

COMMONWEALTH OF PENNSYLVANIA



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April 6, 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,

A handwritten signature in black ink, appearing to read "P. Demanchick", with a long, sweeping horizontal line extending to the right.

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Enclosures:

cc: James Mullins, Law Bureau
Erin Laudenslager, Bureau of Technical Utility Services
Certificate of Service
*246157

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 6th day of April 2018.

SERVICE BY E-MAIL & INTER-OFFICE MAIL

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Dated: April 6, 2018
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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

COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

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DATED: April 6, 2018

I. INTRODUCTION

On March 12, 2018, the Pennsylvania Public Utility Commission (Commission) issued a Secretarial Letter seeking to measure the effects of the Tax Cuts and Jobs Act (TCJA) on small natural gas distribution companies (NGDCs). The Tax Cuts and Jobs Act: Tax Reform Bill Signed Into Law on December 22, 2017, Docket No. M-2018-2641242, Secretarial Letter (Mar. 12, 2018) (March 12 Secretarial Letter). To that end, the Secretarial Letter directed certain NGDCs identified in Attachment A to provide verified responses to the Data Requests in Attachment B, as well as complete Excel spreadsheet templates to assist in calculating the effect of the TCJA on taxable income and customer rates. The Commission also directed interested parties to file comments concerning the legal and ratemaking framework that applies, whether the tax savings realized as a result of tax reform should be passed back to ratepayers and if so, what method should be used.

Prior to this Secretarial Letter, the Commission issued two other Secretarial Letters in the above-captioned proceeding directing interested parties to file comments regarding the TCJA's effect on (1) major Commission-regulated electric, natural gas, water, sewer, and wastewater companies and (2) telecommunications carriers. The Office of Consumer Advocate (OCA) has submitted Comments addressing both Secretarial Letters. As stated in previous Comments, and further elaborated below, the OCA submits that tax savings resulting from the change in the federal tax code 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 immediately.

To calculate the tax savings, the utility should calculate its projected tax expense for 2018 as if the TCJA had not gone into effect and compare it to its projected tax expense for 2018 under the new tax law. The OCA recognizes, however, that small NGDCs may not be able to calculate their projected 2018 tax expense, and it may be necessary to calculate actual tax expense from

2017 on a pre- and post-TCJA basis. The difference in tax expense, along with any excess Accumulated Deferred Income Taxes (ADIT), is the amount that should be returned to ratepayers.

In general, the OCA recommends that the tax savings be returned to customers on a revenue basis (specifically distribution revenue for electric and natural gas utilities) through the use of a Section 1307 mechanism similar to the State Tax Adjustment Surcharge (STAS) or the Distribution System Improvement Charge (DSIC). This would result in a percentage adjustment to the customer bill. The OCA recognizes that a small NGDC's billing systems may make it difficult to implement a negative surcharge in this manner. Additionally, it is possible that the annual tax savings amount for some small NGDCs will be small. In those circumstances, it would be reasonable to return the savings to ratepayers in another manner such as in the form of a one-time annual credit to customers in each year until the utility's next base rate proceeding.

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-TCJA 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 the following year's tax expense on a pre- and post-TCJA basis following the same procedure as before. A return of the annual savings should continue until a general base rate proceeding when new rates pursuant to a general rate proceeding reflect the new tax law.

In accordance with the Commission's request, the OCA incorporates its Comments filed on March 9, 2018, by reference. [The Tax Cuts and Jobs Act: Tax Reform Bill Signed Into Law on December 22, 2017](#), Docket No. M-2018-2641242, OCA Comments at 8-12 (Mar. 9, 2018) (March 9 OCA Comments). The OCA recognizes that there may be some differences between the larger utilities and the small NGDCs. To the extent that these differences require a different ratemaking

approach, the OCA will elaborate below. The end result, however, should be the same. To the extent that federal tax expense is included in current rates and/or excess ADIT results from the tax law change, the tax expense savings and excess ADIT should be flowed through to ratepayers in a timely manner. Additionally, included as Attachment A is the OCA's response to the Data Requests propounded in the March 12 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). For a more comprehensive discussion of the TCJA, its effect on utility rates, and state actions in response to the TCJA, see the OCA's Comments filed on March 9. See March 9 OCA Comments at 3-6.¹

On February 12, 2018, the Commission released a Secretarial Letter commencing this proceeding by which the Commission seeks 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. The Tax Cuts and

¹ Since March 9, 2018, some states have taken further steps to ensure that the tax savings resulting from the TCJA are flowed back to ratepayers. On March 20, 2018, the Kentucky Public Service Commission approved a settlement wherein Kentucky Utilities Company and Louisville Gas and Electric Company agreed to reduce rates by approximately \$176.9 million. Kentucky Industrial Utility Customers, Inc., v. Kentucky Utilities Co. and Louisville Gas and Electric Co., Case No. 2018-00034, Order at 10 (Mar. 20, 2018). In doing so, however, the Kentucky PSC modified the settlement by requiring the utilities to reduce their rates by an additional \$26.9 million, due to modifications the PSC made to the manner in which the utilities calculated the tax reduction. Id., at 7-8. On March 26, 2018, the New Jersey Board of Public Utilities approved several orders requiring sixteen utilities to reduce rates to ensure "that customers will reap the benefits of lower federal taxes for utility companies." NEW JERSEY BOARD OF PUBLIC UTILITIES, NJ BOARD OF PUBLIC UTILITIES TAKES ACTION TO ENSURE UTILITIES PASS FEDERAL TAX SAVINGS ON TO CUSTOMERS (Mar. 26, 2018), http://www.bpu.state.nj.us/bpu/newsroom/announcements/pdf/20180326_pr.pdf. In total, the Board approved approximately \$56 million in rate reductions for water utility customers and \$215 million for electric and gas customers. Id. Additionally, on March 13 and March 15, 2018, the Federal Energy Regulatory Commission issued two show-cause orders to ensure that certain public utilities address the impact of the TCJA on their transmission rates. AEP Appalachian Transmission Company, Inc. et al., Docket Nos. EL18-62-000, *et al.*, 162 FERC ¶ 61,225, Order to Show Cause (Mar. 13, 2018), Alcoa Power Generating Inc. – Long Sault Division, et al., Docket Nos. EL18-72-000, *et al.*, 162 FERC ¶ 61,224, Order to Show Cause (Mar. 15, 2018). Responses are due within sixty days.

Jobs Act: Tax Reform Bill Signed Into Law on December 22, 2017, Docket No. M-2018-2641242, Secretarial Letter (Feb. 12, 2018) (February 12 Secretarial Letter) The February 12 Secretarial Letter referred specifically to the Commonwealth's larger electric, natural gas, water, and wastewater utilities, but stated that review of telecommunication carriers and smaller public utilities would follow.

The Commission released a second Secretarial Letter on March 2, 2018 directing the Commonwealth's thirty-seven (37) incumbent local exchange carriers (ILECs) to provide information regarding the impact of the TCJA on their tax expense and plans to flow through any savings to the ILECs' Pennsylvania consumers. Additionally, the March 2 Secretarial Letter directed interested parties to submit comments.

On March 12, 2018, the Commission published a Secretarial Letter seeking to determine the effects of the TCJA on small NGDCs. Specifically, the Commission identified Herman Oil & Gas Co. Inc., Leatherstocking Gas Co. LLC, North East Heat & Light Co., Pike County Light & Power Co., Riemer Natural Gas LLC, and Valley Energy Inc. 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 as of January 1, 2018. The OCA submits these Comments in accordance with the March 12 Secretarial Letter.

B. Process Issues

The OCA is an interested party and intends to review the information solicited by the Commission, including any calculation of utility state and federal taxes and other financial information as requested in the Commission's Data Requests.² The OCA will require access to such utility supplied information, in its original live format. 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, the 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, to the extent that the small NGDC collects tax expense from ratepayers and/or has excess ADIT as a result of the tax law change, rates should be adjusted to reflect the reduced state and federal income tax expense.

As stated in the OCA's Comments filed on March 9, 2018, the TCJA's reduction of the federal corporate tax rate has a direct and measurable impact on the tax expense of regulated

² In the OCA's initial Comments filed on March 9 responding to the February 12 Secretarial Letter, it 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. See February 12 Secretarial Letter, Att. C; see also March 9 OCA Comments at 1, 7. The OCA is unable to verify whether Attachment C of the March 12 Secretarial Letter contains similar errors and omissions. Therefore, a thorough review of the small NGDCs' live, electronic spreadsheets will be needed to confirm the accuracy of the calculations.

utilities, both as to federal tax expense and state tax expense, as currently reflected in base rates, as well as creating excess ADIT for those that have existing ADIT balances. See March 9 OCA Comments at 4-5, Att. A at 3-6. Pursuant to Section 1307, the Commission has the authority to take steps to assure that the benefits of this extraordinary and substantial, non-recurring event, which is the result of a change in law beyond the utility's control, are promptly recognized in utility rates. 66 Pa.C.S. § 1307.

The OCA recognizes that the small NGDCs identified in the March 12 Secretarial Letter may not have federal tax expense incorporated in base rates for a number of reasons. For example, the utility may be in a net loss carry forward position or the utility filed as a sole proprietorship. In such instances, the OCA understands that it would not be appropriate to reduce the utility's rates if it is not currently collecting tax expense from ratepayers. For this reason, the OCA awaits the filings from each utility to determine whether those companies collect tax expense from ratepayers. The OCA looks forward to those filings.

To the extent that a small NGDC collects tax expense from ratepayers and/or has excess ADIT, however, the principles outlined above and in the OCA's Comments filed on March 9 are applicable. Namely, the Commission should recognize that these tax savings are an extraordinary and substantial, non-recurring event justifying the return of the savings to ratepayers on an immediate basis. See March 9 OCA Comments at 8-12.

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

In general, 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. In essence, a utility should calculate the effect the TCJA has on its tax expense for 2018 by comparing its projected tax expense for 2018 under the TCJA

and its projected 2018 tax expense as if the TCJA had not taken effect in 2018. The difference, along with excess ADIT as calculated by the normalization requirements, would then be credited to ratepayers on a revenue basis. Specifically, with natural gas utilities, the NGDC would credit ratepayers on a distribution revenue basis.

Further, the surcharge would be reconciled at the end of 2018 or the next general rate proceeding, whichever is sooner. This process would continue until the utility rolls the negative surcharge into base rates and eliminates the surcharge in the next general rate proceeding when new rates reflecting the reduced tax expense are in effect. For a more comprehensive discussion of this procedure, please see the OCA's Comments filed on March 9. March 9 OCA Comments at 12-14.

Specifically with small NGDCs, however, it may be necessary to modify this process. First, in determining the effect of the TCJA on its federal and state income tax expense, the small NGDC may be unable to project its tax expense for 2018. In such instances, it may be necessary to use the company's actual 2017 tax expense on a pre- and post-TCJA basis to calculate the amount to refund to ratepayers for 2018. The company would then reconcile its actual 2018 tax expense at the end of the year to determine what it should have credited ratepayers. The small NGDC would then use this actual 2018 tax expense to project the amount of savings to be returned in the following year, if the company has not yet reflected the tax savings in rates pursuant to a general rate proceeding. Secondly, if the utility demonstrates that it would be burdensome to implement a negative surcharge, similar to the STAS, the OCA recommends that the utility adopt a method most convenient to the utility and its billing system. For example, the utility could establish a one-time annual credit to return the tax savings to customers rather than using an on-going surcharge

mechanism. This would occur annually until the utility's next general rate proceeding when the new rates reflect the tax changes.

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 or credit 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 because of the TCJA represent an extraordinary and substantial, non-recurring expense reduction that must be passed back to ratepayers. With respect to small NGDCs, if the small NGDC is collecting federal tax expense reflecting higher tax rates than required by the TCJA or has excess ADIT, some minor modifications to the methodology and mechanism may need to be made in order to flow the savings to ratepayers expeditiously. The OCA provides some additional discussion responding to the Commission's Data Requests, included as Attachment A.

Respectfully Submitted,



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Dated: April 6, 2018
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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 small NGDCs should explicitly state whether current rates reflect federal tax expense and whether it has an ADIT balance. 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 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?

1. Methodology

Generally, 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, as well as any excess ADIT accounting for the normalization rules, 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 return of the annual tax expense should continue until the next general rate proceeding when the new rates reflecting the reduced tax expense are in effect. See pg. 6-7, supra.

If, however, a small NGDC can verify that it would be unable to provide an estimate of its 2018 tax expense, it may be necessary to use its actual 2017 tax expense to estimate the amount to

be flowed back to ratepayers in 2018. The small NGDC would then reconcile the credit based on actual 2018 tax expense at the end of the year or its next base rate proceeding, whichever is sooner. See, pg. 7-8, supra. Subsequently, the small NGDC may use actual 2018 tax expense to project the tax savings to credit ratepayers in the following year, if it has not yet reflected the tax savings in rates pursuant to a general rate proceeding.

2. Mechanism

Generally, 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 pg. 6-7, supra.

If, however, the small NGDC can verify that such a method would be burdensome, it may utilize a method most convenient for the company and its billing system. For example, the Company could provide an annual, one-time billing credit that would be assessed each year until the credit is rolled into base rates and eliminated at the next general rate proceeding after new rates reflecting the reduced tax expense are in effect. See pg. 7, supra.

3. Allocation

In general, tax savings should be returned to ratepayers on a distribution revenue basis. This obviates the need for a specific customer class allocation. See pg. 6-7, supra. For small NGDCs where the amount to be returned may be small or billing system limitations make the use of a negative surcharge difficult, the Company could provide an annual billing credit per customer that would be assessed each year until the company's next general rate proceeding when new rates reflect the TCJA. See pg. 7, 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 March 9 OCA Comments at 8-12. 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 ?

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 or annual billing credit in accordance with the normalization rules. See March 9 OCA Comments, Att. A at 3-6 (contains an in-depth explanation of excess ADIT and the normalization requirements).

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 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?

Generally, companies should use their projected tax expense for 2018 to quantify the impact of the TCJA for 2018. 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 pg. 6, supra, see also March 9 OCA Comments at 12-14. 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.

If a small NGDC is unable to calculate its tax expense for 2018, however, it may be necessary to calculate the tax expense savings based on the utility's actual 2017 tax expense. The utility would then reconcile its tax savings at the end of the year using its actual 2018 tax expense and use that data to credit ratepayers for the following year if it cannot verify its projected tax expense. See pg. 7-8, supra.

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.