COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

March 9, 2018

Secretary Rosemary Chiavetta
Pennsylvania Public Utility Commission
400 North Street, 2nd Floor
Harrisburg, PA 17105

Re: Tax Cuts and Jobs Act of 2017
Docket No. M-2018-2641242

Dear Secretary Chiavetta:

Enclosed please find the Bureau of Investigation and Enforcement's (I&E) **Comments** in this proceeding.

Copies are being served on all active parties of record as evidenced in the attached Certificate of Service. If you have any questions, please contact me at 717-783-7998.

Sincerely,

Allison C. Kaster

Allison C. Kaster
Prosecutor
Bureau of Investigation and Enforcement
PA Attorney I.D. No. 93176

ACK/wsf
Enclosure

cc: Erin Laudenslager, Bureau of Technical Utility Services
James Mullins, Law Bureau

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Tax Cuts and Jobs Act of 2017 M-2018-2641242

COMMENTS OF THE
BUREAU OF INVESTIGATION & ENFORCEMENT

Allison C. Kaster
Prosecutor
PA Attorney ID #93176

Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Post Office 3265
Harrisburg, Pennsylvania 17105-3265

Dated: March 9, 2018

I. INTRODUCTION

On February 12, 2018, the Pennsylvania Public Utility Commission ("Commission") issued a Secretarial Letter seeking comments to determine the effects of the Tax Cuts and Jobs Act ("TCJA" and "Tax Act") on the tax liabilities of Commission-regulated utilities and the feasibility of reflecting those impacts in rates. Pursuant to a subsequent Secretarial Letter dated March 2, 2018, the due date for filing comments was extended to March 27, 2018.

The TCJA was signed into law on December 22, 2017, which significantly reduced the corporate Federal Income Tax rate from 35% to 21% effective January 1, 2018. In general, the 35% tax rate is currently embedded in the rates of jurisdictional utilities; therefore, until rates are modified to reflect this tax reduction, rates paid by customers will no longer be just and reasonable in violation of the Public Utility Code ("Code").[1]

In the Secretarial Letter, the Commission requested that utilities provide responses to data requests to calculate the TCJA's net effect on income tax expense and rate base and to assist the Commission in its calculation of the effects on taxable income and customer rates. Additionally, the Commission requested that interested parties submit comments addressing:

---

[1] 66 Pa. C.S. § 1301.

(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 customers due to these reduced taxes be effective as of January 1, 2018.

The Bureau of Investigation and Enforcement ("I&E") appreciates the opportunity to offer its input regarding these matters. I&E serves as the Commission's prosecutory bureau for the purposes of representing the public interest in ratemaking and service matters, and in enforcing compliance with the Code.[2] With this in mind, and with the benefit of the experience that I&E has accumulated in prosecuting base rate cases, I&E files these timely comments to ensure that rates are just and reasonable.

II. COMMENTS

A. Customer Rates Must be Adjusted

Rates must be adjusted to ensure that customers receive the benefit of this tax reduction in a timely manner. As will become apparent when jurisdictional utilities respond to the Commission's data requests, these savings will likely be significant and it is important to flow the savings to ratepayers to ensure that rates are just and reasonable as mandated by the Public Utility Code. Importantly, it must be made clear that utilities

---

[2] 66 Pa. C.S. §§ 101 *et seq.*, and Commission regulations, 52 Pa. Code §§ 1.1 *et seq. See Implementation of Act 129 of 2008; Organization of Bureaus and Offices,* Docket No. M-2008-2071852 (Order entered August 11, 2011).

cannot use the revenues from the TCJA tax reduction for other purposes, such as increasing their earned return or funding capital projects.

Commission authorized rates allow for the recovery of prudent operating expenses and the opportunity for investors to earn a fair rate of return on invested capital. Income tax expense is included in the cost of service; therefore, rates for many jurisdictional utilities are currently designed to recover income tax expense assuming a 35% federal rate. Given the Tax Act's recent reduction to 21%, rates that currently have the 35% tax rate imbedded must be reduced to reflect the lower tax expense and the amortization of excess accumulated deferred income taxes ("ADIT"). This recommendation is consistent with the "actual taxes paid doctrine" as determined by the Pennsylvania Supreme Court in *Barasch v. Pennsylvania Public Utility Commission*, 507 Pa. 561, 493 A.2d 653 (1985). This ratemaking principle states that utilities may only collect from ratepayers the state and federal taxes that it actually pays; therefore, requiring customers to continue to pay a phantom 35% is improper and results in unjust and unreasonable rates in violation of the Public Utility Code.

At a minimum, three adjustments must be made to reflect the savings. First, the federal income tax expense portion (and any other related changes to state income tax and other iterated expenses based on reduction to the revenue requirement) must be adjusted. The second adjustment must capture the backward-looking tax due to the inflated federal income tax rate of 35% captured in rates between January 1, 2018 and the effective date of the approved mechanism. As discussed below, I&E recommends that the savings be passed back to ratepayers through a negative surcharge. While there are a variety of

ways that such savings can be captured, it is important that ratepayers are refunded the savings between January 1, 2018 and the date the Commission approves a refund mechanism. The third adjustment should capture the impact of all changes resulting from identification of ADIT and bonus depreciation, where applicable. The Tax Act impacts ADIT because it is comprised of taxes already collected by the utilities at the 35% rate but will not be paid to the federal government given the new 21% rate. It may require additional time and data requests from the Commission to determine the specific related dollar amount(s). If a delay is required to identify the amount needed to reclassify excess ADIT to a deferred liability and determine the appropriate number of years required to flow this amount back to ratepayers (based on IRS guidelines), I&E recommends a deadline not later than the Fall of 2018 to incorporate this portion of the adjustment into the surcharge as discussed above.

In addition to the adjustments discussed above, tax savings from FERC reductions may also need to be passed through to ratepayers. Utilities and suppliers purchase transmission and other services under FERC approved rates, which include an allowance for current and deferred federal income tax expense. If FERC jurisdictional utilities are required to flow savings under the Tax Act to Commission regulated utilities or to electric generation suppliers ("EGS"), those savings should likewise flow through to jurisdictional customer to ensure that they receive the full benefit of the Tax Act. A coalition of states, state agencies, and state consumer advocates have asked FERC to revise current formula rates to reflect the savings under the Tax Act. It is I&E's understanding that FERC has not yet announced any policy or procedure to pass along

the tax savings but, if such a policy is passed, any tax rate reduction for such services should likewise be passed on to jurisdictional customers.

Finally, it is important to state that utilities should not be permitted to retain the tax savings to increase their earned return or fund capital projects, which are properly addressed through base rate cases and the Distribution System Improvement Charge. Using the federal income tax savings to circumvent the traditional ratemaking process by requiring customers to pay a tax rate of 35% when utilities are actually paying the much lower rate of 21% violates the actual taxes paid doctrine and results in unjust and unreasonable rates. Ratemaking tools are available for utilities to increase their return and capital spending, but it is improper for customers to continue paying the inflated 35%. Moreover, flowing the savings to ratepayers now ensures that those customers who actually made the excess tax payments to see the benefits of the TCJA. If utilities use the tax savings for future projects, it will take more time for customers to realize the full benefits of the TCJA and, importantly, as time passes, some customers that made tax overpayments to their utilities may no longer be customers of that utility and will never get their money back. Therefore, utilities should not be permitted to divert these tax savings to their shareholders or to capital projects as it should be refunded to customers.

It appears that many utilities across the country recognize that this corporate tax cut must be shared with its ratepayers. For example, Baltimore Gas & Electric announced that it is passing $82 million of tax savings to its gas and electric customers, resulting in an estimated $4.27 monthly reduction for its combined gas and electric customers. Similarly, Commonwealth Edison Company is passing $200 million of tax

savings to its customers and, once approved by the Illinois Commerce Commission, the average residential customer can expect an estimated $2.00-$3.00 decrease on their monthly bill. Similarly, I&E anticipates that jurisdictional utilities will also

B. A Negative Surcharge is the Appropriate Way to Refund

As noted above, the tax benefit must be spread to ratepayers, and the methodology to do so can be accomplished in a variety of ways: a rate reduction, a tax adjustment rider applied to customer bills, amortization of a regulatory liability, or a combination of these pursuant to Commission approval. I&E's preferred methodology is that this excess deferred tax component flow through the newly established surcharge until each utility files a base rate case.

This newly established negative surcharge specifically for the purposes of crediting monies to ratepayer bills for the impacts of the TCJA would be most effective as it allows the Commission's Bureau of Audits to reconcile and verify the changes made. The surcharge would be shared equally among customer classes and be zeroed out and eliminated when each utility files its next base rate case thereby adjusting the tax-related items in the rate filing. As discussed above, I&E encourages the inclusion of an adjustment for the excess deferred tax amount to flow through this surcharge. However, if that is not determined to be practical by the Commission, a deadline of Fall 2018 should be set to require companies to establish the dollar amount and number of years (based on IRS guidelines) to pass back the required amount to ratepayers. When a subsequent base rate case is filed, companies should be required to begin refunding the monies with interest as discussed above. A report should be filed with the Commission

to show the workpapers used to determine the excess deferred tax amount and the number of years required to flow back this amount to ratepayers.

However, if the Commission decides it is appropriate to delay return of excess deferred taxes to ratepayers until the filing of a base rate case, I&E strongly encourages the Commission to require affected companies to pay interest to ratepayers over the amortization period at the prime rate for commercial borrowing as is done for the DSIC and over/under collections for purchased gas costs. Requiring companies to establish the regulatory liability now will eliminate any future concerns about retroactive ratemaking when each company files its next base rate case.

C. Customer Refunds Should Be Effective January 1, 2018

The negative surcharge should incorporate all tax savings beginning January 1, 2018 to properly account for the change in the federal tax rate.

III. CONCLUSION

Again, I&E appreciates the opportunity to provide these comments. For purposes of clarity, I&E notes that the comments it now presents were made only after a preliminary review and without the benefit of considering the positions advanced by other parties. However, as discussed above, I&E maintains that the savings resulting from the TCJA should be passed back to ratepayers through a negative surcharge.

Respectfully submitted,

Allison C. Kaster
Deputy Chief Prosecutor
PA Attorney ID #93176

Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Post Office 3265
Harrisburg, Pennsylvania 17105-3265

Dated: March 9, 2018