Respondent's
~~Petitioner's~~ Exhibit No. 3

INDIANA-AMERICAN WATER COMPANY, INC.

INDIANA UTILITY REGULATORY COMMISSION

CAUSE NO. 45032 S4, PHASE 2

DIRECT TESTIMONY

OF

JOHN R. WILDE

SPONSORING ATTACHMENTS JRW-1 through JRW-2

DIRECT TESTIMONY
OF
JOHN WILDE

CAUSE NO. 45032 S4
PHASE 2

INTRODUCTION

Q. Please state your name and business address.

A. My name is John Wilde, and my business address is 131 Woodcrest Road, Cherry Hill, NJ 08003.

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

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

Q. Please summarize your educational background and work experience.

A. I graduated from Saint Norbert College, De Pere, Wisconsin in 1984 with a Bachelor of Business Administration Degree in Accounting. I have a graduate certificate in state and local taxation, as well as a Master of Science Degree in Taxation from the University of Wisconsin-Milwaukee. I have over 30 years of experience as a tax and accounting professional serving utilities with regulated operations in multiple states. Before coming to American Water, I spent fifteen

years as the head of tax for a corporate group (WEC Energy Group, Inc., formerly Integrys Energy Group, Inc.) that had six utilities with operations in four states.

Q. What are your current employment responsibilities?

A. My duties include management and oversight of the corporate tax function for American Water and its subsidiaries, including IAWC.

Q. Have you previously testified before any regulatory commissions?

A. Yes. I have testified before the Federal Energy Regulatory Commission, the Public Service Commission of Wisconsin, the Michigan Public Service Commission, the Virginia State Corporation Commission, the Illinois Commerce Commission, the Minnesota Public Utilities Commission, the Virginia State Corporation Commission, the Missouri Public Service Commission, the California Public Utilities Commission, the West Virginia Public Service Commission, and the Pennsylvania Public Utility Commission.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address the timing and method of returning Indiana-American's excess accumulated deferred income taxes ("ADIT") resulting from the reduction in the federal corporate income tax rate by the Tax Cuts and Jobs Act of 2017 (the "TCJA" or "Act"), in accordance with the Order of the Commission entered on February 16, 2018 and the Docket Entry entered on May 14, 2018. Company witness John M. Watkins's Direct Testimony submitted in Phase 1 of this Cause discusses the ADIT concept and the impact the TCJA has on

the ADIT balances of regulated utilities, including Indiana-American. My testimony discusses the difficulties in remeasuring Indiana-American's ADIT at this time and explains why the excess ADIT cannot be normalized or amortized at this time. It then discusses the Company's proposals for amortization of its "protected" and "unprotected" excess ADIT balances and recommends that the disposition of those balances be considered as part of the general rate case the Company plans to file later this summer.

Q. Please summarize Indiana-American's proposal with respect to amortization of its excess ADIT.

A. Indiana-American proposes to amortize the Company's protected excess ADIT balances through the application of the Average Rate Assumption Method ("ARAM"). As explained below, the Company will not be able to calculate the precise impact of the TCJA on its ADIT balances or to determine the appropriate amortization periods consistent with federal normalization requirments until approximately the end of first quarter of 2019. It is my understanding that the Company expects to file a general rate case later this summer. Therefore, Indiana-American proposes that the determination and amortization of its excess ADIT be considered in its upcoming rate case, and that the amortization of excess ADIT be incorporated into the new rates, by which time we expect to have completed the excess ADIT remeasurement and amortization calculations.

EFFECTS OF THE TCJA ON INDIANA-AMERICAN'S ADIT BALANCES

Q. Please describe the effect of the TCJA on Indiana-American's ADIT balances.

A. As Mr. Watkins noted in his Phase 1 testimony, upon the passage of the TCJA, the deferred tax assets and liabilities on the Company's books, which were established at a federal tax rate of 35%, had to be remeasured using a federal tax rate of 21%. At the end of 2017, Indiana-American had a significant net deferred tax liability, booked at the 35% federal corporate tax rate, and driven significantly by accelerated and bonus depreciation of fixed assets for tax purposes. The estimated remeasurement of that liability using a 21% federal corporate tax rate for financial accounting purposes at the end of 2017, demonstrates there is a balance of "excess" ADIT that will have to be amortized in future customer rates.

Excess ADIT falls into two categories: "protected" balances (i.e., those balances restricted by Internal Revenue Service ("IRS") normalization rules), which are generally associated with utility plant, and "unprotected" balances (i.e., those balances not restricted by the IRS normalization rules).

Indiana-American's initial estimate of the net excess ADIT balance (protected/plant-related and unprotected/non-plant-related) as of December 31, 2017, is $71,073,677 (($71,378,794) deferred tax liability for the plant-related and $305,118 deferred tax asset for the non-plant-related). (See Attachment JRW-1.) However, these estimates are still uncertain and subject to revision.

Q. Why are the Company's initial excess ADIT balance estimates uncertain and subject to revision?

A. As utilities and accounting professionals work through the impact of TCJA, some tax changes may not be fully recognized for months or even years. The reason is that accounting and tax guidance is still being developed that will clarify how various provisions of the new law should be treated, and the December 31, 2017 estimates are being modified as the Company files its 2017 tax returns and undergoes audits of tax returns for years prior to 2018. More specifically, as I explain below, calculating the TCJA's effect on ADIT balances that need to be normalized into future rates and implementing a method to normalize the resulting excess is a complex and involved process. The Company's current estimated net excess ADIT balances are not suitable for ratemaking purposes, and they should not be incorporated into rates until the balances and the applicable amortization periods have been determined with more assurance and precision.

Q. Please explain the methods available to amortize the excess ADIT created by the TCJA.

A. With respect to "protected" excess ADIT balances, the TCJA as a general rule does not dictate a specific method, but sets a limit on how fast the amounts can be refunded. Specifically, the amounts cannot be refunded any faster than the pattern created by using the Average Rate Assumption Method ("ARAM"). That said, the TCJA recognizes that utilities that compute depreciation using composite methods may not have the records necessary to compute ARAM. If qualified, those utilities may refund the excess ADIT using an alternate method commonly referred to as Reverse South Georgia Method. ("RSGM"). In order to use this method, the TCJA states that the utility taxpayer must meet two conditions:

"A) the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and

"(B) the taxpayer's books and underlying records did not contain the vintage account data necessary to apply the average rate assumption method."

In general, this is an acknowledgement that utilities that compute depreciation using composite methods might not have records needed to compute ARAM. Notwithstanding that, utilities that have developed the records needed to compute ARAM and/or put systems in place that can compute ARAM, or have the ability to do so, must use ARAM; the use of RSGM is allowed only if the utility does not indeed have the records or the systems necessary to compute ARAM.

Q. Does Indiana-American propose to use ARAM to remeasure and amortize its protected excess ADIT balance?

A. Yes. Since the Company has the underlying records available, the Company believes it must use ARAM to determine the proper rate to flow back excess protected ADIT to customers to comply with the normalization rules specified in the Tax Act of 1986, the TCJA, and in the IRS's rules.

Q. Why does Indiana-American treat excess ADIT related to its repairs deduction as protected?

A. Indiana-American's parent company, American Water Works Company, Inc. ("American Water") qualified for the repairs deduction through a Form 3115 Application for Change in Accounting Methods, which was filed for the taxable year ended December 31, 2008. That application resulted in a Consent Agreement

with the Internal Revenue Service that was signed by the IRS on July 30, 2010 and by American Water on September 10, 2010. A copy of the Consent Agreement is Attachment JRW-2. That Consent Agreement is what dictates the outcome of how the excess ADIT associated with the repairs deduction must be addressed.

Q. What does the Consent Agreement provide with respect to the repairs deduction?

A. The Consent Agreement approves the application for the change in accounting methods so as to implement the repairs deduction, but it does so conditionally. Paragraph 9 at page 6 is the condition which controls here:

> 9) If any item of property subject to the taxpayer's Form 3115 is public utility property within the meaning of §168(i)(10) or former §167(I)(3)(A):
>
> (A) A normalization method of accounting (within the meaning of § 168(i)(9), former § 168(e)(3)(B), or former §167(I)(3)(G), as applicable) must be used for such public utility property.

Q. So what does this condition mean with respect to the time period over which the excess ADIT associated with the repairs deduction must be returned?

A. Given that the repairs deduction that is the subject of the Consent Agreement relates to public utility property, we must utilize a normalization method of accounting within the meaning of the Internal Revenue Code. Section 203(e) of the Internal Revenue Code provides that a normalization method is *not being used* if the taxpayer, in computing its cost of service for ratemaking purposes must reduce its excess tax reserve more rapidly or to a greater extent than such reserve would be

reduced under ARAM. So if Indiana-American's cost of service for ratemaking purposes is computed by reducing excess ADIT associated with the repairs deduction more rapidly than ARAM, then it would not be a normalization method and we would be in violation of the condition in the Consent Agreement. Excess ADIT associated with the repairs deduction is thus "protected" by the IRS normalization rules in the same manner as excess ADIT related to utility property.

Q. Can Indiana-American or any other utility in the consolidated group of American Water companies compute ARAM today?

A. No. This is not due to lack of records, but to the fact that the Company has not built those records out into an ARAM data set or set up systems to process ADIT balances pursuant to ARAM. The Company is working expeditiously to implement the necessary computer software changes to compute ARAM. These changes include formatting vintage deferred tax records into a data structure with which American Water's tax accounting software can utilize them to compute ADIT balances and normalize amortization periods pursuant to ARAM. This is a complicated and laborious process, which we estimate will not be completed until the end of the first quarter of 2019.

Q. Should the Company start amortizing excess ADIT before it has determined its ADIT balances and amortization periods pursuant to ARAM?

A. No. The Company should not pass any excess ADIT to customers before it has determined its protected and unprotected excess ADIT balances and the appropriate amortization periods pursuant to ARAM. Returning any portion of the Company's

excess ADIT before determining what is protected and what is unprotected would risk a normalization violation and loss of accelerated depreciation, to the detriment of both the Company and its customers. Customers benefit from the Company's use of accelerated tax depreciation because the resulting ADIT is included in the capital structure at zero cost and provides a source of funds for infrastructure investment. If Indiana-American returns excess ADIT to customers for protected assets more rapidly than ARAM would permit, the Company could lose its ability to utilize accelerated tax depreciation.

Q. What is your recommendation with respect to the treatment of excess ADIT at this time?

A. As Mr. Watkins has stated in his testimony in Phase 2 of this cause, in order to allow sufficient time for Indiana-American to complete its evaluation of the TCJA's impact on the Company's ADIT, and to consider that impact in the full context of the Company's revenue requirements, the Company believes the appropriate setting in which to decide the treatment of excess ADIT balances is the upcoming general rate case to be filed later this summer. We therefore recommend that the Commission defer its decision on the amortization and refund of excess ADIT until the time an order is issued in Indiana-American's next general rate case.

Q. How are customers' interests protected if Indiana-American does not complete its ARAM analysis and develop estimates suitable for ratemaking purposes of the net excess ADIT until the conclusion of its next rate case?

A. Excess ADIT will be deferred until the Company's next rate case. At that time the appropriate amortization period will be determined. Customer interests will be protected because the excess deferred taxes will remain in the capital structure as a zero cost source of capital, serving to reduce Indiana-American's return. In this manner, the deferral will essentially generate a carrying charge for the benefit of customers until the next rate case.

Q. Does this conclude your direct testimony?

A. Yes it does.

VERIFICATION

I, John Wilde, Vice President - Tax, American Water Works Service Company, Inc., affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information and belief.

John Wilde

Date: 6/19/2018

Indiana-American Water
Cause No. 45032 S4 Phase 2, Item 1(e)(i)
Schedule JRW-1 - REVISED

FILED
August 8, 2018
INDIANA UTILITY
REGULATORY COMMISSION

American Water Works Company, Inc.

Deferred Balances Report - Fed/State/FBOS (Reporting)
Case A - Fed at 35% with RTP, 1010 Indiana American Water Co

12/31/2017

Code	Name	Beginning Balance	Rate Change	Opening Balance Sheet Adj. (P/L)	APIC Conversion (BSO)	Adjusted Opening Balance	Reg A/L & ITC Movement PY (BSO)	TBBS Adjustments (P/L)	Final Reclasses for FN (BSO)	Current Activity	Reg A/L & ITC Movement (P/L)	Other Deferred Adjustments (P/L)	Other Deferred Adjustments (BSO)	Ending Balance
A1	Advances & contributions	66,495,877	0	0	0	66,495,877	0	0	74,048,322	3,838,889	0	0	0	144,383,088
A4	Tax Losses and Credits	4,358,249	0	0	5,461	4,363,710	0	194,252	0	(571,331)	0	0	0	3,986,632
A5	Pension Benefits	(197,368)	0	0	20,572	(176,796)	0	0	(237,329)	374,809	0	0	0	(39,315)
A7	Other	1,461,707	0	0	(151,814)	1,309,893	0	0	0	(216,993)	82,894	0	(97,026)	1,078,769
L1	Utility plant, primarily depreciation	(257,300,740)	0	0	(1,418,436)	(258,719,176)	631	(211,929)	(74,048,322)	(14,388,912)	0	8,645	(2,950,600)	(350,309,664)
L13	Pension Benefits	(237,329)	0	0	0	(237,329)	0	0	237,329	0	0	0	0	0
L5	OTHER	(1,521,373)	0	0	18,477	(1,502,896)	0	0	0	272,699	(52,551)	13,379	443,124	(826,246)
Unassigned	Unassigned	0	0	(1,516)	1,516	0	0	0	0	0	0	(29,882)	29,882	0
Total		(186,940,976)	0	(1,516)	(1,524,225)	(188,466,717)	631	(17,677)	0	(10,690,838)	30,343	(7,858)	(2,574,620)	(201,726,736)

Indiana-American Water
Cause No. 45032 S4 Phase 2, Item 1(e)(i)
Schedule JRW-1

American Water Works Company, Inc.

Deferred Balances Report - Fed/State/FBOS (Reporting)
2017 Combined December YE Final 10K, 1010 Indiana American Water Co

12/31/2017

Code	Name	Beginning Balance	Rate Change	Opening Balance Sheet Adj. (P/L)	APIC Conversion (BSO)	Adjusted Beginning Balance	Return To Provision (P/L)	TBBS Adjustments (P/L)	Final Reclasses for FN (BSO)	Current Activity	Reg A/L & ITC Movement (P/L)	Other Deferred Adjustments (P/L)	Other Deferred Adjustments (BSO)	Ending Balance
A1	Advances & contributions	66,495,877	(23,185,180)	0	0	43,310,697	0	0	48,229,824	2,500,380	0	0	0	94,040,900
A4	Tax Losses and Credits	4,358,249	(1,729,096)	0	0	2,629,153	6,638	116,551	0	(353,626)	0	0	0	2,398,717
A5	Pension Benefits	(197,368)	68,816	0	0	(128,552)	13,399	0	(154,579)	244,124	0	0	0	(25,607)
A7	Other	1,461,707	(509,655)	0	0	952,052	(86,693)	0	0	(141,334)	100,749	0	(109,953)	714,822
L1	Utility plant, primarily depreciation	(257,300,740)	93,241,405	(182,576)	0	(164,241,911)	(942,531)	(138,036)	(48,229,824)	(9,144,613)	0	8,645	(2,885,935)	(225,574,205)
L13	Pension Benefits	(237,329)	82,750	0	0	(154,579)	0	0	154,579	0	0	0	0	0
L5	OTHER	(1,521,373)	519,078	0	18,170	(984,125)	200	0	0	177,617	(63,870)	13,379	23,766,660	22,909,860
Unassigned	Unassigned	0	0	(71,009,012)	0	(71,009,012)	0	0	0	0	0	(36,318)	71,045,330	0
Total		(186,940,976)	68,488,118	(71,191,588)	18,170	(189,626,276)	(1,008,987)	(21,484)	0	(6,717,451)	36,879	(14,294)	91,816,102	(105,535,513)

Indiana-American Water
Cause No. 45032 S4 Phase 2, Item 1(a)(iii)
Schedule JRW-1

American Water Works Company, Inc.

Deferred Balances Report - Pre-Tax (Reporting)
2017 Combined December YE Final 10K, 1010 Indiana American Water Co

Code	Name	Ending Balance
A1	Advances & contributions	378,114,673
A4	Tax Losses and Credits	11,257,269
A5	Pension Benefits	(102,960)
A7	Other	2,768,521
L1	Utility plant, primarily depreciation	(930,314,627)
L13	Pension Benefits	0
L5	OTHER	92,118,052
Unassigned	Unassigned	0
Total		(446,159,073)

Gross Temporary Difference on Plant only	(553,910,338)
Change in blended tax rate	-13.31%
DTL remeasurement related to Plant	73,747,622
Gross Temporary Difference on Tax Losses and Credits	10,925,704
Change in federal tax rate	-14.00%
DTA remeasurement related to Fed NOL	(1,529,599)
State only plant temporary items	(7,274,825)
Change in federal rate	-14.00%
Remeasurement on federal benefit of state items	1,018,476
Gross Temporary Difference on Plant only	(23,078,070)
Curr/Def State rate difference	-1.23%
State rate difference	282,706
Total	73,519,206
Items not recoverable	(2,140,412)
Total estimated Plant excess ADIT	**71,378,794**

Gross Temporary Differences non-plant related	97,172,455
Minus Current Reg Liability	(95,315,002)
	1,857,453
Change in blended tax rate	-13.31%
DTL remeasurement related to non-Plant	(247,301)
Fed only non-plant temporary items	(346,894)
Change in federal rate	-14.00%
Remeasurement on fed only items	48,565
State only non-plant temporary items	1,033,006
Change in federal rate	-14.00%
Remeasurement on federal benefit of state items	(144,621)
Gross Temporary Difference on non-plant	3,401,050
Curr/Def State rate difference	-1.23%
State rate difference	(41,663)
Total	(385,020)
Items not recoverable	79,903
Total estimated Non-Plant excess ADIT	**(305,117)**

Total estimated excess ADIT	**71,073,677**

	Before	After	Change
Federal Rate	35.00%	21.00%	
State Def Rate	4.90%	4.90%	
Blended Rate	38.19%	24.87%	-13.31%
State Def Rate	4.90%		
State Curr Rate	6.13%		
Difference	1.23%		

AMERICAN WATER

September 10, 2010

Courier's Desk
Internal Revenue Service
Attn: CC:ITA:B01- Innessa Glazman
1111 Constitution Avenue, N.W., Room 5336
Washington, DC 20224

RE: American Water Works Company, Inc. & Subs.
EIN: 51-0063696
CAM-108421-09
CONSENT AGREEMENT

Dear Ms. Glazman:

This letter relates to a Form 3115, Application for Change in Accounting Method, filed by the above-mentioned Taxpayer on behalf of itself and various subsidiaries, requesting permission to change their method of accounting for (1) costs to repair and maintain tangible property, and (2) dispositions of certain tangible depreciable property, for the taxable year that ended December 31, 2008.

Please find enclosed a Consent Agreement dated July 30, 2010, and signed by the Taxpayer on September 10, 2010. However, we note that the EINs for two of the entities subject to the Form 3115 and enclosed Consent Agreement, American Water Engineering, Inc., and United Water Virginia, Inc., were incorrectly reflected in Appendix A to the Consent Agreement. In its information response to the IRS, by letter dated July 1, 2009, the Taxpayer provided the correct EINs of the two entities, American Water Engineering, Inc. (EIN: 76-0654501), and United Water Virginia, Inc. (EIN: 54-1016694). The Taxpayer will be effecting the change permitted in the Consent Agreement.

If you have any questions, please call the Taxpayer's authorized representative, Robert Weiss, at 202-414-1421.

Sincerely,

Mark Chesla
Vice President and Controller

Enclosures
Executed Consent Agreement

CONSENT AGREEMENT

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

American Water Works Company, Inc.
and Subs.
P.O. Box 5600
Cherry Hill, NJ 08003

Attn: Mark N. Chesla
VP and Controller

EIN: 51-0063696

Person to Contact:
Innessa Glazman
Telephone Number:
(202) 622-7327
Refer Reply to:
CC:ITA:B01 CAM-108421-09
Employee Identification Number:
52-08393

JUL 30 2010

In re: Application for Change of Accounting Method
Form 3115 - See Appendix A

Dear Mr. Chesla:

This letter refers to a Form 3115, Application for Change in Accounting Method, filed by American Water Works Company, Inc. & Subs., EIN:51-0063696, on behalf of thirty applicants (see Appendix A) (collectively "the taxpayer"), requesting permission to change the taxpayer's method of accounting for: (1) costs to repair and maintain tangible property, and (2) dispositions of certain tangible depreciable property. The change is requested for the taxable period beginning January 1, 2008 and ending December 31, 2008 ("year of change").

The Department of the Treasury has published proposed regulations that clarify the application of §§ 162 and 263 of the Internal Revenue Code to expenditures paid or incurred to repair, improve, or rehabilitate tangible property. See Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property, 73 FR 12838-01 (March 10, 2008), 2008-1 C.B. 871. A threshold issue in applying the rules under §§ 162 and 263 is determining the appropriate unit of property to which the rules should be applied. The proposed regulations reserve the rules for determining the appropriate unit of property for network assets, which are defined as railroad track, oil and gas pipelines, water and sewage pipelines, power transmission and distribution lines, and telephone and cable lines. See § 1.263(a)-3(d)(2)(iii)(C)(2) of the proposed regulations, 73 FR 12857. The preamble to the proposed regulations states that the unit of property for network assets should be addressed on an industry-by-industry basis in future Internal Revenue Bulletin guidance. See preamble discussion at 73 FR 12843.

Section 6.09 of Rev. Proc. 2010-1, 2010-1 I.R.B. 1, 16, provides that the Internal Revenue Service generally will not issue a letter ruling if the request presents an issue that cannot be readily resolved before a regulation or any other published guidance is issued. A letter ruling includes an Associate Office's response granting or denying a

request for a change in a taxpayer's accounting method. Section 2.01 of Rev. Proc. 2010-1. The unit of property determination for network assets is an issue that cannot be readily resolved before a regulation or other published guidance is issued. Further, because the taxpayer's proposed method of accounting is based on the unit of property determination, the propriety of the taxpayer's proposed method of accounting is also an issue that cannot be readily resolved. Thus, the Service declines to rule on whether the taxpayer's unit of property determination for its network asset is correct, and accordingly, whether its proposed method of accounting is a proper method of accounting.

Further, pursuant to section 4.02(1) of Rev. Proc. 2010-3, 2010-1 I.R.B. 110, 118, the Service will not ordinarily issue a letter ruling or determination letter on any matter in which the determination requested is primarily one of fact. The determination of the unit of property for dispositions of tangible depreciable property is a factual one. Thus, the Service declines to rule on whether the taxpayer is using the appropriate unit of property for determining dispositions of tangible depreciable property subject to its Form 3115 and, accordingly, whether its proposed method of accounting for determining dispositions of such property is a proper method of accounting.

FACTS

The taxpayer is a corporation that is in the business of operating as public water and wastewater utility company that pumps, treats, and distributes water to and from residential, commercial, and industrial customers in the United States. The taxpayer uses an overall accrual method of accounting. Its principal business activity code is 221300. The taxpayer is requesting permission to: (1) change its method of accounting for costs associated with the routine repair and maintenance of all of the taxpayer's network assets; and (2) change its units of property for determining dispositions of certain tangible depreciable property.

Routine repair and maintenance costs

The costs included in this request consist of costs associated with the routine repair and maintenance of taxpayer's tangible property. The taxpayer represents that these costs are incurred to keep the taxpayer's property in ordinarily efficient operating condition, and that they do not materially increase the value or substantially prolong the useful life of any unit of property compared to the value or useful life of the property before the general decline or event that led to the repairs or maintenance. The taxpayer represents that the repair and maintenance costs do not adapt any unit of property to a new or different use. The taxpayer represents that the repair and maintenance costs do not include costs to replace any unit of property or any major components or substantial

structural parts of any unit of property. The taxpayer represents that the repair and maintenance costs are not incurred as part of a plan of rehabilitation, modernization, or improvement to any unit of property. The taxpayer represents that the repair and maintenance costs do not result from any prior owner's use of any unit of property.

Section 162 allows a deduction for all the ordinary and necessary expenses paid during the taxable year in carrying on any trade or business.

Section 1.162-4 of the Income Tax Regulations allows a deduction for the cost of incidental repairs that neither materially add to the value of property nor appreciably prolong its useful life, but keep it in an ordinarily efficient operating condition.

Under the taxpayer's present method of accounting for repair and maintenance costs, the taxpayer capitalizes the repair and maintenance costs described above and recovers these costs using the appropriate method over the applicable recovery period and the applicable convention as prescribed by §168(a).

Under the taxpayer's proposed method of accounting for repair and maintenance costs, the taxpayer will treat the repair and maintenance costs as ordinary and necessary business expenses pursuant to §§ 162 and 1.162-4.

Disposition of certain tangible depreciable property

The items of tangible depreciable property subject to the taxpayer's request to change its units of property for determining dispositions are described as network assets. Such property is depreciated by the taxpayer under § 168.

The taxpayer represents that:

1. None of the assets that are the subject of the taxpayer's Form 3115 are leasehold improvements.

2. None of the assets subject to the taxpayer's Form 3115 is subject to a general asset account election under § 168(i)(4) and the regulations thereunder.

3. None of the assets subject to the taxpayer's Form 3115 is subject to a mass asset account election under former § 168(d)(2)(A).

4. Depreciation for all of the assets subject to the taxpayer's Form 3115 is not determined in accordance with § 1.167(a)-11 (regarding the Class Life Asset Depreciation Range System (ADR)).

5. None of the assets subject to the taxpayer's Form 3115 is subject to the repair allowance under § 1.167(a)-11(d)(2) (including expenditures incurred after December 31, 1980, that were for the repair, maintenance, rehabilitation, or improvement of property placed in service by the taxpayer before January 1, 1981).

6. None of the assets subject to the taxpayer's Form 3115 were disposed of in a transaction to which a nonrecognition section of the Code applies (for example, § 1031, transactions subject to § 168(i)(7)).

7. There is no building (and its structural components) that is the subject of the taxpayer's Form 3115.

Under the taxpayer's present method of accounting, the taxpayer uses a method other than the functional interdependence test to identify the unit of property for purposes of determining when a depreciable network asset is disposed of.

Under the taxpayer's proposed method of accounting, the taxpayer will use the functional interdependence test to identify the unit of property for purposes of determining when a depreciable network asset is disposed of. The taxpayer will use the same unit of property for purposes of determining when a depreciable network asset is placed in service (and when depreciation begins) and when the depreciable network asset is disposed of (and when depreciation ends).

The taxpayer has represented that, on the date the Form 3115 was filed, it was not under examination and it was not before an appeals office or a federal court with respect to any income tax issue. See sections 3.07, 3.08(2) and 3.08(3) of Rev. Proc. 97-27, 1997-1 C.B. 680, as modified by Rev. Proc. 2002-19, 2002-1 C.B. 696.

SECTION 481(a) ADJUSTMENT

The information provided indicates that, as of the beginning of the year of change, the required aggregate adjustment under § 481(a) (the § 481(a) adjustment) for the year of change is ($461,238,422). This amount represents a netting of the net negative § 481(a) adjustment for maintenance and repairs with the net positive § 481(a) adjustment for dispositions. The netting represents a one-time exception allowed the taxpayer for the year of change based on its particular situation. As a rule, the netting of the § 481(a) adjustment for maintenance and repairs with the § 481(a) adjustment for dispositions is not allowed under the provisions of Rev. Proc. 97-27. The § 481(a) adjustment for each applicant is shown in Appendix A. The net amount represents a decrease in computing taxable income.

American Water Works Company, Inc. & Subsidiaries
CAM-108421-09

CONSENT/TERMS AND CONDITIONS OF CONSENT

Based solely on the facts presented and representations made, permission is hereby granted the taxpayer to change its method of accounting from the present method to the proposed method, beginning with the year of change, provided that:

(1) The taxpayer takes the entire net § 481(a) adjustment into account in computing taxable income in the year of change. See section 2.02(1) of Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432.

(2) The taxpayer keeps its books and records for the year of change and for subsequent taxable years (provided they are not closed on the date it receives this letter) on the method of accounting granted in this letter. This condition is considered satisfied if the taxpayer reconciles the results obtained under the method used in keeping its books and records and the method used for federal income tax purposes and maintains sufficient records to support such reconciliation; and

(3) No portion of any net operating loss that is attributable to a negative § 481(a) adjustment may be carried back to a taxable year prior to the year of change that is the subject of any pending or future criminal investigation or proceeding concerning (a) directly or indirectly, any issue relating to the taxpayer's federal tax liability, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability. See section 5.02(4) of Rev. Proc. 97-27.

(4) None of the items of property subject to the taxpayer's Form 3115 is subject to a general asset account election under § 168(i)(4) and the regulations thereunder;

(5) None of the items of property subject to the taxpayer's Form 3115 is subject to a mass asset account election under former § 168(d)(2)(A);

(6) The taxpayer does not determine depreciation for any of the items of property subject to the taxpayer's Form 3115 in accordance with § 1.167(a)-11 (regarding the Class Life Asset Depreciation Range System (ADR));

(7) None of the items of property subject to the taxpayer's Form 3115 is subject to the repair allowance under § 1.167(a)-11(d)(2) (including expenditures incurred after December 31, 1980, for the repair, maintenance, rehabilitation, or improvement of property placed in service before January 1, 1981);

8) None of the cost (or a portion thereof) of the assets subject to the taxpayer's Form 3115 is expensed or amortized under any provision of the Code, regulations, or other published guidance in the Internal Revenue Bulletin (for example, § 179D, § 1400I); and,

9) If any item of property subject to the taxpayer's Form 3115 is public utility property within the meaning of § 168(i)(10) or former § 167(l)(3)(A):

(A) A normalization method of accounting (within the meaning of § 168(i)(9), former § 168(e)(3)(B), or former § 167(l)(3)(G), as applicable) must be used for such public utility property;

B) As of the beginning of the year of change, the taxpayer must adjust its deferred tax reserve account or similar reserve account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to such public utility property; and

C) Within 30 calendar days of filing the federal income tax return for the year of change or of receiving this letter ruling, whichever is later, the taxpayer must provide a copy of its Form 3115 (and any additional information submitted to the Service in connection with such Form 3115) to any regulatory body having jurisdiction over such public utility property.

EFFECT OF THIS ACCOUNTING METHOD CHANGE

The accounting method change granted in this letter is a letter ruling pursuant to § 601.204(c) of the Statement of Procedural Rules. See also section 2.01 of Rev. Proc. 2010-1, 2010-1 I.R.B. at 6 (or any successor). The taxpayer ordinarily may rely on this letter ruling subject to the conditions and limitations described in Rev. Proc. 97-27.

However, the consent granted under this letter ruling for the taxpayer's requested change is not a determination by the Commissioner that the taxpayer is using the appropriate unit of property for determining dispositions of tangible depreciable property and does not create any presumption that the proposed unit of property is permissible

for such purposes. The director will ascertain whether the taxpayer's determination of its unit of property for dispositions of tangible depreciable property is correct.

Further, the taxpayer should not infer approval of any tax treatment not specifically stated in this letter ruling. For example, this letter does not address the application of § 263A, which generally requires taxpayers to capitalize certain direct and indirect costs of property produced or acquired for resale, or the propriety of the taxpayer's classification of property under § 168(e) or Rev. Proc. 87-56, 1987-2 C.B. 678. Further, this letter ruling does not imply approval of any tax treatment (including amounts that are part of the § 481(a) adjustment) when the Code, the regulations, or other published guidance provides specific limitations and/or prohibitions. The Service expresses no opinion on the propriety of the unit(s) of property the taxpayer proposes to use in determining the deductibility of repair and maintenance costs. The unit of property determination is a factual one within the jurisdiction of the director.

The director must apply the ruling in determining the taxpayer's liability unless the director recommends that the ruling should be modified or revoked. The director will ascertain whether (1) the representations upon which this ruling was based reflect an accurate statement of the material facts, (2) the change in method of accounting was implemented as proposed in accordance with the terms and conditions of the Consent Agreement and Rev. Proc. 97-27, (3) there has been any change in the material facts upon which the ruling was based during the period the method of accounting was used, (4) there has been any change in the applicable law during the period the method of accounting was used, (5) the amount of the § 481(a) adjustment was properly determined, and (6) the taxpayer's determination of its unit of property is correct. In the case of (1), (2), (3), or (4) above, if the director recommends that the ruling should be modified or revoked, the director will forward the matter to the national office for consideration before any further action is taken. Such a referral to the national office will be treated as a request for technical advice, and the provisions of Rev. Proc. 2010-2, 2010-1 I.R.B. 90 (or any successor) will be followed. See section 11.01 of Rev. Proc. 97-27.

As noted above, the Department of the Treasury has published proposed regulations that clarify the application of §§ 162 and 263 to expenditures paid or incurred to repair, improve, or rehabilitate tangible property. See Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property, 73 FR 12838-01 (March 10, 2008), 2008-1 C.B. 871. If final or temporary regulations are adopted with positions that are inconsistent with the method of accounting that the taxpayer implements in accordance with this letter ruling, the taxpayer will be required to follow any instructions in those final or temporary regulations concerning methods of accounting for the repair, improvement, or rehabilitation of tangible property for future taxable years.

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AUDIT PROTECTION

An examining agent may not propose that the taxpayer change the same method of accounting as the method changed by the taxpayer under this ruling for a year prior to the year of change provided the taxpayer implements the change as proposed, in accordance with the terms and conditions of this ruling and Rev. Proc. 97-27, and the ruling is not modified or revoked retroactively because there has been a misstatement or an omission of material facts. See sections 9.01 and 9.02(1) of Rev. Proc. 97-27.

However, the Service may change the taxpayer's method of accounting for the same item for taxable years prior to the requested year of change if there is any pending or future criminal investigation or proceeding concerning (a) directly or indirectly, any issue relating to the taxpayer's federal tax liability for any taxable year prior to the year of change, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability for any taxable year prior to the year of change. See section 9.02(4) of Rev. Proc. 97-27.

CONSENT AGREEMENT

If the taxpayer agrees to the terms and conditions set forth above, an individual with the authority to bind the taxpayer in such matters must sign and date the attached copy and return it within 45 days from the date of this letter to:

Internal Revenue Service
Attention: Innessa Glazman, CC:ITA:B01
P.O. Box 14095
Benjamin Franklin Station
Washington, D.C. 20044

The signed copy constitutes an agreement regarding the terms and conditions under which the change is to be effected ("Consent Agreement") within the meaning of § 481(c) and as required by § 1.481-4(b). The Consent Agreement shall be binding on both parties except that it will not be binding upon a showing of fraud, malfeasance, or misrepresentation of a material fact. In addition, a copy of the executed Consent Agreement must be attached to the taxpayer's federal income tax return for the year of change. For further instructions, see section 8.11 of Rev. Proc. 97-27. Alternatively, a taxpayer that files its returns electronically may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter ruling.

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The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

The accounting method change granted in this letter is directed only to the taxpayer and may not be used or cited as precedent. See section 11.02 of Rev. Proc. 2010-1, 2010-1 I.R.B. at 49. Final or temporary regulations under § 167 or § 168 pertaining to one or more of the issues addressed in this letter ruling have not yet been adopted. Therefore, if final or temporary regulations under § 167 or § 168 should be adopted with positions that are inconsistent with the conclusions reached in this letter ruling, the method of accounting utilized as a result of the letter ruling will no longer be regarded as a proper method of accounting and would be subject to change within the framework of §§ 446 and 481.

American Water Works Company, Inc. & Subsidiaries
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In accordance with the provisions of a power of attorney currently on file, we are sending a copy of the ruling letter to your authorized representatives.

Sincerely yours,

JOHN P. MORIARTY
Chief, Branch 1
Office of the Associate Chief Counsel
(Income Tax and Accounting)

cc: Internal Revenue Service
Industry Director, LM:NRC
Natural Resources and Construction
1919 Smith Street, Stop 1000HOU
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1301 K Street, NW, Ste 800W
Washington, DC 20005

Gwynneth H. Stott, CPA
PricewaterhouseCoopers LLP
2001 Market Street, Ste 1700
Philadelphia, PA 19103

Signed this 10th day
of September, 2010
American Water Works Inc & Subs
(taxpayer)
By _____, Vice President and Controller
(Name and corporate title of parent officer)