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. 18-47-AU-COI

REPLY COMMENTS OF DUKE ENERGY OHIO, INC.

March 7, 2018

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Pursuant to the Entry issued by the Public Utilities Commission of Ohio (Commission) on February 20, 2018, in the above-captioned proceeding, Duke Energy Ohio, Inc., (Duke Energy Ohio or Company) hereby submits its Reply Comments regarding the impacts of the Tax Cuts and Jobs Act of 2017 (TCJA) on public utilities and their customers.

I. INTRODUCTION

Duke Energy Ohio recognizes that its customers, through payment of their utility bills, provide the funding for the Company's federal income tax liabilities. In that regard, the Company's customers should be charged for those liabilities at the federal income tax rate that applies to the Company at any given time. Adjustment of rates to accomplish that outcome, however, is neither simple nor quick. As discussed in the Company's Initial Comments, Duke Energy Ohio recommends that the Commission take into consideration:

- Short-term reductions in customer bills,
- Mitigation of future rate volatility, and
- Protection of the utilities' creditworthiness, for the ultimate benefit of customers' rates and service.

Although there does not appear to be disagreement regarding the need for adjustments, following the passage of the TCJA, a review of the initial comments filed in this proceeding shows that there are substantial differences in the way various entities understand what calculations need to be made for adjustments, how those adjustments should be provided to customers, and when the changes should be implemented. Duke Energy Ohio will discuss these differences in the following Reply Comments.

II. WHAT CALCULATIONS SHOULD BE MADE?

In asking what calculations should be made, Duke Energy Ohio refers to comments regarding the calculations that should—or should not—be made in order to appropriately adjust charges to address the TCJA.

The Northwest Ohio Aggregation Coalition (NOAC) proposes that each utility must identify every charge paid by customers toward tax liabilities and reduce that charge to equal what the Company "paid to the IRS."[1] NOAC fails to recognize several key points. First, NOAC's proposal ignores normalization accounting requirements—requirements that prevent the utility from passing accelerated depreciation benefits to the customers on the same timeline as that applicable to the Company's realization of those benefits. Rather, such benefits are spread out, or "normalized," over the useful life of the property, plant, and equipment. Thus, what the utility actual pays the IRS is not a measure of what adjustments should be made to rates. Second, NOAC fails to include in its analysis the fact that amounts that have already been "paid to the IRS" were paid under federal income tax rates in effect prior to the TCJA. There is no legal justification for such an adjustment. Finally, what NOAC seeks in this argument would be a substantial revision of existing law. Utility rates are not adjusted annually based on actual revenues and expenses. Rather, rates are set based on the revenue and expense that a utility incurs during a given, twelve-month period, under the law in effect at that time.[2] It is well understood that the rates are set so as to give the utility an opportunity to earn a fair rate of return. The rates do not guarantee that the utility will earn any particular return; they just provide a reasonable opportunity to do so. The basis for establishing rates for utility service is prescribed in R.C. 4909.15 and there is no provision in the statute that requires, or even allows,

[1] Comments of NOAC, pg. 1 (Feb. 15, 2018).
[2] R.C. 4909.15.

base rates to be adjusted for actual events occurring after the test year. Thus, if a utility incurs costs higher than those included in its test year revenue requirement, its rate of return will be lower. Correspondingly, if it can reduce its costs or if a cost item is even eliminated altogether, the utility will earn a higher return. This regulatory lag is the difference between the utility's actual expenses and the expenses that were included as part of the company's overall revenue requirement for establishing base rates. This can be negative or positive but is a fundamental concept of doing business as a regulated utility. Income tax expense happens to be one of those components of the revenue requirement that can increase or decrease. If a utility's expenses increase to the point where it can longer expect to earn a reasonable return, Ohio law allows the utility to seek an increase in base rates by filing for relief. The process includes a review by the Commission, a hearing, and an order by the Commission. A change in one or more cost items could be the cause for a utility requiring an increase in rates but it is practically unheard of for a utility to increase its base rates without having to follow the process established in the Ohio Revised Code. Many parties in this case suggest that the due process owed to stakeholders when a utility seeks a rate increase be abandoned when they are seeking rate decreases from the utilities.

The Environmental Defense Fund, Ohio Environmental Council, Environmental Law & Policy Center, Natural Resources Defense Council, and Sierra Club (collectively, Environmental Advocates) ask the Commission for another inappropriate calculation. When discussing the impact of the TCJA on energy efficiency riders, the Environmental Advocates suggest that the Commission consider whether there has been "any prior overcollection [of federal income taxes] and make the appropriate rate adjustments."[3] Neither this Commission-Ordered Investigation nor any utility-specific proceeding that results from it should be seen as an opportunity to

[3] Comments of Environmental Advocates, pg. 4 (Feb. 15, 2018).

retroactively review or modify previously approved rates. The suggestion by the Environmental Advocates to look for any "prior over collection" must be disregarded. The Environmental Advocates' proposal would suggest, if fairness was of any concern, that utilities should be allowed to look back over a period of time to recover costs that have been "under-collected." However, it is likely that the Environmental Advocates are suggesting a "heads, you win; tails, we lose" regulatory model where only reductions in expenses are flowed through rates and increases in costs are borne by the utility.

Interstate Gas Supply, Inc., (IGS Energy) believes that this proceeding should be used to reduce fees and charges paid by competitive commodity suppliers. Although IGS Energy limits its request to any such fees or charges that include a return on equity component, it did not provide any examples of the fees or charges it is concerned about. And it must be understood that such fees and charges are not generally set in a manner that would include a return on equity or any other calculation that would be impacted by a change in federal income tax rates.

The Northeast Ohio Public Energy Council (NOPEC) emphasizes that it "opposes consideration of a utility's need for increased revenues or whether it currently is earning its authorized rate of return . . .."[4] NOPEC's proposal to make such adjustments without due process suggests that the Commission blatantly defy Ohio law by implementing changes to utility rates without any consideration as to the justness and reasonableness of such rates. Indeed, the Commission's approach following the enactment of the Tax Reform Act of 1986 (TRA 1986) was precisely the opposite of NOPEC's belief. In 1987, the Commission specifically reviewed the financial information provided by utilities. Based on that information, it required no rate reductions where a utility's annual taxable income was lower than $75,000 or

[4] Comments of NOPEC, pg. 7 (Feb. 15, 2018).

where a utility's current estimated rate of return does not exceed the rate of return authorized in the last rate case (or exceeded it only to an insignificant amount).[5]

It is also noteworthy that, regardless of its opposition to considering current rates, NOPEC suggests that the calculations of appropriate adjustments be made based on a finding that all regulated utilities' rates are, by definition, unjust and unreasonable. As noted above, the "justness and reasonableness" of utility rates is a question that stakeholders or the Commission can raise by filing a complaint. Using this appropriate forum, the Commission can investigate any need for an increase or decrease in utility revenues or the rate of return currently being earned, while ensuring that the utility and all stakeholders are not deprived of any due process in determining whether any given utility's rate are just or unjust, or reasonable or unreasonable.

In its comments, the Office of the Ohio Consumers' Counsel (OCC) recognizes the requirements for due process. The OCC devotes considerable discussion to the provisions of R.C. 4905.26 arguing that this statute "provides that the PUCO, upon its own initiative, may investigate any situation where the PUCO believes" rates are "unjust" or "unreasonable."[6] But the Commission did not invoke R.C. 4905.26 when it established this investigation. The only statutory authority referenced by the Commission when it established this proceeding was its power to establish utilities' accounting for regulatory liabilities. The Commission's January 10, 2018 Entry, makes no mention whatsoever questioning whether rates are "just and reasonable." Nevertheless, despite OCC frequently referencing the provisions of R.C. 4905.26, it gives short shrift to an explicit provision of that statute that requires due process be afforded to the utility via an investigation and hearing. OCC even quotes the Ohio Supreme Court to support its argument:

[5] *In the Matter of the Commission's Investigation of the Financial Impact of the Tax Reform Act of 1986 on Regulated Ohio Utility Companies*, Case No. 87-831-AU-COI, *et al.*, 1987 Ohio PUC LEXIS 601, pg. 2 (Sep. 9, 1987) (1986 COI).
[6] Comments of OCC, pg. 2 (February 15, 2018).

"If, after an investigation and hearing pursuant to (R.C. 4905.26), the commission determines that existing rates are unjust and unreasonable, it must follow that the commission can remedy the situation by ordering that new rates be put into effect."[7] There is nothing unclear in this quotation. The determination of whether rates are unjust or unreasonable can only occur "after an investigation and hearing."

Importantly, the language referenced by the OCC also indicates that, to the extent rates are found to be unjust and unreasonable, the remedy is prospective only; *i.e.*, "the commission can remedy the situation by ordering that new rates be put into effect." Nothing in the Court's decision suggest that there is any requirement to retroactively adjust rates. In this regard, it is also worthwhile considering the actions taken by the Commission following the enactment of TRA 1986. OCC's suggestions that rates be adjusted without due process or even retroactively completely misconstrues the Ohio Revised Code and the Court decisions it references.

In summary, the Commission must recognize that regulated utilities are subject to normalization accounting requirements and, therefore, that it should not base adjustments on amounts "actually paid" to the IRS. Furthermore, even in the face of the recent federal tax cut, the Commission is still bound by the prohibition against retroactive ratemaking, as well as requirements that regulated utilities have the opportunity to earn a just and reasonable return.

III. HOW SHOULD ADJUSTMENTS BE PASSED TO CUSTOMERS?

In this section, Duke Energy Ohio will address comments relating to the manner in which the benefit of tax reductions should be passed on to customers.

The OCC wants to ensure that all tax reduction benefits be used to directly reduce customers' utility bills. OCC specifically addresses the possibility that, as has been proposed in

[7] *Id.* at pg. 3 (quoting *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 58 Ohio St.2d 153, 157 (1979)) (emphasis added).

some other states, tax savings might be used to fund various investments or projects.[8] OCC offers several justifications for opposing the use of tax savings for the funding of projects[9] but, of course, does not address the major benefit: Making all of the necessary adjustments in customers' bills, and doing so immediately, will cause those bills to be lower in the short run. But they will rise in the longer run, as the Company's rate base increases.[10] There is merit in the avoidance of rate volatility; merit that OCC ignores.

The Environmental Advocates similarly ask that the Commission order refunds to customers to reflect the entirety of the tax cut.[11] However, they do recognize that the Commission has previously approved the use of a portion of tax cut savings to be used for projects that would benefit consumers.[12] As referenced, in 1987 the Commission authorized portions of tax cut savings to be used for improvements to customer service and for conservation programs for customers.[13] This was deemed to be reasonable and appropriate by the Commission in 1987 and should not be viewed differently now.

Duke Energy Ohio would note that the methodology for identifying such programs, as proposed by the Environmental Advocates, is unnecessary. Rather than allowing the utilities to develop programs that would be appropriate for their customers and circumstances, the Environmental Advocates would prefer to be involved in the internal decision-making process and would limit projects to those that would modernize the grid and incorporate clean energy

[8] Comments of OCC, pp. 16-17 (Feb. 15, 2018).
[9] *Id.* at pp. 17-18 (Feb. 15, 2018).
[10] *See* Comments of Duke Energy Ohio, pg. 6 (Feb 15, 2018).
[11] Comments of Environmental Advocates, pp. 1, 5 (Feb. 15, 2018).
[12] *Id.*
[13] *See, e.g., In the Matter of the Application of Columbus Southern Power Company for Authority to Reduce Rates to Reflect the New Federal Corporate Income Tax Rate*, Case No. 87-2049-EL-ATA, 1987 Ohio PUC LEXIS 1106, Finding and Order (Dec. 17, 1987); *In the Matter of the Application of The Dayton Power and Light Company for Authority to Modify and Reduce its Rates for Gas and Electric Service to Jurisdictional Customers to Reflect Federal Corporate Income Tax Rate Changes*, Case No. 87-842-GE-ATA, 1987 Ohio PUC LEXIS 651, Finding and Order (June 16, 1987).

resources.[14] Such a process would add significant delay and would not be an efficient use of stakeholder time, when utility-identified projects would nevertheless be subject to the scrutiny of the Commission, its Staff, and any interested parties.

As discussed above, the Commission should be aware of the long-term impacts of its orders and take actions that will avoid unnecessary rate volatility.

IV. WHEN SHOULD ADJUSTMENTS BE MADE?

In this section, Duke Energy Ohio will discuss comments relating to the timing and processes appropriate for making adjustments. The Commission instituted this proceeding almost immediately after the effective date of the TCJA. At that time, it ordered utilities to create a deferred liability to account for the estimated reduction in federal income tax resulting from the TCJA. In doing so, the Commission is apparently striving to ensure that the ultimate impacts to customers will not be affected by the time required for a diligent and accurate determination of such impacts.

Nevertheless, NOAC asks that the Commission order that utilities immediately stop collecting any amounts in excess of the new federal income tax rate, rather than simply requiring an accounting change while the process continues.[15] NOAC, in this request, ignores the difficulties inherent in this change and the time that will be required to correctly identify and calculate the correct amounts. The Commission's approach allows for that process and allows the utilities due process.

NOPEC similarly looks for immediate bill changes, citing to other states that have already required utilities to file revised tariffs.[16] It is important to recognize that NOPEC only cites to states favorable to its position, even though not all states have taken that approach. For

[14] Comments of Environmental Advocates, pg. 6 (Feb. 15, 2018).
[15] Comments of NOAC, pg. 2 (Feb. 15, 2018).
[16] Comments of NOPEC, pp. 3-4 (Feb. 15, 2018).

example, the North Carolina Utilities Commission initiated an investigatory proceeding, much like the present investigation in Ohio, seeking comments from regulated utilities. And, in that proceeding, the North Carolina utilities were put on notice that rates being collected were provisional until final disposition of the matter.[17]

NOPEC also fails to evaluate any differences between the laws in other states and the law in Ohio. It should be apparent but the Commission is bound by Ohio law and not by the laws of other states. It also fails to take into account the immediate impact of the Commission's order directing utilities to create a deferred liability under a statute that does provide for due process. And, finally, it fails to mention the numerous riders that have already been proactively adjusted to account for the impact of the TCJA. For example, as noted in initial comments, Duke Energy Ohio has already filed adjusted rates for its Riders DCI, DR-IM, and AU, providing the vast majority of TCJA benefits to customers.[18]

OCC wants utilities to estimate the base rate impact and immediately begin providing a credit on customers' bills. As noted above, the Commission has no authority to order an immediate bill credit in this case. There is no pending complaint, the Commission has not concluded its investigation in this case, and there has been no hearing to litigate the issues raised by the parties.

OCC argues that the Commission could deem the implications of the TCJA an "emergency" that needs Commission action under R.C. 4909.16 in order to "protect the public." OCC's notion that the impacts of the TCJA constitute an emergency is nothing more than hyperbole. Even if nothing else changed in customers' rates besides reducing them for lower taxes, the impact to customers is relatively small, smaller than any number of factors (such as

[17] *In the Matter of The Federal Tax Cuts and Jobs Act*, Docket No. M-100, Sub. 148, 2018 N.C. PUC LEXIS 3 (Jan. 3, 2018).
[18] Comments of Duke Energy Ohio, pp. 9-10 (Feb. 15, 2018).

changes in commodity pricing) that affect their overall rates. Nevertheless, OCC again misses the point that there is no pending case for any utility filed under R.C. 4909.16.

OCC proposes that this estimate not be trued-up to reflect the actual impact until the time of the utility's next base rate case.[19] It fails to account for the long time lag between such rate cases. It also fails to account for various utilities' commitments not to file base rate cases for identified numbers of years. Even with that, OCC does not suggest that the utility would be allowed carrying costs in the event that the impact turned out to be lower than the estimate (even though it advocates for carrying costs to be paid to customers, to address rider overpayments from January 1 until the date rider rates are amended). Its rationale is that all base rates have been unjust and unreasonable since the effective date of the TCJA.[20] As discussed above, that assertion is simply incorrect.

OCC similarly asks that utilities be required to estimate excess accumulated deferred income taxes (ADITs) and begin immediately providing a bill credit for that amount.[21] Even more, OCC proposes that the utilities must provide customers with carrying costs to reflect the time lag since January 1, 2018, even though accounting entries are already being made.[22] OCC's recommendation that carrying costs be included in refunds of excess ADITs reflects a misunderstanding of ADITs and conventional ratemaking in Ohio. ADITs and the excess ADITs offset rate base. Any ADITs that were included in the last base rate case (even if they are now split between ADITs and excess ADITs) are offsets to rate base and, thus, already provide customers with a return at the weighted-average cost of capital approved in the last rate case.

[19] Comments of OCC, pg. 12 (Feb. 15, 2018).
[20] *Id.* at pg. 11.
[21] *Id.* at pg. 14.
[22] *Id.* at pg. 14.

OCC's proposal to accrue carrying costs on excess ADITs would unfairly give customers double credit from the same regulatory liability.

OCC and the Industrial Energy Users-Ohio (IEU) ask the Commission to address the new federal income tax rates in the context of open rate cases to use new tax rate.[23] However, such an approach does not comport with Ohio law. As prescribed in R.C. 4909.15, "the revenue and expenses of the utility shall be determined during a test period." This statute also establishes parameters for such test period and establishes the extent to which adjustments may be made to revenues and expenses for the test period. For natural gas, water-works, and sewage disposal utilities, R.C. 4909.15 explicitly allows for adjustments be made to the test period for changes "reasonably expected to occur" for the twelve-month period immediately following the test period but, conspicuously, there is no provision allowing such changes for electric utilities. It is unambiguous that the General Assembly intended to exempt electric utilities from this provision; therefore, there is no statutory authority to make changes for test year revenue and expenses "reasonably expected to occur."

Duke Energy Ohio has no pending rate case for natural gas; so, R.C. 4909.15 is moot with respect to the Company's rates for natural gas service. The Company's pending rate case for electric service is based on a test year that ended March 31, 2017. Consequently, under R.C. 4909.15, there is no statutory provision that would allow for an adjustment for a change in any revenue or expense that occurred nine months after the end of the test year. There is no exception in the statute addressing whether this provision applies, whether the case is still pending or not.

Duke Energy Ohio acknowledges that the Ohio Revised Code does provide for a process to review whether a utility's rates are "unjust, unreasonable, unjustly discriminatory, unjustly

[23] *Id.* at pp. 8-10; Comments of IEU, pp. 7-8 (Feb. 15, 2018).

discriminatory, unjustly preferential, or in violation of law," under R.C. 4905.26. But no complaint has been filed against Duke Energy Ohio suggesting that its rates for electric or natural gas are "unjust, unreasonable, unjustly discriminatory, unjustly discriminatory, unjustly preferential, or in violation of law." Second, due process and the express language of R.C. 4905.26 requires that such a complaint would be the subject of a hearing. Inasmuch as there is no pending complaint against Duke Energy Ohio related to its rates for electric and natural gas service and there has certainly been no hearing to assess the justness and reasonableness of existing rates, the Company's base rates are not currently subject to change with regard to the impacts of the TCJA.

The Commission must continue to take the time necessary to carefully evaluate the adjustments that it requires, and it should do so on a utility-specific basis.

V. MISCELLANEOUS ISSUES

OCC also demands that the Commission amend all utilities' tariffs as a part of this investigation, making all rates and riders subject to refund.[24] Not only would such an action be entirely unrelated to the TCJA's impacts, but, along with many other suggestions by the OCC and other parties, it would deny the utilities the due process that such an action would require. The OCC's suggestion should be ignored.

VI. CONCLUSION

For all the foregoing reasons, Duke Energy Ohio respectfully requests that the Commission approve and adopt the recommendations contained in Duke Energy Ohio's Initial and Reply Comments, enabling the Company to provide benefits to customers and continue building the energy future that customers and communities deserve.

[24] Comments of OCC, pp. 6-8 (Feb. 15, 2018).

Respectfully submitted,

/s/ Jeanne W. Kingery
Rocco O. D'Ascenzo (0077651)
(Counsel of Record)
Deputy General Counsel
Jeanne W. Kingery (0012172)
Associate General Counsel
139 East Fourth Street
1303-Main
Cincinnati Ohio 45202
513-287-4320
513-287-4385 (fax)
Rocco.dascenzo@duke-energy.com
Jeanne.kingery@duke-energy.com

CERTIFICATE OF SERVICE

The Commission's e-filing system will electronically serve notice of the filing of this document on March 7, 2018, on the parties referenced on the service list of the docket card who have electronically subscribed to the case.

/s/ Jeanne W. Kingery