

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

555 Walnut Street, 5th Floor, Forum Place
Harrisburg, Pennsylvania 17101-1923
(717) 783-5048
800-684-6560

FAX (717) 783-7152
consumer@paoca.org

March 9, 2018

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: The Tax Cuts and Jobs Act: Tax Reform
Bill Signed Into Law on December 22, 2017
Docket No. M-2018-2641242

Dear Secretary Chiavetta:

Attached for electronic filing are the Comments of the Office of Consumer Advocate in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

/s/ Barrett C. Sheridan

Barrett C. Sheridan

Assistant Consumer Advocate

PA Attorney I.D. # 61138

E-Mail: BSheridan@paoca.org

Enclosures:

cc: James Mullins, Law Bureau
Erin Laudenslager, Bureau of Technical Utility Services
Certificate of Service
*244918

CERTIFICATE OF SERVICE

The Tax Cuts and Jobs Act: Tax Reform : Docket No. M-2018-2641242
Bill Signed Into Law on December 22, 2017 :

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate's Comments, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 9th day of March 2018.

SERVICE BY E-MAIL & INTER-OFFICE MAIL

Bureau of Investigation and Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

SERVICE BY E-MAIL & FIRST CLASS MAIL, POSTAGE PREPAID

Office of Small Business Advocate
300 North Second Street
Suite 202
Harrisburg, PA 17101

/s/ Barrett C. Sheridan
Barrett C. Sheridan
Assistant Consumer Advocate
PA Attorney I.D. # 61138
E-Mail: BSheridan@paoca.org

Phillip D. Demanchick
Assistant Consumer Advocate
PA Attorney I.D. #324761
E-Mail: PDemanchick@paoca.org

Counsel for Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101
Phone: (717) 783-5048
Fax: (717) 783-7152
*244921

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

The Tax Cuts and Jobs Act: Tax Reform Bill
Signed Into Law on December 22, 2017

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: Docket No. M-2018-2641242
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COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

Phillip D. Demanchick
Assistant Consumer Advocate
PA Attorney I.D. # 324761
E-Mail: PDemanchick@paoca.org

Barrett C. Sheridan
Assistant Consumer Advocate
PA Attorney I.D. # 61138
E-Mail: BSheridan@paoca.org

Counsel for
Tanya J. McCloskey
Acting Consumer Advocate

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152

DATED: March 9, 2018

I. INTRODUCTION

On February 12, 2018, the Pennsylvania Public Utility Commission (Commission) issued a Secretarial Letter commencing a proceeding seeking to measure the effects of the Tax Cuts and Jobs Act on major Commission-regulated electric, natural gas, water, and wastewater public utilities. The Tax Cuts and Jobs Act: Tax Reform Bill Signed Into Law on December 22, 2017, Docket No. M-2018-2641242, Secretarial Letter (Feb. 12, 2018) (Secretarial Letter). The Commission directed interested parties to file comments concerning whether the tax savings realized as a result of the tax reform should be passed back to ratepayers and if so, what method should be used. The Secretarial Letter also directed certain utilities identified in Attachment A to provide verified responses to the Data Requests in Attachment B in order to calculate, among other things, the net effect on income tax expense and rate base as a result of the implementation of the TCJA. The Commission also requested the utilities to complete Excel spreadsheet templates to assist in calculating the effect on taxable income and customer rates related to the TCJA.¹

The Tax Cuts and Jobs Act is the most sweeping and complex federal tax reform since 1986. Due to the enactment of a reduced federal corporate income tax rate, utilities will realize tax savings in two ways, a reduced annual tax expense and excess ADIT. The Office of Consumer Advocate (OCA) submits that these tax savings represent an extraordinary and substantial, non-recurring reduction in utility expense that should be treated outside of a general rate proceeding and flowed back to ratepayers. Furthermore, to allow utilities to keep a tax expense it is not otherwise incurring may violate the ‘actual taxes paid’ doctrine and result in rates that are not just

¹ Upon review of the live, electronic Excel spreadsheet, the OCA identified some errors in the electronic formulae related to the calculation of state and federal taxable income and some omission of data needed to calculate federal taxable income that may impact the tax calculation. If the utilities do not use the proper formula and data, the accuracy of the submissions by utilities may be affected. Accordingly, the OCA specifically requests access to the live, electronic Excel spreadsheets in order to review them. See also pgs. 7-8, infra.

and reasonable. For these reasons, the OCA submits that all tax expense savings realized as a result of the tax reform be flowed back to ratepayers as of January 1, 2018.

The OCA further submits that the Commission can utilize the established surcharge and reconciliation mechanism contained in Section 1307 of the Public Utility Code to accomplish this goal. Specifically, utilities should establish a negative surcharge in the form of a credit reduction. To calculate the negative surcharge, the utility should calculate its projected tax expense for 2018 as if the Tax Cuts and Jobs Act had not gone into effect and compare it to its projected tax expense for 2018 under the new tax laws. The savings can be returned to customers on a revenue basis (specifically distribution revenue for electric and natural gas utilities) similar to the State Tax Adjustment Surcharge or the Distribution System Improvement Charge. This would result in a percentage adjustment to the customer bill.

The OCA submits that since estimated tax effects would be used to calculate the savings, the utility should reconcile to its actual 2018 tax expense on a pre- and post-Tax Cuts and Jobs Act basis. In addition, if the utility has yet to file for a general base rate proceeding with rates effective as of January 1, 2019, the utility should submit a projection of its 2019 tax expense on a pre- and post-Tax Cuts and Jobs Act basis following the same procedure as before. The negative surcharge should continue until a general base rate proceeding when the surcharge is rolled into base rates and eliminated, and new rates pursuant to the general rate proceeding reflecting the new tax law go into effect.

In accordance with the Commission's request, the OCA submits these comments further elaborating its position in this matter. Additionally, attached as Appendix A is the OCA's response to the Data Requests propounded in the Secretarial Letter.

A. Procedural History

On December 22, 2017, President Donald Trump signed into law the Tax Cuts and Jobs Act, the most sweeping and complex tax reform since 1986. Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (TCJA or the Act). This legislation's provisions will have important effects on the public utility industry. Most importantly, the TCJA established a new federal tax rate for corporate income tax. The tax reform sets a flat tax rate of 21 percent on all corporate income replacing the graduated tax brackets with the highest rate of 35 percent. Additionally, the TCJA provides a 20 percent deduction for income from a trade or business conducted within the United States by a partnership, S corporation, or sole proprietorship.² These changes went into effect on January 1, 2018.

On February 12, 2018, the Commission published a Secretarial Letter commencing a proceeding by which the Commission will seek to determine the effects of the TCJA on the tax liabilities of the major Commission-regulated electric, natural gas, water, and wastewater public utilities for 2018 and future years and the feasibility of reflecting such impacts in the rates charged to Pennsylvania utility ratepayers.³ The Secretarial Letter directed interested parties to submit comments addressing: (1) whether the Commission should adjust current customer rates to reflect the reduced annual state and federal income tax expenses of public utilities due to the tax rate changes in the TCJA, (2) if so, the appropriate negative surcharge or other methodologies that would permit immediate modifications to consumer rates, and (3) whether the surcharge or other methodology should provide that any refunds to ratepayers due to these reduced taxes be effective

² Other changes to the tax code could potentially affect public utilities.

³ On March 2, 2018, the Commission issued a Secretarial Letter notifying telecommunications carriers that the Commission seeks to determine the effects of the TCJA on existing price cap rates, rates for interconnection service, and rates for other retail and wholesale services. Additionally, the Commission has requested that interested parties submit comments addressing questions regarding the effects of the TCJA on telecommunications companies. The Commission continues to consider the effect of the TCJA on smaller public utilities not listed in Attachment A. The OCA supports this consideration.

as of January 1, 2018. Responses are to be provided on March 9, 2018. The OCA submits these Comments in accordance with the Secretarial Letter.

B. Effects of the Tax Cuts and Jobs Act

The corporate tax rate reduction is having an immediate impact on investor-owned utilities in two significant areas, the first being reduced tax expense. As a regulated entity, utilities are allowed to earn a pre-determined rate of return on rate base sufficient to attract capital investment, even after it has paid its federal and state taxes. Effectively, the ratepayer pays the utility's tax bill. Federal taxes, however, are not flowed through (i.e. on a dollar-for-dollar basis), rather the amount of taxes that a ratepayer must pay on behalf of the utility is determined in advance of the utility's actual tax payment at a general rate proceeding. During the ratemaking process, the federal income tax component of a utility's rates is accounted for through a gross up of the utility's net income. Now that the TCJA is in effect, this gross up may not adequately capture the reduced federal corporate income tax rate. For this reason, utilities are now charging ratepayers for an expense at a rate that it may not be incurring.

The second impact the TCJA has on investor-owned utilities is that it will cause utilities to have excess Accumulated Deferred Income Taxes (ADIT). The Internal Revenue Code (IRC) applies different rules for when a public utility may actually incur a tax versus when it must recognize the tax for book purposes, *i.e.* the amount it collects from ratepayers for its cost of service. ADIT is a regulatory tool tracked by a utility to ensure that funds ratepayers pay towards a utility's income taxes align with the actual federal taxes paid by a company over a period of time. When the federal tax rate, however, decreases from 35 percent to 21 percent, the Company has to pay less tax in the future than it collected from ratepayers in the past. This extra capital is excess ADIT.

Based on the above, the TCJA has likely reduced the taxes paid by utilities below what is being collected in rates. As discussed in more detail below, these tax savings are an extraordinary, non-recurring and substantial event that warrant returning any savings to ratepayers as of January 1, 2018.

C. State and Public Utility Action

Many state commissions have initiated proceedings to determine the effects of the TCJA.⁴ At the time of the submission of these comments, many proceedings remain in the comment phase, with state commissions still investigating the full impact of this legislation. Some states have indicated the importance of returning these benefits to ratepayers and the OCA agrees. Commissioner Olson from the Arizona Corporation Commission stated “I acknowledge it is a significant task to make these reductions to the rates of every utility that maintains recovery of federal tax revenue in their revenue requirement. Still, it is imperative that this Commission and the regulated utilities work together to pass the tax savings onto the ratepayers.”⁵ In opening an investigation into the effects of the tax reform, Chairman of the Hawaii Public Utilities Commission stated that “the Public Utilities Commission will work with regulated utilities and the Consumer Advocate to ensure these tax savings are passed on to customers.”⁶ On January 3, 2018, the Governor of Louisiana promptly wrote to the Louisiana Public Service Commission asking that the Commission ensure that these tax savings are flowed back to ratepayers.⁷

⁴ The following states have initiated an investigation into the effects of the Tax Cuts and Jobs Act: Arizona, Arkansas, Delaware, Hawaii, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, South Dakota, Tennessee, Utah, Virginia, West Virginia, Wisconsin, Wyoming.

⁵ Arizona Corporation Commission, Commissioners Call for Federal Income Tax Reform Rate Reduction (Dec. 21, 2017), <http://www.azcc.gov/Divisions/Administration/news/2017Releases/2017-12-21newsrelease.asp>

⁶ Big Island Now, PUC Opens Investigation of Legislation’s Impact on Public Utilities in Hawai’i, (Jan. 28, 2018), <http://bigislandnow.com/2018/01/28/puc-opens-investigation-of-legislations-impact-on-public-utilities-in-hawaii/>

⁷ Letter from John Bel Edwards, Governor, Louisiana, to Louisiana Public Service Commission (Jan. 3, 2018), <http://gov.louisiana.gov/assets/docs/Letters/JBE-ltr-PSC-1.3.18.pdf>

Additionally, some utilities have taken the initiative to reduce their rates to reflect the effects of the tax reform by filing Petitions with their respective Commissions. For example, Baltimore Gas & Electric (BG&E), a sister company of PECO Energy Company (PECO), submitted revised rates reflecting changes to its revenue requirement authorized in its most recent general rate proceeding.⁸ BG&E calculated the difference between the income tax expense previously authorized and calculated that income tax expense as if the lower corporate income tax rate had been in effect during the test year. Additionally, in calculating the amount of excess ADIT, BG&E split it into two categories: property related ADIT and non-property related ADIT.⁹ While the company amortized non-property related excess ADIT over ten years, it amortized the excess property related ADIT over the remaining useful life of the asset to ensure that it flows back in compliance with the Internal Revenue Service's (IRS) normalization requirements.¹⁰ BG&E then added these amounts together to determine the entire revenue requirement decrease which it ultimately reflected by reducing the company's volumetric charges.¹¹ Louisville Gas and Electric Company and Kentucky Utilities Company, sister companies of PPL Electric Company, have also agreed to provide a 'Tax Cuts and Jobs Act Surcredit' which will reflect the benefits of the TCJA from January 1, 2018 to April 30, 2019, the day before base rates are expected to change following base rate case proceedings.¹² Other examples include Nevada Power Company and the Public Service Electric and Gas Company of New Jersey.¹³

⁸ Baltimore Gas & Electric, Supplement 613 to Md. E-6 and Supplement 443 to Md. G-9 Reduction in Electric and Gas Base Distribution Rates to Flow Through Tax Savings Resulting from the Tax Cuts and Jobs Act of 2017, Maillog No. 218429, filed Jan. 5, 2018, rates effective Feb. 1, 2018, <http://www.psc.state.md.us/official-filings/>

⁹ Id.

¹⁰ Id.

¹¹ Id.

¹² Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company and Louisville Gas and Electric Company, Case No. 2018-00034, Direct Testimony of Kent W. Blake at 4-5 (KY PSC Jan. 29, 2018).

¹³ Application of Nevada Power Company d/b/a NV Energy filed under Advice Letter No. 485 to revise Tariff No. 1-B to establish the 2017 Tax Rate Reduction Rider, Docket No. 18-02010, Advice Letter No. 485, (Feb. 14, 2018), http://pucweb1.state.nv.us/PDF/AxImages/DOCKETS_2015_THRU_PRESENT/2018-2/27522.pdf; Public Service

D. Summary of Commission Action/Legal Authority

As stated in the February 12, 2018 Secretarial Letter, the Commission has commenced a proceeding “to determine the effects of the TCJA on the tax liabilities of Commission-regulated public utilities for 2018 and future years and the feasibility of reflecting such impacts in the rates charged to Pennsylvania utility ratepayers.” Secretarial Letter at 1. The OCA agrees with the premise of the Commission’s proceeding – that the Commission has a statutory obligation pursuant to Section 1301 of the Public Utility Code to ensure that all rates charged are just and reasonable. *Id.*; 66 Pa. C.S. § 1301. The TCJA’s reduction in corporate tax rate has a direct and measurable impact on the tax expense of regulated utilities, both as to federal tax expense and state tax expense, as currently reflected in base rates. Pursuant to Section 1307, the Commission has the authority to take steps to assure that the benefits of this extraordinary, non-recurring event and substantial change, which is the result of a change in law beyond the utility’s control, are promptly recognized in utilities’ rates to ensure that ratepayers are paying only a just and reasonable level of rates. 66 Pa.C.S. § 1307. For a more comprehensive discussion of the Commission’s legal authority, please see pgs. 8-11, infra.

E. Process Issues

The OCA is an interested party and intends to review the information solicited by the Commission, including the calculation of utility state and federal taxes based on the February 12, 2018, Secretarial Letter, Attachment C template. The OCA will require access to the utility supplied information, in its original live format. As mentioned in Footnote 1 of these Comments, the OCA has identified some errors in the electronic formulae related to the calculation of state and federal taxable income, as well as the omission of some data from the spreadsheets necessary

Electric and Gas Co., *PSE&G proposes to lower customer bills by 2 percent on Apr. 1*, PSEG (Mar. 2, 2018), <https://www.pseg.com/info/media/newsreleases/2018/2018-03-02.jsp#.Wp7KXGrwa71>.

to calculate federal taxable income. A thorough review of the live, electronic spreadsheet will be needed to confirm the accuracy of the calculations. To the extent that utilities report information to the Commission with request for confidential treatment, the OCA submits that an appropriate protective agreement or order should be promptly implemented. 52 Pa. Code §§ 5.362(a)(7) (protective orders for trade secrets). In a non-adversarial proceeding, a petition for protective order is referred to Law Bureau for recommended disposition by the Commission. 52 Pa. Code §§ 5.365(b). The OCA is ready to work with Commission staff and other interested parties to promptly resolve these process issues, so the Commission, OCA and other interested parties can review the calculations and move expeditiously.

II. RESPONSE TO COMMISSION QUESTIONS

1. Should the Commission adjust current customer rates to reflect the reduced annual state and federal income tax expenses of public utilities due to the tax rate changes in the TCJA

Yes. The TCJA's reduction in corporate tax rate has a direct and measurable impact on the tax expense of regulated utilities, both as to federal tax expense and state tax expense, as currently reflected in base rates. Pursuant to Section 1307, the Commission has the authority to take steps to assure that the benefits of this extraordinary, non-recurring event and substantial change, which is the result of a change in law beyond the utility's control, are promptly recognized in utilities' rates to ensure that ratepayers are paying only a just and reasonable level of rates. 66 Pa.C.S. § 1307.

It is axiomatic that the process of establishing base rates is in general a forward looking endeavor, without "line by line examination of the relative success or failure of the utility to have accurately projected its particular items of expense or revenue..." Philadelphia Electric Co. v. Pa. P.U.C., 93 Pa. Commw. 410, 419, 502 A.2d 722, 727-28 (1985). An exception to this rule in the

case of retroactive recovery or unanticipated expenses has been recognized where the expenses are extraordinary, substantial, and nonrecurring. *Id.*; *see, e.g. Popowsky v. Pa. P.U.C.*, 695 A.2d 448 (Pa. Commw. 1997) (PPL OPEB) (Change in accounting standards imposed substantial expenses which could not have been anticipated at the time of prior base rate case.) This recognized exception is of critical importance. The significant changes in tax law that took effect January 1, 2018, could not have been anticipated. Given that the last such major reform of federal tax laws occurred in 1986, the impact of the TCJA on utilities' tax expense is also an unanticipated event. Moreover, the changes in utilities' tax expenses as a result of the TCJA are likely to be substantial. The OCA respectfully submits that the Commission must now take prompt action to adjust public utilities' rates to reflect the benefits to ratepayers of this change in federal tax law.

The Commission has two regulatory mechanisms at its disposal. Section 1308(a) allows public utilities to file a change in rates. 66 Pa.C.S. § 1308(a). Pursuant to Section 1307, the Commission may prescribe by order a mandatory obligation for public utilities to file tariffs to implement a sliding scale of rates or automatic adjustment clause, to become effective when and in the manner as ordered by the Commission. 66 Pa.C.S. §§ 1307(a), (b). The Section 1307 surcharge or automatic adjustment clause is tariffed, subject to the Commission's approval as to the initial rates. *Id.* The Section 1307 surcharge is then subject to periodic reconciliation and review by the Commission and adjustment as necessary to address a deficiency or surplus. 66 Pa.C.S. §§ 1307(a), (e).

The OCA submits that a Section 1307 surcharge appears to be the most appropriate mechanism to address the change in utilities' federal and state tax expenses which are the result of the TCJA.¹⁴ The purpose of Section 1307 is "to permit reflection in customer charges of changes

¹⁴ Proceeding on Commission's Own Motion with Respect to the Effect of the Tax Reform Act of 1986 on Utility Rates, et al., 62 Pa. PUC 623 (1986) (TRA86 Initial Order). The OCA acknowledges that the Commission took a

in one component of a utility's cost of providing public service without the necessity of the broad, costly and time-consuming inquiry required in general rate cases" Pennsylvania Indus. Energy Coalition v. Pa. P.U.C., 653 A.2d 1336 (Pa. Commw. 1995) (PIEC), *aff'd per curiam*, 543 Pa. 307, 670 A.2d 1152 (Pa. 1996), *citing* Nat'l Fuel Gas Distribution Corp. v. Pa. P.U.C., 473 A.2d 1109, 1121 (1984). "[T]he very function of the typical automatic adjustment clause is to permit rapid recovery of a specific *identifiable* expense item, with a more comprehensive analysis upon reconciliation of actual costs with previously projected costs used to establish the effective rate. The initial process is essentially a mathematical review of the projections provided by the public utility." Masthope Rapids Property Owners Council v. Pa. PUC, 581 A.2d 994, 999-1000 (1990) (emphasis in original). A Section 1307(a) automatic rate adjustment is appropriate where expressly authorized or "for easily identifiable expenses that are beyond a utility's control, *such as tax rate changes* or changes in the costs of fuel." Popowsky v. Pa. P.U.C., 13 A.3d 583, 590-91 (Pa. Commw. 2011) (Popowsky (Newtown)) (emphasis added), *citing* Popowsky v. Pa. P.U.C., 869 A.2d 1144, 1156-57 (2005) (Popowsky 2005), *appeal denied*, 895 A.2d 552 (2006).

The Commission has approved Section 1307 surcharges for the recovery of public utilities' expenses arising from changes in state tax rates and certain tax liabilities. State Tax Adjustment Surcharge, 44 Pa. PUC 545 (1970) (STAS Order).¹⁵ The STAS provides public utilities an opportunity to recover the increased tax expense while affording ratepayers the protection of "later review [of] each utility's situation to enable us to require refunds or other remedies to customers

different approach in 1986 than what the OCA is now recommending. The OCA notes that the ratemaking and regulatory framework has changed significantly since 1986, as illustrated by the variety of alternative ratemaking mechanisms now employed by Pennsylvania utilities, including the number of single-issue surcharges employed for the recovery of costs. *See, e.g., Alternative Ratemaking Methodologies*, Tentative Order at 9-10 (May 17, 2017) (List of cost trackers or surcharges in common use by major electric and natural gas utilities).

¹⁵ The State Tax Adjustment Surcharge order is also appended to the Commission's STAS Guidelines. *See*, 52 Pa. Code § 69.52; Exh. A. The General Assembly added Section 1307(g.1) in 2002, affirming that certain state tax changes are subject to recovery or adjustment pursuant to Section 1307. 66 Pa.C.S. § 1307(g.1).

in any appropriate case.” *Id.*, at 546. The Commission has approved the use of Section 1307 surcharges for the recovery of gas transition costs resulting from FERC Order 636;¹⁶ the costs of PennVest loans not previously recovered in base rates;¹⁷ changes in purchased water expense;¹⁸ storm damage expenses;¹⁹ default service costs; energy efficiency expenses; and universal service expenses.²⁰ The extraordinary and substantial decrease in federal tax expense is no less deserving of such special ratemaking treatment to immediately provide any benefit to ratepayers.

The OCA urges the Commission to take prompt action so that public utilities adjust their rates, through a Section 1307(a) Negative Federal Tax Adjustment Surcharge, to account for the difference in federal tax rates and corresponding impact on state tax expense. The OCA submits that a Section 1307(a) negative surcharge meets the necessary regulatory and legal requirements to address this extraordinary occurrence. The decrease in the federal tax rate is a matter beyond the control of each public utility and is likely to have an extraordinary, non-recurring, and substantial impact on the utility’s tax expenses. The difference between pre-2018 federal tax rates and TCJA reduced federal tax rate effective January 1, 2018 can be readily calculated and applied to a utility’s 2018 base rate revenues to calculate an appropriate net negative surcharge. A Section 1307(a) surcharge tariff filing can be rapidly implemented, with the Section 1307(e) reconciliation process providing an opportunity for review and adjustment to address a deficiency or surplus.

¹⁶ Recovery of FERC Order 636 Transition Cost – Statement of Policy, 52 Pa. Code § 69.341, *et seq.*

¹⁷ PENNVEST Obligations for Water and Sewer Companies – Statement of Policy, 52 Pa. Code § 69.361, *et seq.* A Section 1307(a) surcharge for recovery of PENNVEST obligations is limited to recovery of the principal and interest, subject to reconciliation and refund.

¹⁸ (*Popowsky (Newtown)*, 13 A.3d 583.

¹⁹ *Pa. P.U.C. v. PPL Electric Utilities Corporation*, Docket No. R-2012-2290597, Opinion and Order (Apr. 3, 2014)(*PPL SDER*), *on recon.*, Opinion and Order (May 22, 2014)(PPL petition for reconsideration denied)(*PPL SDER Reconsideration*); *aff’d*, *McCloskey v. Pa. P.U.C.*, 2015 Pa. Commw. Unpub. LEXIS 919 (2015).

²⁰ *See, Alternative Ratemaking Methodologies*, Tentative Order at 9.

66 Pa.C.S. §§ 1307(a), (e).²¹ The Section 1307 negative surcharge could then be zeroed out and eliminated as part of the public utility's next Section 1308 base rate case.²²

2. What is the appropriate negative surcharge, or other methodologies that would permit immediate modifications to consumer rates?

As stated above, the OCA supports the use of a negative federal tax adjustment surcharge pursuant to Section 1307 of the Public Utility Code that would require utilities to flow back the tax savings to ratepayers immediately.

A. The OCA's Proposed Negative Surcharge Methodology

The OCA's proposed methodology would function as follows: each utility subject to Commission jurisdiction would file a negative surcharge to be effective preferably by April 1, 2018, but no later than May 1, 2018. The negative surcharge would be based on projected 2018 data as calculated pursuant to the response to Question 1 of the Commission's Data Requests.²³ Each utility would estimate its pro forma federal income tax expense in 2018 as if the TCJA did not take effect. The utility would then calculate its 2018 pro forma income tax expense according to the provisions of the TCJA.²⁴ The difference in the two amounts would then be credited as a reduction to the customer's bill. The negative surcharge would be "trued-up" after its first year of operation by comparing the utility's actual 2018 federal income tax expense both on a pre- and post-TCJA basis. The negative surcharge would be rolled into base rates in the utility's next base rate case and ended when the new base rates reflect the TCJA.

²¹ See, Section 1307(e) Reconciliation Statement Pilot Program, Docket No. M-2013-2345492, Final Implementation Order at 12 (2015). The Commission's Final Implementation Order establishes the process and protections which apply when a reconciliation statement is 1) uncontested and there is no material issue of fact in dispute, or 2) contested and so subject to a hearing, recommended decision, and final Commission review.

²² See, PPL SDER at 27, PPL SDER Reconsideration, at 11-14.

²³ How does the reduction in the corporate Federal Income Tax Rate from 35% to 21% affect your federal tax obligations for calendar year 2018 and subsequent tax years? Please quantify your response as to the effects on both current and deferred tax obligations. Secretarial Letter, Att. B.

²⁴ The OCA submits that if a smaller utility is unable to project its tax expense for 2018, it may be necessary to use actual 2017 tax expense to calculate the negative surcharge.

The tax savings should be returned to ratepayers on a revenue basis, similar to the operation of the STAS or DSIC. For electric and natural gas utilities, distribution revenues would be utilized. A resulting percentage reduction would then be applied to the customer's bill.

B. True-Up Procedure

The Commission should direct that each utility submit a reconciliation of its federal income tax expense at the end of 2018 or in its next base rate proceeding, whichever is sooner. The true-up should calculate the difference between the company's tax expense under the old law for the year of 2018 and its actual tax expense under the TCJA for the year of 2018. The difference is the amount that the utility should have credited to ratepayers in its negative surcharge for 2018. The reconciliation would be consistent with the Commission's requirement of a regular or annual "true-up" imposed on the sliding scale adjustment procedures. See 66 Pa.C.S. §§1307(e). The true-up procedure would also allow the Commission to study and clarify any present uncertainties that exist with respect to the new federal tax law. In this manner, both utilities and their ratepayers can be assured of receiving fair treatment under the negative surcharge procedure.

The OCA submits that during this true-up procedure, for each year until the utility files a base rate case, a utility should project the following year's tax expense under a pre- and post-TCJA basis to determine the difference in its tax expense for that year. Similar to the procedure above, the company would then adjust its negative surcharge to account for any changes between future taxable years. The utility would then reconcile the negative surcharge each time after the year has completed.

The interim negative surcharge should be rolled into base rates and eliminated in the very next general rate case after the new rates accounting for the reduced federal tax rate are effective. There is no reason why, on a long-term basis, federal tax expense should be treated outside the

context of a base rate case. While interim measures are necessary to capture the effects of this substantial tax change, the ultimate treatment of federal tax expense should continue to be part of the overall determination of just and reasonable rates in a utility's general rate proceeding.

3. Should the surcharge or other methodology provide that any refunds to ratepayers due to these reduced taxes be effective as of January 1, 2018.

Yes. The negative surcharge should incorporate all tax savings beginning as of January 1, 2018 because as of this date the annual expense that the utility needs to collect for its tax obligations will need to be adjusted to reflect the changes of the TCJA.

III. CONCLUSION

The OCA appreciates the opportunity to comment on the The Tax Cuts and Jobs Act: Tax Reform Bill Signed Into Law on December 22, 2017. As discussed above, the OCA submits that tax savings produced as a result of the TCJA represent an extraordinary and substantial, non-recurring expense reduction that must be passed back to ratepayers through a negative surcharge. The OCA provides some additional discussion in its responses to the Commission's Data Requests, included as Attachment A.

Respectfully Submitted,



Phillip D. Demanchick
Assistant Consumer Advocate
PA Attorney I.D. # 324761
E-Mail: PDemanchick@paoca.org

Barrett C. Sheridan
Assistant Consumer Advocate
PA Attorney I.D. # 61138
E-Mail: BSheridan@paoca.org

Counsel for:
Tanya J. McCloskey
Acting Consumer Advocate

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152

Dated: March 9, 2018
245064

Question 1: How does the reduction in the corporate Federal Income Tax Rate from 35% to 21% affect your federal tax obligations for calendar year 2018 and subsequent tax years? Please quantify your response as to the effects on both current and deferred tax obligations

The companies will need to provide this information. The OCA requests that each Company provide this information and the live, working Excel spreadsheets to the OCA. The OCA would note that each company should calculate the impact on the current federal tax expense, as well as the impact on Accumulated Deferred Income Taxes (ADIT). The ADIT calculation should reflect both the property and non-property related ADIT.

Question 2: If a reduced tax obligation is passed through to ratepayers, explain the methodology to be used to compute the reduction, the rate mechanism to accomplish the reduction, and the allocation among customer classes?

I. Methodology

Utilities should return these tax savings back to ratepayers through a negative surcharge pursuant to Section 1307 of the Public Utility Code. First, the utility should calculate its projected tax expense for the year of 2018 based under the previous tax laws compared to its 2018 tax expense in accordance with the provisions of the TCJA. The difference should be the amount returned to ratepayers. Second, utilities should submit a reconciliation of the federal tax expense after the first year it is in effect by comparing the actual 2018 tax expense on a pre- and post-TCJA basis. This will ensure that all the tax savings have been properly flowed back to all ratepayers. Third, the utilities should roll the negative surcharge into base rates and eliminate it during the next general rate proceeding after the new rates reflecting the reduced tax expense are in effect. See pgs. 12 – 14, supra.

2. Mechanism

The OCA recommends that the Commission require utilities to flow back these tax savings through a negative federal tax adjustment surcharge pursuant to Section 1307 of the Public Utility Code on an immediate basis, similar to the STAS. See pgs. 12 – 14, supra.

3. Allocation

The tax savings should be returned to ratepayers on a revenue basis, similar to the STAS. This obviates the need for a specific customer class allocation. For electric and natural gas utilities, distribution revenues should be used to establish the percentage reduction. See pg. 13, supra.

Question 3: If any of the potential tax savings from the reduced federal corporate tax rate can be used for purposes other than to reduce customer rates, provide details on how and where those tax savings can be used.

The OCA submits that utilities should pass all of these tax savings back to ratepayers. It is not reasonable for Pennsylvania public utilities to keep these tax savings or put them to other uses. See pgs. 8 – 11, supra. Numerous mechanisms are already in place supporting utility operations, many with special consumer protections that would be bypassed if ratepayer tax savings were used for those purposes.

Question 4: Does the Company have any Net Operating Losses (NOL) as of 12/31/2017? Please Quantify the impact of the Tax Cuts and Jobs Act (TCJA)?

A Net Operating Loss (NOL) refers to a situation where a public utility's expenses and allowable deductions reduces its taxable income below zero. For tax purposes, the public utility is unprofitable. Where the taxable income of a public utility is less than zero, it reduces the utility's effective federal tax rate to zero. In these situations, the Company would not have to pay federal

tax in that year. Utilities were allowed to apply NOLs in the two previous taxable years (called a “carryback”) from the year the NOL was established. Additionally, the Company could also choose to carryforward the NOL for up to 20 years. The Company could apply the NOLs in future years to reduce taxable income.

The TCJA changes some provisions related to NOL. Specifically, NOLs arising after year 2017 can no longer be applied to previous tax payments, but can only be carried forward. Furthermore, the twenty-year limitation on NOL carryforward has been removed and certain limitations were placed on the use of NOLs incurred after 2017.

The OCA submits that based on the above, NOLs that public utilities currently have should be unaffected by these changes as the TCJA’s NOL provisions only apply to NOLs incurred after 2017.

Question 5: Does the company have any Deferred Tax Liabilities as of 12/31/17? Please quantify the impact of the Tax Cuts and Jobs Act (TCJA)?

The OCA requests that the companies also provide this information in live, working Excel spreadsheets to the OCA. The OCA submits that, along with reduced tax expense, any excess ADIT that results from the TCJA should be returned to ratepayers as part of the Section 1307 mechanism in accordance with the normalization rules.

ADIT is a regulatory tool to track differences in the timing of tax expense caused by using normalized depreciation for calculating income tax expense for ratemaking purposes and tax depreciation to calculate the actual annual tax liability of the utility. These tax timing differences can cause the Company to collect a greater tax expense from ratepayers than it actually incurs on an annual basis. ADIT is reduced over time when the book depreciation used to determine rates exceeds the tax depreciation and therefore, the annual deduction for ratemaking purposes is greater

than the annual deduction actually taken by the utility. With this methodology, the utility and the ratepayers pay the same amount of taxes over a given period of time.

When the federal tax rate for corporate income changes, however, a utility's actual tax expense for a taxable item generating ADIT will never equal what the utility has collected from ratepayers for book purposes. Ratepayers essentially pre-paid income taxes at 35 percent, but due to the TCJA, the utility will have to pay these taxes at only 21 percent. The difference that the utility never has to pay because of the TCJA is referred to as excess ADIT.

1. Excess ADIT Should Be Returned to Ratepayers

Simply put, excess ADIT should be returned to ratepayers. Due to the TCJA, Pennsylvania utilities have collected an expense that they will not incur in the future.¹ The Data Requests issued by the Commission require utilities to calculate the effect of the TCJA on their respective ADIT balances making this information readily available to the Commission. For this reason, excess ADIT, along with the reduction in tax expense, should be calculated and returned to ratepayers as part of the Section 1307 mechanism.

2. Method

Given that ADIT tracks timing differences for various taxable items, there are two categories of ADIT: property-related ADIT and non-property related ADIT. These categories require different rules when returning excess ADIT back to ratepayers. Accordingly, the OCA will deal with each separately.

¹ Many jurisdictions have already established deferred regulatory accounts to track excess ADIT. See e.g. Instituting a Proceeding to Investigate the Impacts of The Tax Cuts and Jobs Act of 2017, Docket No. 2018-0012, Order No. 35241 at 5-6 (HI PUC Jan. 26 2018), An Investigation of the Impact of the Tax Cuts and Jobs Act on the Rates of Atmos Energy Corp., Delta Natural Gas Co., Inc., Columbia Gas of Kentucky, Inc., Kentucky-American Water Co., and Water Service Corp. of Kentucky, Case No. 2017-00481, Order at 2 (KY PSC Dec. 27, 2017), Application of Mike Hunter, The Attorney General of Oklahoma, to Lower the Rates and Charges for Electric Service and Provide for Any Refund Due to the Customers of Public Service Company of Oklahoma Resulting from the Tax Cuts and Jobs Act of 2017, Cause No. PUD 201700572, Interim Order Granting Attorney General's Motion for Immediate Reduction in Rates and Protection of Customer Interests at 6 (OK SCC Jan 8, 2018).

a. Property Related Excess ADIT

Property-related ADIT refers specifically to timing differences in recognizing depreciation on a utility's capital assets. Current tax laws allow utilities to accelerate depreciation to recognize greater depreciation deductions on a capital asset in a shorter period than its useful life for ratemaking purposes. Even if a Company used accelerated depreciation to calculate its tax expense, for ratemaking purposes, depreciation was required to be normalized. This required normalization caused ratepayers to pay more in tax expense than the utility was paying on a current basis. Ordinarily, the ADIT created from this scenario would even out over a depreciable asset's service life. In enacting the TCJA, however, the reduced corporate income tax rate creates a situation where the utility's actual tax expense will be less than what it collects from ratepayers because the future tax rate is now lower than was anticipated when rates were determined. In other words, the utility is collecting more than what is needed for its future tax payments.

The TCJA requires that property related excess ADIT be flowed back using the Average Rate Assumption Method (ARAM), or alternatively, using the Alternative Method. TCJA § 13001(d)(1). ARAM requires utilities to return the property-related excess ADIT to ratepayers over the remaining lives of the property, as used in its regulated book of accounts, which generated the ADIT. Under ARAM, if timing differences for the property reverse, the amount of the adjustment to the property-related ADIT reserve is calculated by multiplying the (i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question (the applicable average rate), and (ii) the amount of the timing differences that reverse during such period. TCJA § 13001(d)(3)(B). The Alternative Method may only be used if the following two criteria are met: (1) the regulatory agency requires utilities to compute depreciation for public utility property based on an average life or composite

rate method and (2) a utility does not have the data necessary to apply ARAM. TCJA § 13001(d)(2). Under the Alternative Method, the utility must calculate the excess ADIT on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation and reduce the excess ADIT ratably over the remaining regulatory life of the property. TCJA § 13001(d)(3)(C).

The OCA requests, therefore, that property-related excess ADIT be returned to customers through the negative surcharge in an amount respecting the normalization rules.

b. Non-Property Related Excess ADIT

Non-property related excess ADIT refers to tax timing differences with regard to taxable items that are unrelated to capital assets. With respect to these items, normalization requirements do not apply. This means that utilities are free to flow back non-property related excess ADIT under any time frame found reasonable.

The OCA submits that non-property related excess ADIT should be amortized back to ratepayers over some reasonable period. The OCA submits that a period of 10 years may be reasonable.²

Question 6: Are there any impacts on riders/surcharges resultant from the TCJA? If so, please explain.

The OCA submits that to the extent another surcharge collects an amount for federal taxes and does not reflect the 2018 TCJA tax rates, then that surcharge must be adjusted to reflect the new federal tax rates. For surcharges calculated on an annual basis, an interim adjustment should be made to that surcharge, to reflect the lower tax obligation. If the surcharge is subject to quarterly

² See Supplement 613 to Md. E-6 and Supplement 443 to Md. G-9 Reduction in Electric and Gas Base Distribution Rates to Flow Through Tax Savings Resulting from the Tax Cuts and Jobs Act of 2017, Maillog No. 218429, filed Jan. 5, 2018, rates effective Feb. 1, 2018, <http://www.psc.state.md.us/official-filings/>

adjustment or semi-annual adjustment, then the first scheduled adjustment or reconciliation for 2018 should incorporate the new TCJA tax rates which apply to that surcharge as of January 1, 2018.

Question 7: Are there any other changes made in the TCJA that will impact the company? If so, please explain.

The OCA requests that the companies provide this information and live, working electronic Excel spreadsheets to the OCA if used to identify other changes.

Question 8: What test year should be used to quantify the new 21% federal tax rate to be effective 1/1/18?

Companies should use their projected tax expense for 2018 to quantify the impact of the TCJA for a 2018 negative surcharge. The companies should then use actual tax expense data from 2018 after the year has concluded to reconcile the tax savings calculation. The process should then be repeated for the following year using projected tax expense data, until new base rates incorporating the tax savings become effective. See pgs. 12-14, supra.

Given that many companies have not had base rate cases in many years, the use of the 2018 calendar year will provide for the best data for making these calculations.

Question 9: Please provide the following information regarding your last Commission approved rate case:

- a. Docket Number
- b. Date Filed
- c. Approved Rate of Return
- d. Approved Increase in Annual Revenues
- e. Allocation of Approved Increase Among Major Customer Classes
- f. Effective Date of New Rates

The OCA requests that the companies provide this response to the OCA.