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FILE Ohio | Public Utilities Commission

Mike DeWine, Governor
Sam Randazzo, Chairman

June 24, 2019

Docketing Division
Public Utilities Commission of Ohio
180 East Broad Street
Columbus OH 43215

RE: *In the Matter of the Application of Aqua Ohio, Inc., for Implementation of the Tax Cuts and Jobs Act of 2017, Case No. 18-1843-WW-UNC; In the Matter of the Application of Aqua Ohio, Inc. for Approval of Tariff Revisions, Case No. 18-1844-WW-ATA.*

Dear Docketing Division:

Enclosed please find the Review and Recommendations of the Staff of the Public Utilities Commission of Ohio (Staff) in the Matter of Aqua Ohio, Inc.'s Application for Implementation of the Tax Cuts and Jobs Act of 2017, Case No. 18-1843-WW-UNC, et al.

Tamara S. Turkenton
Director, Rates and Analysis Department
Public Utilities Commission of Ohio

David Lipthratt
Chief, Research and Policy Division
Public Utilities Commission of Ohio

Enclosure
Cc: Parties of Record

Aqua Wastewater Inc.
Case No. 18-1843-WW-UNC
Case No. 18-1844-WW-ATA

SUMMARY

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (TCJA) was signed into law. Among other changes, the TCJA lowered the federal corporate income tax rate from a maximum 35 percent to a flat 21 percent, effective January 1, 2018. Additionally, the reduction in the federal corporate tax rate may result in excess accumulated deferred income taxes (EDIT) balances because the amount of ADIT that a public utility has recorded in its books will exceed the amount the public utility needs to pay its future federal income tax obligations.

On January 10, 2018, the Public Utilities Commission of Ohio (Commission) opened a Commission-ordered investigation (COI), Case No. 18-47-AU-COI, in order to study the impacts of the TCJA on the Commission's jurisdictional, rate-regulated utilities and determine the appropriate course of action to pass benefits on to ratepayers. By Entry issued January 10, 2018, the Commission invited all of the rate-regulated Ohio utilities, as well as other interested stakeholders, to file comments discussing the following: (i) those components of utility rates that the Commission will need to reconcile with the TCJA and (ii) the process and mechanics for how the Commission should do so.[1] Additionally, the Commission directed utilities to record on their books as a deferred liability, in an appropriate account, the estimated reduction in federal income tax resulting from the TCJA, effective January 1, 2018. The utilities were instructed to continue this treatment until otherwise ordered by the Commission.[2]

On December 20, 2018, Aqua Ohio, Inc. (Aqua or Company) filed an application before the Commission to establish a rider to credit to its customers the benefits of the TCJA (Application). Aqua initiated this proceeding in order to resolve issues related to the impact of the TCJA on the rates charged to customers. On March 22, 2019, Aqua Ohio Inc. filed an amended application to reflect necessary revisions to the calculation of the surcharge.

Aqua proposes to apply a credit, the TCJA Negative Surcharge, to the base water rates in its Franklin Division to reflect the tax savings realized under the TCJA. This credit will provide the following benefits:

1) Reduction in the Federal Income Tax (FIT) Rate:
   a) The estimated balance of deferrals recorded by the Company for water service accumulated from January 1, 2018, through December 31, 2018 is $2,321,452. This estimated balance of deferrals will be included in the TCJA Negative Surcharge beginning when the order is in place.
   b) The credit amount applied to each applicable customer will be reflected as a percentage of the customer's base water charges.

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[1] *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. 18-47-AU-COI, Entry at 1-2 (Jan. 10, 2018).
[2] *Id.* at 2.

c) This credit amount will be adjusted annually to reflect further changes in the FIT and will continue until the Commission approves new base water rates at which time the reduction will be incorporated into the base rates.

2) Excess ADIT:

a) Normalized EDIT (total balance of approximately $12,441,219) will be amortized in accordance with the Internal Revenue Code (IRC) Average Rate Assumption Method (ARAM) as required to conform to tax normalization rules. The normalization rate will adjust annually in accordance with ARAM.

b) Non-Normalized EDIT[3] (total balance as of approximately $3,604,846) which includes those related to property, plant, and equipment will be amortized over a period of ten years beginning with the first month the negative surcharge is effective.

c) The amortization of all EDITs will be grossed up using the revenue conversion factor based on the prevailing federal income tax rate.

d) The TCJA Negative Surcharge applied to each applicable customer will be reflected as a percentage of the customer's base water charges. This credit will be adjusted annually to reflect further changes in the EDITs, and will continue until the Commission approves new base water rates, at which time the reduction will be incorporated into the base rates.

STAFF REVIEW

Staff performed a review of the Company's attachments to the original and amended Applications, including the proposed tariff revisions reflecting the TCJA Negative Surcharge (Attachment A); and the supporting calculations for the proposed credit amount, including balances of EDIT, deferrals, and estimated rates (Attachment B). Additionally, Staff reviewed the workpapers provided by the Company to support the various tax impacts recognized in the filing.[4]

STAFF RECOMMENDATION

<u>Reduction in the FIT Recommendations:</u>

Staff recommends that the Company refund over a period of 12 months the deferred tax savings from January 1, 2018 through the date in which the TCJA Negative Surcharge becomes effective. Additionally, Staff recommends that carrying charges be applied to the monthly balance of deferrals, with such carrying charges based on the long-term debt rate approved in Aqua's most recent distribution rate case[5], and that the carrying charges cease to accrue once the TCJA Negative Surcharge becomes effective. Staff Attachment A illustrates the application of the carrying charges through December 31, 2018. This results in a Stub Period balance of $2,376,324 through

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[3] Aqua refers to Non-Normalized EDIT as "unprotected excess ADIT". For purposes of this Staff Letter, "Non-Normalized EDIT" and "unprotected excess ADIT" have the same meaning.
[4] See response to Staff DR #1
[5] *In the matter of the Application of Aqua Ohio, Inc. to Increase Its Rates and Charges for its Waterworks Service,* Case No. 16-0907-WW-AIR.

December 31, 2018. Staff further recommends that the Company update this balance to include deferrals from January 1, 2019 until the TCJA Negative Surcharge becomes effective.

In addition, Staff recommends that the FIT savings going forward be based on the Company's most recent water base rate case.[6] This method results in annual FIT savings of $2,492,759, as shown on Staff Attachment B. Staff recommends that the reduction in the FIT savings be included in the TCJA Negative Surcharge until the Commission approves new base water rates at which time the FIT savings will be incorporated into base rates.

EDIT Recommendations:

Staff recommends that Normalized EDIT include only such balances that are required to be amortized in accordance with ARAM. In addition, Staff recommends that Non-Normalized Plant-Related EDIT balances that do not have IRC limitations placed on the amortization be treated the same as Non-Normalized EDIT. Staff confirmed that the Company is including in Normalized EDIT balances only such amounts that are required to be amortized in accordance with ARAM.

Staff recommends that all EDIT balances be based on the balance as of December 31, 2017 in order to ensure that 100 percent of the EDIT is refunded to customers. Staff recommends that Normalized EDIT be amortized in accordance with ARAM in order conform to normalization rules, and that Non-Normalized EDIT be amortized over a period of 120 months (10 years). Additionally, Staff recommends that the amortization of EDIT be grossed up using the revenue conversion factor based on the prevailing federal income tax rate.

Staff recommends that the amortization of all EDIT balances be refunded through the TCJA Negative Surcharge until the balances have been fully amortized. Staff believes that a separate mechanism is the preferred means to refund EDIT to customers; therefore, Staff recommends that the Commission reject the Company's proposal to terminate the TCJA Negative Surcharge at the time new base water rates are approved.

Rate Design Recommendations:

Staff recommends that the Commission adopt the Company's proposed rate design whereby the TCJA Negative Surcharge is reflected as a percentage of the customer's base water charges.

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[6] *In the matter of the Application of Aqua Ohio, Inc. to Increase Its Rates and Charges for its Waterworks Service,* Case No. 16-0907-WW-AIR.

Staff Attachment A

Stub Period With Carrying Charges

Line		January	February	March	April	May	June	July	August	September	October	November	December
1	Monthly Beginning Balance (Previous Month Line	-	(157,033)	(250,925)	(441,231)	(567,632)	(786,806)	(1,030,568)	(1,320,835)	(1,624,488)	(1,846,339)	(2,083,546)	(2,223,081)
2	Monthly Income Tax Savings (DR #1)	(156,714)	(93,064)	(188,902)	(124,354)	(216,425)	(240,074)	(285,496)	(297,676)	(214,808)	(229,233)	(130,796)	(143,910)
3	Balance Subject to Interest	(78,357)	(203,565)	(345,376)	(503,408)	(675,845)	(906,843)	(1,173,316)	(1,469,673)	(1,731,892)	(1,960,955)	(2,148,944)	(2,295,036)
4	Carrying Charges (Line 3 * (Line 8 ÷ 12))	(319)	(828)	(1,405)	(2,047)	(2,748)	(3,688)	(4,771)	(5,977)	(7,043)	(7,975)	(8,739)	(9,333)
5	End Month Balance (Line 1 + Line 2 + Line 4)	(157,033)	(250,925)	(441,231)	(567,632)	(786,806)	(1,030,568)	(1,320,835)	(1,624,488)	(1,846,339)	(2,083,546)	(2,223,081)	(2,376,324)
6													
7												Total Stub Period $	(2,376,324)
8	Cost of Debt	4.88%											

Staff Attachment B

FIT Reduction Based on Previous Base Rate Case (Case No. 16-0907-WW-AIR)

Line No.		21% Tax Rate	35% Tax Rate
1	Rate Base	169,153,285	169,153,285
2	Adjusted Operating Income[a]	11,332,633	10,035,978
3	Required Op. Income (Line 1 * 7.47%)	12,635,750	12,635,750
4	Income Deficiency (Line 3 - Line 2)	1,303,117	2,599,772
5	Gross Revenue Conversion Factor[b]	1.3426428	1.6318274
6	Revenue Increase Required (Line 4 * Line 5)	1,749,621	4,242,380
7	Change in Revenue Increase (Line 6 $_{35\%}$ - Line 6 $_{21\%}$)	**$ 2,492,759**	

[a] See Tax Expense Reduction (Line 11)

[b] See Gross Revenue Conversion Factor Revision (Line 20)

Line No.	Tax Expense Reduction	
8	Tax Expense @ 35%	3,241,638
9	40% Reduction (Line 8 * 40%)	1,296,655
10	Operating Income @ 35%	10,035,978
11	Operating Income @ 21% (Line 10 + Line 9)	**$ 11,332,633**

Line No.	Gross Revenue Conversion Factor Revision	21% - GRCF	35% - GRCF
12	Gross Revenue	100%	100%
13	Uncollectibles	1.02%	1.02%
14	Net Revenue (Line 12 - Line 13)	98.9800%	98.9800%
15	Ohio Gross Receipts Tax (Line 14 * Line 4.75%)	4.7016%	4.7016%
16	Income Before Federal Income Tax (Line 14 - Line 15)	94.2784500%	94.2784500%
17	Federal Income Tax (Line 16 * FIT Rate)	19.7984745%	32.9974575%
18	Operating Income Percentage (Line 16 - Line 17)	74.4799755%	61.2809925%
19			
20	Gross Revenue Conversion Factor (Line 1 ÷ Line 18)	**1.342642762**	**1.631827357**

Source: Stipulation in Case No. 16-0907-WW-AIR unless otherwise noted