

Prepared Testimony of

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Good afternoon, I appreciate the opportunity to speak with you today regarding the impact of the Tax Cuts and Jobs Act on the customer rates charged by jurisdictional public utilities in the Commonwealth of Pennsylvania.

## **Background**

On February 12, 2018, the Pennsylvania Public Utility Commission (Commission) initiated a proceeding to determine the effects of the Tax Cuts and Jobs Act (Act) on the tax liabilities of Commission-regulated electric, natural gas, water, and wastewater public utilities for 2018 and future years. This proceeding also sought to determine the feasibility of reflecting any potential impacts of the Act on the rates charged to the Pennsylvania ratepayers of these utilities. More specifically, as part of this proceeding, the Commission sought public comments and utility data related to: (1) whether the Commission should adjust current customer rates to reflect the reduced state and federal income tax expenses of these public utilities due to the tax rate changes in the Act, and, if so, (2) the appropriate rate methodology to allow immediate changes to consumer rates.

Based on this extensive investigation, the Commission found that “due to the substantial decrease in the federal corporate tax rate that became effective on January 1, 2018, it appears that existing rates may be excessive and, therefore, no longer just and reasonable.”<sup>1</sup> In addition to the change in tax rates, the Commission, as part of its investigation, considered the effect of the tax rate change on accumulated deferred

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<sup>1</sup> *Tax Cuts and Jobs Act*, PUC Docket No. M-2018-2641242 (Order entered March 15, 2018).

income taxes and considered changes to bonus depreciation. As such, the Commission issued an order earlier this year directing 17 major electric, natural gas, water, and wastewater utilities to begin adding credits or “negative surcharges” to monthly customer bills, effective with their July 2018 bills. The estimated tax savings are expected to reduce consumer bills by approximately \$421 million per year.

I note that customers located in certain utility service territories where those utilities have current rate case proceedings before the Commission will not see reduced bills immediately. However, any tax savings to the utilities resulting from the Act will be accounted for when determining customer rates as part of those rate case proceedings.

### **Effect of the Act on Businesses**

The Act has provided positive benefits to certain businesses and industries across the Nation. These benefits vary depending on the structure of how a particular business or industry operates and whether that business or industry is subject to federal and/or state regulation. In the Commonwealth, public utility rates charged to customers are regulated by the Commission. However, unlike public utilities in the Commonwealth, most industries across the Nation are not price-regulated; rather, they have the ability to adjust their prices quickly based on changes in economic conditions, supply, demand, or whatever market force might affect their business structures. Because these industries have more regulatory freedom than utilities, they also have more flexibility when it comes to passing on any positive effects on revenue created by the Act – whether it be passing the benefit on to customers or reinvesting that revenue back into the company.

## **Ratemaking and Taxes**

In the Commonwealth, utilities operate as monopolies and, therefore, the General Assembly has placed two basic limitations on the monopolistic behavior of utilities: price regulation and service regulation. When a utility needs to change its prices or rates because of a change in expenses, taxes, sales, or upcoming infrastructure projects, the utility must file a rate case with the Commission to demonstrate that the revenue it wishes to collect for its service is just and reasonable. The fundamental principle of ratemaking is that rates should be set so that a utility has a reasonable opportunity to recover the costs prudently incurred in providing service. The following equation summarizes this principle:

$$RR = E + D + T + (RB \times ROR)$$

Where:

- RR Revenue Requirement or the total revenue to be collected from customers through rates.
- E Operating Expenses, including wages, benefits, costs associated with the distribution of electricity, water, wastewater, and natural gas, etc.
- D Depreciation Expense or the loss, not restored by current maintenance, which is due to all factors causing the ultimate retirement of the property.
- T Taxes including Federal Income Taxes, State Corporate Net Income Tax, Public Realty Tax, and State Gross Receipts Tax.
- RB Rate Base or prudently constructed utility property that is used and useful in the provision of service.

ROR Overall Rate of Return or the compensation to investors for the investment in a company's debt or equity.

In a rate case proceeding, the revenue requirement is calculated and rates are set for each type of customer (e.g., residential, commercial, or industrial). Because taxes are added into expenses, depreciation, and the return component, any change in tax rates directly affects the utilities' revenue requirement, and consequently, the rates charged by those utilities to their customers.

To provide context, existing customer rates were set to recover taxes based on a 35% statutory tax rate before the Act was passed. The Act resulted in a reduction to a 21% tax rate for utilities.

### **Effect of the Act on Utilities**

As a result of the Act, the Commission has now lowered the rates of 17 major electric, natural gas, and water/wastewater utilities. The total refunded is estimated to be \$421 million per year or an average reduction of 4.19% in distribution charges. Electric utilities are estimated to return \$277 million per year to consumers, which would result in an average reduction of 5.11% in distribution charges on monthly bills; natural gas utilities will return nearly \$106 million per year, reducing monthly distribution charges by an average of 4.92%; and water/wastewater utilities will return \$38 million per year to their customers, resulting in an average 2.21% reduction in monthly distribution charges. The percentage decrease in distribution charges varies from utility to utility, depending on the revenue and tax impact for each utility. The actual dollar savings for consumers

will vary depending on their individual usage and rate class. In addition, since the date the order was issued, several utilities have filed petitions for the Commission to reconsider or modify the credit being passed back to customers. Each utility's petition for reconsideration can be found on the Commission's website ([www.puc.pa.gov](http://www.puc.pa.gov)) at the docket numbers included in the Appendix. The rate reduction will remain in place until a company files a base rate case and incorporates all of the effects of the Act into base rates.

To provide an example, here in York County, a majority of residents receive their electric utility service from Metropolitan Edison Company, natural gas utility service from Columbia Gas of Pennsylvania, Inc., and water/wastewater utility service from the York Water Company.

- Metropolitan Edison Company will be returning \$37,135,115 to customers, which will result in an average reduction of 8.55% in distribution charges on monthly bills.
- Columbia Gas of Pennsylvania, Inc. and York Water Company are addressing any changes resulting from the Act in their current base rate case proceedings before the Commission at Docket Nos. R-2018-2647577 and R-2018-3000019, respectively. For these companies, the savings as the result of this Act will be passed on to customers as part of these proceedings.

The estimated amount that will be passed back for other utilities in the Commonwealth can be found in the Appendix.

## **Regulated Incumbent Telephone Utilities**

On March 2, 2018, the Commission initiated a similar proceeding to determine the effects of the Act and impact on rates of Commission-regulated incumbent local exchange carriers (ILECs). These are public utilities that operate under an alternative form of regulation under Chapter 30 of the Public Utility Code that does not include the traditional rate base/rate of return ratemaking equation previously described. Two key issues being investigated by the Commission are the tax rate reductions' potential qualifications as so-called "exogenous events" pursuant to the ILECs' various Chapter 30 plans and the Commission's maintenance of just and reasonable rates in light of those tax rate reductions. Because these telecommunications utilities are not traditionally price regulated, our investigation requires a different analysis, but the Commission is looking into the issue.

Our investigation is temporarily stayed pending our resolution of complaints filed by the Office of Consumer Advocate against the annual rate change filings of some of these ILECs in which the OCA also raised the potential need for these ILECs to account for the Act's tax savings through their alternative regulation plans.

## **Conclusion**

Since the passage of the Act, the Commission has worked diligently to ensure that consumers across the Commonwealth will receive savings on their utility bills triggered by changes in federal tax rates. As I previously mentioned, the customer savings we have identified so far are now valued at more than \$421 million per year. We will continue

working to confirm that these savings are appropriately passed onto customers through the ongoing base rate case and other proceedings before the Commission.

Thank you again for inviting me here to speak today. I welcome the opportunity to answer any questions you may have.



## Appendix

### Tax Cuts and Jobs Act of 2017 - General Proceeding M-2018-2641242

#### Tax Cuts and Jobs Act Company Proceedings

Utility Code	Company Name	Docket Number	Estimated Effect	
			Change in Revenue Requirement	Percent Bill Change
110050	Citizens' Electric Co of Lewisburg	R-2018-3000558	\$107,183	-0.82%
110300	Metropolitan Edison Co	R-2018-3000597	\$37,135,115	-8.55%
110400	Pennsylvania Electric Co	R-2018-3000599	\$39,496,910	-8.50%
110450	Pennsylvania Power Co	R-2018-3000602	\$9,393,898	-8.07%
110500	PPL Electric Utilities Corp	R-2018-3000775	\$72,343,787	-7.05%
110650	Pike County Light & Power Co	R-2018-3000942	\$73,924	-0.67% *
111200	Wellsboro Electric Co	R-2018-3000562	\$79,567	-0.66%
111250	West Penn Power Co	R-2018-3000604	\$30,091,002	-7.34%
121100	Peoples Natural Gas Co - Equitable Division	R-2018-3000503	\$21,730,300	-7.18%
121850	National Fuel Gas Distribution Corp	R-2018-3000527	\$4,320,438	-2.20%
122250	Peoples Natural Gas Co	R-2018-3000498	\$19,870,256	-4.82%
122300	PECO Energy Co - Gas	R-2018-3000512	\$4,239,398	-1.41%
122350	Peoples Gas Company LLC	R-2018-3000502	\$6,248,271	-6.68%
123100	UGI Utilities Inc - Gas Division	R-2018-3000736	\$15,656,213	-5.78%
125127	UGI Central Penn Gas Inc	R-2018-3000738	\$5,967,773	-8.19%
125146	UGI Penn Natural Gas Inc	R-2018-3000737	\$6,157,318	-3.90%
212070	Newtown Artesian Water Co	R-2018-3000932	-\$55,315	0.93%
212285	Pennsylvania-American Water Co	R-3018-3000724	\$44,159,256	-6.79%
212955	Superior Water Company Inc	R-2018-3000847	\$52,450	-2.04%
230073	Pennsylvania-American Water Co - Wastewater	R-2018-3000725	\$2,008,087	-7.68% *
230240	Aqua Pennsylvania Wastewater Inc	R-2018-3000738	-\$88,602	1.27%
<b>Currently Pending Rate Case</b>				
110150	Duquesne Light Company	R-2018-3000124	\$19,676,260	-4.09%
110550	PECO Energy Company - Electric Division	R-2018-3000164	\$68,341,000	-5.31%
111100	UGI Utilities, Inc. - Electric Division	R-2017-2640058		
120700	Columbia Gas of Pennsylvania, Inc.	R-2018-2647577	\$21,597,194	-4.11%
210013	Suez Water Pennsylvania Inc.	R-2018-3000834	\$1,626,692	-3.72%
210104	Aqua Pennsylvania, Inc.	R-2018- TBD	-\$10,182,346	2.39%
213550	York Water Company	R-2018-3000019	\$950,565	-2.05%

\* denotes that the company has filed a Petition for Reconsideration.