BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's Investigation of the Financial Impact of the Tax Cuts and Jobs Act of 2017 on Regulated Ohio Utility Companies	))))	Case No. 18-0047-AU-COI

TESTIMONY
OF
JONATHAN J. BORER

RESEARCH AND POLICY DIVISION
RATES AND ANALYSIS DEPARTMENT

STAFF EXHIBIT NO. _____

TESTIMONY OF JONATHAN J. BORER

1. Q. **Please state your name and business address.**

A. My name is Jonathan J Borer. My business address is 180 East Broad Street, Columbus, Ohio 43215-3793.

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

A. I am employed by the Public Utilities Commission of Ohio (PUCO) as a Utility Auditor 2 in the Research and Policy Division of the Rates and Analysis Department. My duties include conducting investigations of assigned phases of rate case applications and other financial audits of public utility companies subject to the jurisdiction of the PUCO.

3. Q. **Would you briefly state your educational background?**

A. I earned a Bachelor of Science in Accounting and a Bachelor of Science in Management from Purdue University in 2014. In 2017, I attended the Annual Regulatory Studies Program offered by the Institute of Public Utilities as well as the National Association of Regulatory Commissioners (NARUC) Utility Rate School.

4. Q. **Please briefly outline your work experience.**

A. I have been with the PUCO since November 2016 with my entire time spent in the Rates and Analysis Department. Prior to working at the PUCO, I was employed with Morgan Stanley within the Global Wealth Management Group.

5. Q. **What is the purpose of your testimony in this proceeding?**

A. The purpose of my testimony is to address the accounting authority pertaining to the Commission's directive that Ohio public utilities record the estimated reduction in federal income tax related to the Tax Cuts and Jobs Act (TCJA) as a deferred liability on their books. More specifically, this testimony will address whether or not the Commission's directive adheres to Generally Accepted Accounting Principals (GAAP). In addition, I will discuss a framework to assess the reasonableness of imposing a deferred liability.

6. Q. **What is Staff's understanding of the Commission's directive?**

A. Staff's understanding of the directive is that the Commission ordered utilities to record the savings from the TCJA as a deferred liability on their books. This liability would include in part, the savings resulting from a reduced federal income tax expense and the "excess" accumulated deferred income taxes (ADIT), which represent money that must be returned to customers since it is no longer owed to the IRS. Staff believes the savings resulting from a reduced federal income tax expense will be deferred from

January 1, 2018 until rates are adjusted to reflect the reduced income tax rate.

7. Q. **What is being used as an authoritative reference in making this determination?**

A. The Financial Accounting Standards Board (FASB) has the authority to establish and interpret GAAP in the United States. The Security and Exchange Commission and American Institute of Certified Public Accountants both recognize FASB standards as the official authority for the basis and preparation of financial statements in the United States. The FASB Accounting Standards Codification (ASC or the "Codification") organizes nongovernmental US GAAP using a topic-based model consisting of individual Topics.

The primary source of industry-specific accounting guidance for regulated operations is currently codified into ASC 980, Regulated Operations.

8. Q. **Does the Commission's directive comport with GAAP?**

A. Yes. FASB ASC 980 addresses regulated operations, and subsection 405-25-1 provides guidance on the required criteria, timing, and location for recognizing and recording regulator-imposed liabilities. This subsection states, "Rate actions of a regulator can impose a liability on a regulated entity. Such liabilities are usually obligations to the entity's customers."

This clearly supports the fact that the Commission's directive adheres to GAAP.

9. Q. **Does the Commission have a standard of review for authorizing deferrals?**

A. Yes, the Commission has a standard of review for deferral requests associated regulatory *assets*; however, due to the infrequency of occurrence, there is no standard of review for authorizing deferrals associated with regulatory *liabilities.* These review standards, which were most recently addressed in Case No. 17-2118-GA-AAM[1], are based on the following five criteria:

1. Whether the utility's current rates or revenues are sufficient to cover the costs associated with the requested deferral;
2. Whether the costs are material;
3. Whether the reason for requesting the deferral is outside the utility's control;
4. Whether the expenses are atypical and infrequent; and
5. Whether the financial integrity of the utility will be significantly and adversely affected, if the deferral is not granted.

[1] *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods,* Case No. 17-2118-GA-AAM, Finding and Order (April 18, 2018).

While these standards were intended to be applied to deferred assets, they could be used to provide an approximate review of the reasonableness of a deferred liability.

10. Q. **Would the deferred liability associated with the TCJA meet the criteria used to review deferred assets?**

A. Yes, however, certain criteria need to be reworded in order to properly be applied to deferred liabilities. Modifications to the language have been identified where appropriate.

1. *Are the utility's current rates or revenues* *<u>insufficient</u>* *to cover the costs associated with the deferral?*

The utilities meet this criterion because rates have been developed based on a 35% Federal Income Tax rate (FIT rate), so current rates would be sufficient to cover the deferral associated with reducing the FIT rate to 21%.

2. *Are the* *<u>expense reductions</u>* *material?*

The Commission has directed the utilities to defer all tax savings associated with the TCJA, which broadly speaking, represent a reduction in tax expense. As a result of Ohio's ratemaking formula, the tax expense reductions are material. Ohio's ratemaking formula allows federal income taxes to be recovered on a dollar-for-dollar basis in the revenue requirements of base rates, riders, etc. Since the current and deferred income taxes are directly affected by the FIT rate, the expense reductions are material because changing the FIT rate from 35% to 21% represents a reduction of 40%. In addition, there is an approximate reduction of 18% to the Gross Revenue Conversion Factor (GRCF), exclusive of other taxes. In addition to the materiality of the reduction to income tax expenses, there is the separate issue of excess ADIT. Based on Staff's analysis, the balance of the excess ADIT is tens or even hundreds of millions of dollars, which Staff believes to be material.

3. *Is the reason for requesting the deferral outside the utilities' control?*

Yes. The tax reduction was outside the utilities' direct control. The decision to reduce Federal Income Taxes was an act of Congress and signed by the President of the United States.

4. *Are these expense* <u>*reductions*</u> *atypical and infrequent?*

Yes. While minor changes to the tax code are relatively more frequent[2], major overhauls to the Federal Income Tax rate are quite rare. The last major change to the corporate tax rate occurred in 1986.

---

[2] For example, in 1992, the top tax bracket increased from 34 to 35%.

5. Will the financial integrity of the utility be significantly and adversely affected if the deferral ***is required****?*

No. Utilities' revenues are not impacted by the TCJA; therefore, cash inflows will otherwise remain the same as they would have had the TCJA not been enacted. Conversely, cash outflows to the federal government have *decreased*. All else being equal, this means the utilities are seeing an increase in net income, so in effect, the Commission is ordering the utilities to defer an amount such that net income at the current 21% FIT rate would be the same as net income at the previous 35% FIT rate.

11. Q. **Does this conclude your testimony?**

A. Yes it does. However, I reserve the right to submit supplemental testimony as described herein, as new information subsequently becomes available or in response to positions taken by other parties.

CERTIFICATE OF SERVICE

This is to certify that the foregoing **Testimony of Jonathan J. Borer** has been served upon all of the parties of record in Case No. 18-0047-AU-COI by electronic and/or U.S. mail, postage pre-paid mail this 29th day of June, 2018.

/s/Jodi J. Bair
Jodi J. Bair
Assistant Attorney General

PARTIES OF RECORD:

Amy.spiller@duke-energy.com
bbingaman@firstenergycorp.com
campbell@whitt-sturtevant.com
cdunn@firstenergycorp.com
cmblend@aep.com
Christopher.healey@occ.ohio.gov
cmooney@ohiopartners.org
dstinson@bricker.com
dsawmiller@nrdc.com
Elizabeth.watts@duke-energy.com
fdarr@mwncmh.com
gkrassen@bricker.com
Jeanne.kingery@duke-energy.com
jkylercohn@bkllawfirm.com
jfinnigan@edf.org
joliker@igsenergy.com
josephclark@nisource.com
kathybuckley@verizon.com
bojko@carpenterlipps.com
kboehm@bkllawfirm.com
kevin.moore@occ.ohio.gov
mleppla@theoec.org
mfleisher@elpc.org
whitt@whitt-sturtevant.com
mpritchard@mwncmh.com
mkurtz@bkllawfirm.com
mlozich@securustechnologies.com
mnugent@igsenergy.com
Michael.schuler@aes.com
mwhelan@egas.net
neil.waggoner@sierraclub.org
paul@carpenterlipps.com
glover@whitt-sturtevant.com
randell.griffin@aes.com
rocco.dascenzo@duke-energy.com
selisar@mwncmh.com
sseiple@mwncmh.com
stnourse@aep.com
trhayslaw@gmail.com