes.
Q. And would the ratepayers get interest on that money?
A. No, they would not.
Q. For example, ratepayers often pay an amount of money to the Company up front as security for their payments on their service, right, and the Company holds that money for a certain time; isn't that correct?
A. Customer deposits.
Q. Customer deposits?
A. Yes.
Q. Thank you. And do customers -- is that a reduction to rate base?
A. That is reduction to rate base. But we also build in the expense level that the Company will have to pay the ratepayers in as an expense level on those deposits.
Q. Right. So the Company pays interest to the ratepayers on that, don't they?
A. They do.
Q. Okay. And the ratepayers do get it back at some point in the future?
A. Yes. If they pay promptly and pay

their bills, yes.

Q. Okay. Now, let's compare that to the alternative that Staff has suggested here in the event that the Company gets the income tax treatment that it wants. Would the ratepayers ever get that money back?

A. Eventually when the Company has taxable income that amount would lower but I don't believe -- could you rephrase that question?

Q. Well, maybe I can come at it this way. The amount of money given to the Company in excess of the income taxes they are actually going to remit, will that money ever be given to the IRS? In other words, if their income taxes in the absence of NOLs was going to be a million dollars a year let's say, and with the NOLs it would be $100,000 a year so that they -- if you build that into rates they'd be getting $900,000 a year in excess of what they remit, right? Isn't that the situation we're facing here although --

A. Yes.

Q. -- I know the numbers are different? Would that money ever be remitted to the IRS?

A. I'm not sure.

Q. You're not sure. Okay. So if they

have a tax liability for tax year 2023 and they have sufficient NOLs to offset 80 percent of that taxable income, so they're only going to pay taxes on 20 percent of that income, correct?
A. Correct.
Q. And if they receive money in rates that covers 100 percent of the tax liability on that income, in other words the 80 percent they're not going to pay, would they ever pay that to the IRS or would that just be free money in their pocket?
A. That would be free money in their pocket.
Q. Okay. Free money in their pocket. IRS doesn't get it. Do the customers ever get it back?
A. The only way possibly under the scenario would be if they pay more income taxes than what we built into rates we would reduce that rate base item.
Q. I see. Okay. So Staff's alternative, while providing some sort of mitigation to the ratepayers, in fact does not make them whole?
A. That is correct.
Q. Okay. NOLs in carrying costs. In fact there are no carrying costs on net operating

losses, are there?

A. Not on a net operating loss.

Q. Okay. And if a company was attempting to recover some kind of carrying costs on operating losses from a prior year, would that violate the prohibition on retroactive rate making?

MR. WOODSMALL: Object, your Honor. Legal conclusion.

BY: MR. THOMPSON

Q. To the extent that you understand it as an accountant, would that violate the prohibition on retroactive rate making?

A. Yes.

Q. Now, I think some of the Commissioners have been troubled to hear that the way Staff proposes to treat income taxes in this case is different than the way Staff has treated income taxes in the Staff assisted rate cases that CSWR has brought in the past, okay. Remember those questions?

A. Yes.

Q. Okay. And can you tell me, is there an underlying policy that has driven the different treatment that Staff has taken in the two different kinds of cases?

A. What do you mean by policy?

Q. Well, in other words, when -- when you gave a particular income tax treatment in the Staff assisted rate cases, what drove that decision, was it that the amount was insignificant, was it a concern?

MR. WOODSMALL: Your Honor, he's leading the question -- the witness now. If he wants to ask the question, lead the question.

BY: MR. THOMPSON

Q. Answer, if you can.

A. I don't know that we considered that the NOLs would have caused an impact of them not paying income taxes in prior cases.

Q. Okay. And those Staff assisted cases, would you agree that those were distressed companies?

A. I don't know that they were all distressed companies, no. These were companies that Confluence Rivers owns right now.

Q. Okay.

A. Now, if you're talking about other small assisted cases, some of those companies are stressed.

Q. I'm just --

MR. THOMPSON: That's all the questions I have, Judge.

JUDGE HATCHER: Thank you. We are now at recess until 3:45. 3:45. That is 16 minutes. We will reconvene with witness -- OPC witness Riley. And then, depending on the time and because of the light issue schedule and because today is Friday, I think that will conclude today's --

MR. CLIZER: Hearing.

JUDGE HATCHER: -- evidence testimony. Picture synonym.

MR. THOMPSON: Should we be ready to go with the other two issues for today on Monday?

JUDGE HATCHER: That's what I'm thinking. And I'm speaking out loud to give everybody kind of the heads up and make sure that that complies with everybody's plan.

Ms. Bolin, I just want to remind you that acquisition related costs, the Company is likely to have questions on that and that would be Monday unless the parties all confer and rearrange that. We're at recess until 3:45. Off the record. Thank you.

(At this point in the proceedings, a short recess was taken.)

JUDGE HATCHER: Let's go back on the

record. I apologize for the delay. First, a quick announcement. Monday morning, ten a.m.

MR. THOMPSON: Ten a.m.?

JUDGE HATCHER: Ten a.m. We have a lot of travel that will be accomplished on Monday morning and that makes it much easier for all of us to do that.

We have a witness. We are on the issue of income taxes. I do intend for this to be the last issue, the last witness for Friday.

Mr. Riley, R-I-L-E-Y, please raise your hand and be sworn in.

* * * * *

JOHN RILEY,

The witness, having been first duly sworn upon his oath, testified as follows:

* * * * *

JUDGE HATCHER: Thank you. Please take a seat. And Mr. Clizer.

EXAMINATION CONDUCTED

BY: MR. CLIZER

Q. Since you've already -- well, let's start at the beginning. Can you state your name for the record?

A. John Riley, R-I-L-E-Y.

Q. And have you prepared or caused to be prepared your surrebuttal testimony which has been pre-marked as OPC Exhibit 203?

A. Yes, sir.

Q. Are the answers -- are the questions and answers contained therein true and correct to the best of your knowledge and belief?

A. Yes, they are.

Q. If I were to ask you those same questions today, would your answers be the same or substantially similar?

A. Yes, sir.

MR. CLIZER: I move to admit OPC Exhibit 203, surrebuttal testimony of John S. Riley.

JUDGE HATCHER: You've heard the motion. Are there any objections to the admission of Exhibit 203? Hearing none, it is so admitted.

MR. CLIZER: I tender the witness for cross-examination.

JUDGE HATCHER: Witness is tendered. Oh, I need a hand. Who is -- Mr. Thompson. Thank you guys.

MR. THOMPSON: No questions. Thank you, Judge.

MR. WOODSMALL: No questions, your Honor.

JUDGE HATCHER: Okay. Any Commissioner questions for Mr. Riley?

COMMISSIONER HOLSMAN: No questions, Judge.

JUDGE HATCHER: No. Go ahead.

EXAMINATION CONDUCTED

BY: CHAIRMAN RUPP

Q. Are you a CPA?

A. Yes, sir.

Q. You're a great American.

MR. WOODSMALL: Mr. Thies is.

EXAMINATION CONDUCTED

BY: JUDGE HATCHER

Q. I would like you to respond to Mr. Seltzer's rebuttal testimony Page 5. I'm just going to read you the quote. "However, when those net operating losses are limited or are no longer utilized against future income a deferred tax liability inherent in the NOLs will become due, demonstrating that they are temporary not permanent differences, parentheses, also referred to as, quote, tax timing differences, end quote, end parentheses, period." Mr. Riley, can you respond to that, please?

A. Well, I don't believe there's -- your net operating losses carryforward now forever. So there would never be a deferred tax liability associated.

Q. I need to interrupt here. I've had this discussion in a prior case with your counsel. I have a problem with the use of the word never. Can you clarify and give me either a time estimate, whether it be in decades or centuries or years. But I find the idea of never to be hard to implement from the regulatory standpoint.

A. Okay. Sure. The net operating loss prior to the TCJA was a 20 year time limit. When they changed the tax laws they removed the 20 year limit. So not using the word never, it is -- it will go on as long as -- until the next tax law change.

Q. I didn't need clarification on the statute. We're talking about Confluence and how long will their -- the statement --

A. Oh.

Q. -- in non-accountant's terms -- as I understand Mr. Seltzer's testimony, in non-accountant terms I understand his testimony to say we're probably going to have to pay taxes at some point and this income tax expense will go to pay that once we get there. That's where I'm distinguishing the never. So how long is reasonable, do you think, to have a -- to not include the full income tax expense that they're requesting?

A. Okay. Now, with Ms. Bolin's testimony and the answer to a data request they would -- they estimate they will start paying income tax again in six or seven years. Now, what happens with this net operating loss, through those six years, is as they make -- as they create income, net taxable income, the net operating losses will be applied to that. So absent the 20 percent limit the net operating losses, which were created, you know, years ago, will be applied to that so they will not have to pay that income tax. So that expense doesn't exist absent the 20 percent. But that -- that expense doesn't exist.

So if you're going to include, if I get -- if I'm understanding this correctly. If you're going to include -- or he would like to include the income tax expense in the rate case. The income tax expense will already be paid by the losses -- by finally using the losses. So in essence, to include income tax expense that doesn't exist is -- it's free money to them. They don't need the income tax expense in order to pay the income tax in future years because that's what the net operating losses will do, they will offset taxable income to a point of no income tax absent the 20 percent. But -- that answer the question?

Q.   If I understood Staff's recommendation, or alternative recommendation, they were suggesting keeping track of the money, in terrible non-accountant terms, to ensure that by the next rate case there would be some sort of a true up such that the Staff would then be looking at how much income taxes they are paying and how much they have collected and are in this account up until then. Was that your understanding of their alternate recommendation?

A.   I think their recommendation was in line which what I had suggested that you would offset the net operating -- the income tax expense, which I'm contending is not needed to be paid. And if you include an income tax expense there should be some sort of offset on the books which would be a deferred tax liability because you're providing money -- you would be providing money that would not go to the IRS. And in that instance, typically in a rate -- in rate making is we would consider that accumulated deferred income tax. However, as we stated in testimony, this income tax will never be paid.

But if you're going to give them money to pay income tax you would -- you should -- and they aren't going to pay income tax then you should offset that with some sort of deferred liability. You could call it a deferred tax liability but it's a liability that should -- because it falls in line with the idea of an interest free loan. And so you would -- you would offset rate base in order to provide the ratepayer with a return on their loan.

Q. Do you know if the revenues generated by rates led to Confluence's net operating loss because revenues weren't enough to cover expenses?

A. Well, that's my understanding that -- I mean, the loss that Confluence has incurred, as I said in testimony, is an honest to goodness lack of revenue, too much expenses, no income tax -- income tax specific, you know, that -- how do I say it? It's not generated by any income tax statute, they actually did not have enough revenues to cover their expenses. It's an honest to goodness financial loss, not just an income tax loss. In this case they're both the same, your income tax loss, your financial tax -- your financial loss are the same. There's no specific tax provision that caused the losses.

Q. So to my question, do you know if

revenue's generated led to the operating loss, I'm hearing yes?

A. Yes.

Q. Okay.

JUDGE HATCHER: Thank you. I do have Commissioner questions, we're going to circle back around. Commissioner Holsman.

EXAMINATION CONDUCTED

BY: COMMISSIONER HOLSMAN

Q. In this alternative plan, help me understand. So potentially the Company would receive the money that they would otherwise be taking as taxes but they wouldn't be able to pocket it, as has been earlier suggested, but they would be able to deploy it almost like a no interest loan and then when they came back in for a rate case at some point then that would offset what they could come in for at that point so it would lower -- it would potentially lower rates in the future in a future rate case but that money would flow-through and be available for deployment now, from the time that this case ends until the next rate case, am I understanding that correctly?

A. Well, the suggested alternative of applying -- of creating an income tax liability account would lower rate base and therefore would reduce revenue requirement going forward in the next rate case. The income tax expense built into rates now would be available for the Company to use going forward. But if -- and they essentially would not have to pay it back. So in the future you would have lower rates due to the offsetting with deferred tax liability. But they would -- they would have the income tax expense to use at their discretion.

Q. Okay. So the way -- so the way I understand what you're explaining is that Staff's position is two options. One option is to disallow the taxes and say the net operating loss basically zeros out any requirement for them to remit taxes to the IRS, therefore they're not going to include it in any of the rate base. Second option is is go ahead and include it in the rate base, let them collect what otherwise would have been the taxes had they been treated the same as previous rate cases or in the small Staff assisted rate cases but they would not be able to pocket that money as profit, it would be accounted for.

Is there -- you know, a deferred liability I assume has some sort of accounting mechanism to track it to see where that money goes. Would that money be placed into an account that would be separate and wholly from existing accounts that are there today? Tell me how you would envision the funds, once it's being collected from the rate base, being set aside for deployment by the Company until their next rate case?

A. Well, it wouldn't be set aside. They would be able to use it as it, you know, theoretically comes in.

Q. It would be tracked then?

A. Excuse me?

Q. It would be tracked then?

A. No.

Q. How would we know how much that produced -- how much revenue that produced from the time that it's approved until the time they come back in for their next rate case?

A. Well, Staff -- Staff accounting schedules are fairly accurate and I would say that the income tax expense, or any expense for that matter, isn't going to fluctuate very much through the three or four years of rates here. So as the money comes in they can use it as they choose. The liability account is a bookkeeping feature that you set aside a dollar figure to offset rate base in

order to reflect the ratepayers interest free loan.
Q. Right. Their contribution?
A. Yeah. I mean, because that's --
Q. And that would be applied to the next rate case, correct?
A. Yes.
Q. Whatever that value was --
A. Yes.
Q. -- would then be applied? And so one of the things that we heard in earlier testimony was that there was no notice given to the Company that this change was going -- and OPC wanted to argue that it wasn't a departure but it was a material change in process approach from the way things had been done, rather it was appreciated -- appreciated -- or accelerated depreciation or not, whether it was federally required or not, the way that it has been treated and applied is now different. So to me that is a departure from the way that the Company had previously gone through rate cases, small Staff assisted, all the arbitrary reasonings for why that's the case, now it's different. And there was no notice given that it was going to be different. Would you agree with that -- that testimony?
A. Well, it may be a departure for

Staff. I don't -- there's a legal -- as we've gone through, there's a legal definite -- definitive act with the IRS and accumulated deferred income tax. However, to be honest with you it would not be a departure on how I treat it. I would never have -- I would always try and reduce taxes down to what they actually are.
Q. Okay.
A. I think that's the way it should always be. Now, I don't have all that much experience with small water cases so, I mean, if somebody was to say, well, John, it's --
Q. But it was testimony earlier that it was based on the individual conducting that case and it was also testified that it was an arbitrary amount that triggered a change in direction for how it was going to be applied. And it was also testified that the Company was not given any notice that this was going to occur. So would it be -- would it be fair to say that the alternative proposal that Staff has proposed by allowing for those taxes to be collected but then not be pocketed as profit but to be applied towards reducing rates in the future would be an approach that gives the Company at least a middle ground in the shift in how it's being treated in

terms of towards the property tax -- or towards the income taxes, would that be fair that it's a transitional -- that the alternative approach that Staff is recommending is a transitional approach versus just a denial or a disallowance?

A. I'm not quite sure I would characterize it as fair or unfair. As you said earlier, you said, you know, we're in this sandbox and we have this regulatory framework. And I -- like I said, this idea is not a departure from what I would have argued, it would be the same as it is now. The Company has been buying and -- they've been expanding and buying small water companies for several years now and now they're large enough that they are considered, instead of small water company where Staff is assisting, they're now big enough to play with the big boys. You know, they've got all these lawyers out here, you know.

Q. But in any large case prior to this with any other company, have the taxes been treated in this way?

A. Well, --

Q. I think we heard earlier --

A. -- this actually hasn't really occurred before because there isn't an IRS mandate to calculate taxes that way.

Q. Would you consider the change to be regulatory certainty or regulatory uncertainty?

A. There's -- I'm not really sure if I would -- not really sure I could answer that question now that I've listened to the testimony. There's several different ways to handle the -- this rate case. So I -- I know that you're looking at it as a change from what Staff has done in the past but however the -- I don't -- I don't see it as a --

Q. So if -- if the second option that Staff has proposed --

A. Yeah.

Q. -- would be adopted, the Company would be able to collect those funds and deploy them as like a no interest loan?

A. Uh-huh.

Q. But the accounting result of tracking that would result in potentially lower rates in the future when they come in for the next rate case; is that accurate?

A. That's a possibility, yes.

Q. All right. Thank you.

COMMISSIONER HOLSMAN: Thank you, Judge.

JUDGE HATCHER: Thank you, Commissioner.

Are there any other Commissioner questions? That'll take us to re-cross examination and I believe that starts with Mr. Thompson.

MR. THOMPSON: Thank you, Judge.

EXAMINATION CONDUCTED

BY: MR. THOMPSON

Q. Just to follow up on the questions that Commissioner Holsman was asking you. And you agreed that Staff's alternative might lead to lower rates in the future, do you recall that?

A. Yes, sir.

Q. But wouldn't you agree that treating income taxes the way Staff has urged in this case would lead to lower rates right now?

A. Yes, sir.

Q. Thank you. No further questions.

JUDGE HATCHER: Thank you. Mr. Woodsmall.

MR. WOODSMALL: Yeah.

EXAMINATION CONDUCTED

BY: MR. WOODSMALL

Q. I'm trying to get at this notion of regulatory certainty and you said, well, Staff changed its position. You don't believe Public Counsel has changed its position; is that correct?

A. I don't think I would have, no.

Q. Okay. How long have you been with Public Counsel?

A. First or second time?

Q. The most recent time.

A. I started in 2016.

Q. Okay. So there's been a number of Confluence Rivers' rate cases since that time; is that correct?

A. I'm going to take your word for it, yes, but --

Q. Okay. We heard something about 20 -- 2020, 2018. Now the way a small Staff assisted rate case works, and correct me where I go astray, is Staff will ask for the information and then they will put together a revenue requirement. But that's not binding on Public Counsel, is it?

A. I wouldn't think it is. I didn't work on small water cases.

Q. But Public Counsel could then inquire and object about that, the number that Staff comes out with; is that correct?

A. I'm sure they have.

Q. Okay. So if Staff had not used these net operating losses in the past you had the opportunity to come in object and say that's not the way to do it; is that correct? You had the opportunity --

A. They had that opportunity, yes.

Q. Did you ever take that opportunity?

A. I did not work on a Confluence case.

Q. Okay. So even though Public Counsel had that opportunity, did it ever notice the Company, hey, this is not the way we're going to do it?

A. I'm not really sure of the answer there.

Q. You're not aware that you ever did it?

A. Not aware.

Q. Okay. Let's try and get at the real crux of this argument. And I'm a little slow on the uptake on some technical type issues. But it seems to me what I'm seeing is Staff and Public Counsel keep saying that if you give them taxes -- if you give them money and rates for taxes when they don't pay taxes that that's a gift. Is that essentially what it boils down to?

A. It's -- it's free money. I mean, it's -- yeah.

Q. Okay. Let's spin that around. Try and look at it from the Company perspective here. If the Company covers net operating losses when rates aren't sufficient, isn't that a gift to the ratepayers, to the customers?

A. I'm not quite sure I would call it a gift. It's within your business model so I'm -- you know, you want to call that a gift to the ratepayer.

Q. We don't ever get compensated for that because you keep saying retroactive rate making so we never recover that; is that correct?

A. That's incorrect.

Q. So when would we recover that?

A. You recover that when you start making a profit and you don't have to pay income tax with the -- because the net operating loss would be used.

Q. Great point. So let's inquire into that. We haven't had a net profit for eight years?

A. Yeah.

Q. We're not likely to have a net profit for another eight years. There is a cost of money, whatever that cost is. So we're going to go 16 years with that cost of money and we're never going to get it; is that correct?

A. That's not correct.

Q. Where will we get that cost of money?

A. Well, this is your business model.
Q. That's not my question.
A. Well, you were talking about certainty. And you knew -- or the Company knew when they got into this business that they were going to -- they were going to incur some losses. So how they planned on recouping those losses, I'm not really sure other than if they thought they were going to get income tax expense that they were never going to spend on income taxes, if that was going to be the way they were going to fund everything and then to apply a net operating loss, I mean, that's kind of double dipping.
Q. But --
A. That's how you would get it back.
Q. You're not going to give any recognition for the carrying cost of those losses that we incurred 16 years ago before we had a profit?
A. No.
Q. Okay. That's all the questions I have. Thank you.
JUDGE HATCHER: Mr. Clizer.
MR. CLIZER: I'll try and make it relatively quick.
EXAMINATION CONDUCTED

BY: MR. CLIZER

Q. Let's start with Mr. Woodsmall's second round of cross, whatever that's called, re-cross, that's the word. The Company made a choice to acquire these systems at the existing rates, right?

A. Yes, sir.

Q. No one forced them to?

A. No.

Q. Why did they do that?

A. You know, it's something -- it must be something in their business model to -- they see an opportunity to make money down -- you know, down the road, so...

Q. Now they have to file a CCN to acquire a system, right?

A. Yes.

Q. Does that CCN require you to consider all of the rate impacts?

A. I'm not really sure of all the particulars in that. But I heard testimony today that they could file -- they could ask for rate impact during the CCN but they haven't chose to.

Q. Would the CCN application consideration change considerably if we knew that the

Company was going to attempt to retroactively claw back money?

A. I guess it would then.

Q. And you would agree -- well, what is retroactive rate making?

MR. WOODSMALL: Your Honor, I object, legal conclusion.

BY: MR. CLIZER

Q. What is your understanding as an accountant of the term retroactive rate making as it is used in this case?

A. Retroactive rate making would be an effort to include present rates for past expenses that weren't included in rates earlier.

Q. So is any attempt by the Company to claw back money because it didn't have enough from the rates that were in existence when it required the system that would constitute retroactive rate making?

A. Yes, I believe it would.

Q. I want to turn to questions you received from Mr. Holsman. And I'm not going to touch on departures, differences, any of that. I just want to drill home exactly what the representation is. First of all, there was a lot of talk about Staff's representation. Now, you basically made the same recommendation in your surrebuttal, right?

A. Yes, sir.

Q. Okay. And am I -- that recommendation would be if they're going to normalize -- sorry. If the Commission's going to order normalization you need to book the tax expenses that aren't remitted to the IRS to some kind of tax deferral account or some kind of deferred liability account?

A. Yes, sir.

Q. And would your opinion -- how would that deferred liability account effect rate base in the future?

A. Well, deferred liabilities are an offset to, you know, the calculated rate base and of course it's rate base rate of return. So it has -- it would effect the revenue requirement by the rate of return times rate -- times the deferred liability.

Q. And treating the deferred liability in that manner would be consistent with how deferred liabilities have always been treated by the Commission?

A. As best I understand, yes.

Q. It would be consistent with how the

Commission treats ADIT, for example?

A. Exactly.

Q. So that proposal is in essence exactly equivalent to how the Commission is currently treating ADIT?

A. Yes, sir.

Q. There was a question regarding whether the revenue generated by the systems acquired I think generated the NOL. Just at a high level what is an NOL, can you define it?

A. A net operating loss is basically revenues less expenses equals your -- in this case your financial income. And the revenues are not enough to cover all the expenses.

Q. So it's not really revenues ever generate the NOL it's expenses generate the NOL?

A. That's probably a better way to look at it, yes.

Q. All right. The Judge's first question to you was citing you to a portion of Mr. Seltzer's testimony, do you recall that?

A. Yes, sir.

Q. And the section that was referred to it described the inherent tax liability of the NOL. Do you recall that?

A. Yes, sir.

Q. Is an NOL a tax liability or a tax asset?

A. Well, a net operating loss is considered a tax asset because it will be used to reduce income tax in the future.

Q. So there is no inherent tax liability in an NOL?

A. Not standalone, no, there is not.

Q. So the NOL's going to generate a future tax reduction?

A. That's correct.

Q. So why does the Company need money now to pay for the future tax reduction? Does the Company -- let me rephrase that. Does the Company need money now to pay for a future tax reduction?

A. Well, they shouldn't because as rates are increased and they produce a taxable income their ability to pay their income tax will be advanced because of the net operating loss so --

Q. So how many times --

A. -- you don't need -- they would not need any now. They would not need income tax expense built into rates.

Q. How many times would the Company

benefit from the result of this treatment?

A. How many times? Well, every year until the net operating loss is, you know, used up, so I --

Q. I think you used the phrase double benefit earlier?

A. Well, yes. There's a double benefit if you're going to allow -- I didn't realize you were talking about allowing income tax expense in rates. Yes, there's a double benefit because they'll get paid back as their net operating loss is consumed. They won't have to pay income tax. But if you're ignoring the net operating loss savings, because it reduces income tax, and you include income tax expense in, you've got -- you've got this savings over here but now you even have money. So your double benefit is -- you know, is how it -- is the advantage that they're looking for.

Q. And let's go back really quick to what you and Mr. Holsman -- Commissioner Holsman, my apologies, were discussing regarding -- again, he used the term Staff proposal, I'm going to say the alternative proposal because both you and Staff refer to it. Do you track what I'm saying so far?

A. Yes, sir.

Q. So if the Commission were to start -- order the Company to book excess income tax to a deferred account, when would that deferred account start to be depleted, when would it start to be reduced?

A. If you -- if you take it at -- if you take it at its theoretical definition the deferred income tax -- the reason why you've created this deferred income tax account is because the Commission has allowed income tax expense to be included into rates. That income tax expense will never be repaid. So --

Q. I'm going to stop you because our Judge has indicated, apologies, a strong distaste for the word never.

A. Oh, that's --

Q. So let's --

A. All right.

Q. Let's kind of ground ourselves a little bit here.

A. Okay.

Q. The Company's going to come in -- let's assume, first of all, the Company comes in with no taxable income.

A. All right.

Q. Does that -- does that deferred tax liability, that deferred liability start to decrease if they have no taxable income?
A. No. I might be a little confused with your question. What we started with was income tax expense being included in rates creates the deferred tax liability because you're providing them money that isn't going to an expense. You know, even it's called income tax expense, it's not going to be paid to the IRS. And what I was getting at was if you do that -- and you were asking when would the deferred tax start to be reduced. It technically would not ever reduce.
Q. Okay. Let's drill down on that, let's make sure we have that understanding. Let's say -- let's assume the Company has used up all of its net operating losses carryforwards.
A. Okay.
Q. It has no net loss carryforwards, it has this deferred income tax.
A. Yeah.
Q. What is it using to pay income taxes moving forward?
A. Well, if you -- by then it would be -- you know, we're making some assumptions here.

By then they would be coming back in for a rate increase or rate adjustment. And with no net operating losses probably both Staff and I would be calculating an income tax expense to include in rates then.

Q. I understand. So because income tax expense would be include at that point you would never use the money in the deferred tax account to actually pay income taxes. Is that what you're saying?

A. Yes.

Q. So that's what you mean when you say that it would never -- it would probably never be paid down because the Company would always have money to pay income taxes and wouldn't have to dip into that?

A. It would be an extended time that would -- maybe I need to better explain something. When we're talking about accumulated deferred income tax and the usual arguments we have with Spire and Missouri American and that, the idea is that accumulated deferred income tax reverts back over time and that is what -- the deferred income tax is the interest free money the ratepayer has paid to the Company and that's why it's getting a rate of return off of that loan. And that -- and it is a loan because it eventually, time coming back, it will revert back to -- amortize off of the books as the -- as -- according to the Internal Revenue Service rates. So it will fall back.

In this particular instance there is no -- there's no free -- there's no loan. There's no payment that will -- that reverts back. It's just -- it's going to be free money. So in order to actually amortize it back you'll have to manually, you'll have to artificially say we're just going to amortize this back just to get it back off the books. There's nothing in the mechanism that would do that on its own because there's nothing in this net operating loss that was created by a tax change, or a tax adjustment, that would sponsor this to revert back over a period of time. It's free money from the get-go because the net operating loss is not a tax generated item, it is income doesn't cover expenses. It's a financial loss that equals the tax loss but it's not created by tax -- by a tax.

Q. If you just amortize it off the books then how have customers seen any benefit?

A. Well, they lose their benefit over the period of time because the deferred liability --

if you amortize it like that deferred liability will eventually fall off of the reduction in rate base. So, you know, over time they would lose their benefit.

Q. And is that why you call it a permanent tax savings?

A. Yes, sir.

Q. So just to summarize and make sure everything's okay and I can finish this off. The alternative proposal would be for the excess income tax expense over what's actually remitted to the IRS to be deferred to a liability account that would decrease the Company's future rate base but it would stick around for an extended period of time unless the Commission decided to arbitrarily reduce it just off the books?

A. That is the way I see it because there isn't a time limit, there isn't a -- there isn't a timeframe that created the liability.

Q. I think that does it. Thank you very much?

JUDGE HATCHER: Thank you, Mr. Riley. You are excused, subject to recall. Let's go ahead and finish up our business for today.

As we discussed, this concludes the taking of evidence by the Commission for today. We will adjourn the hearing and reconvene at ten a.m., ten a.m. on Monday. And --

MR. WOODSMALL: Your Honor.

JUDGE HATCHER: Yes.

MR. WOODSMALL: Real quick, just so I understand where we're going. We have the outstanding issue with when we're going to take up Mr. Lyons, I will get you more information on that Monday. Putting that aside, we're doing acquisition related cost and time sheets?

UNIDENTIFIED SPEAKER: Judge, we can't hear whatever's being said, they're not on the microphone.

MR. WOODSMALL: My apologies. It was a procedure related question. We have an issue. The Commission wants to ask questions of the Company witness on water usage rate design. He has availability concerns that we're going to work out. Putting that aside, we're going to start, as I understand it, your Honor, with acquisition related costs and time sheets and that will be it for Monday?

JUDGE HATCHER: I think that's a good plan.

MR. WOODSMALL: Okay. And I only mention

that because the Company can't bump cost of capital forward because its witness Decendes is flying into town.

JUDGE HATCHER: As always, the Commission remains flexible to the needs of witnesses traveling, appearing by WebEx. So we will work around them.

MR. WOODSMALL: Thank you, your Honor.

JUDGE HATCHER: If the parties change their minds on Monday's issues, please e-mail the presiding officer so that he can get an e-mail heads up to the rest of the persons.

MR. THOMPSON: Thank you, Judge.

MR. WOODSMALL: Thank you, your Honor.

MR. CLIZER: Really quick, before you go off the record. You had previously indicated something about wanting to hear from witnesses regarding the consolidation of rate structures, the settlement that had been reached. Is that still the case? Do you want that as part of that hearing or later on the record are we supposed to be getting back to you?

JUDGE HATCHER: Given the witness's availability that I haven't heard any hard exclusions, given the Commission's flexibility, let me get back to you on Monday.

MR. CLIZER: Okay.

JUDGE HATCHER: I think that's an evolving issue. Okay. Nothing else. We are off the record and we are adjourned for today, Friday. Thank you all.

(Deposition was concluded at 4:43 p.m.)

CERTIFICATE OF REPORTER

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I, JILL A. BLESKEY, a Registered Professional Reporter, Certified Shorthand Reporter (IL), and Certified Court Reporter (MO), do hereby certify that the witnesses whose testimony appears in the foregoing hearing was taken by me to the best of my ability and thereafter reduced to typewriting under my direction; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this hearing was taken, and further that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of this action.

Jill A. Bleskey, CSR RPR

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