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**

JOINT APPLICATION FOR REHEARING OF OHIO POWER COMPANY, OHIO EDISON COMPANY, THE DAYTON POWER AND LIGHT COMPANY, DUKE ENERGY OHIO, INC., THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY

Pursuant to Section 4903.10 of the Ohio Revised Code and Rule 4901-1-35 of the Ohio Administrative Code, Ohio Power Company ("AEP Ohio"); Duke Energy Ohio, Inc. ("Duke"); and The Dayton Power and Light Company ("DP&L"); Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (collectively, "FirstEnergy," and with AEP Ohio, Duke, and DP&L the "Joint Applicants" or "EDUs") respectfully file this Application for Rehearing of the Commission's January 10, 2018 Entry in this proceeding.

Joint Applicants agree that it is necessary and appropriate for the Commission to "consider the impacts of the Tax Cuts and Jobs Act of 2017 [(TCJA)] and determine the appropriate course of action to pass benefits resulting from the legislation on to ratepayers." Entry at ¶ 1. Consistent with the Commission's directives, Joint Applicants intend to submit comments discussing both "those components of [Joint Applicants'] rates that the Commission will need to reconcile with the TCJA" and "the process and mechanics for how the Commission should do so." *Id.* at ¶ 4.

Before submitting comments, however, Joint Applicants make this application for rehearing requesting that the Commission clarify and, if necessary, modify the Commission's directive requiring utilities "to record on their books as a deferred liability * * * the estimated reduction in federal income tax resulting from the TCJA" is without prejudice to the outcome of these proceedings. *See id.* at ¶ 7.

Moreover, Joint Applicants submit that the Entry is unlawful and unreasonable in the following respects:

I. The Commission should clarify on rehearing that the accounting directive contained in Paragraph 7 of its January 10 Entry is preliminary, temporary, and without prejudice to the outcome of this proceeding or any subsequent related proceeding and only pertains to retail rates subject to the Commission's jurisdiction.

II. The Commission should clarify on rehearing that the accounting directive does not predetermine the outcome of any future rate or rate proceeding.

III. To the extent the Commission's accounting directive in this generic industry-wide proceeding without advanced notice or hearing forms the basis for changing base rates or approved riders for individual EDUs, the Entry is unreasonable and unlawful. Financial impacts of the TCJA should only be prospectively reflected in rates: (1) if a rider mechanism and associated tariff already provides for such reconciliation, or (2) as part of a future base rate proceeding that results in comprehensive prospective rate changes.

   A. Some TCJA impacts will automatically flow through riders but only in accordance with the terms of the approved rider mechanism and tariffs.

   B. Changes in rider rates established under the ESP process must conform to the requirements established for the ESP process.

   C. Base rates for EDUs can only be changed prospectively as part of a proceeding under R.C. 4909.18.

   D. The accounting directive in the Entry must be applied in a way that is consistent with normalization rules.

The grounds for this application for rehearing are set forth more fully in the accompanying memorandum in support.

Respectfully submitted,

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MEMORANDUM IN SUPPORT

INTRODUCTION

The EDUs understand and appreciate the Commission's desire to initiate this proceeding and examine issues relating to rate impacts associated with federal tax reform. There is little doubt that retail customers will realize benefits from tax reform through retail utility rates. But the EDUs jointly seek rehearing to clarify and confirm the Commission's intentions with specificity and, if necessary, to modify the accounting directives contained in the Commission's January 10 Entry. This is a significant and complex undertaking, and the EDUs urge the Commission to methodically pursue the task in a thorough manner using a process that is fair and deliberate for each utility. As further explained below in their propositions of law, the EDUs want to also ensure that the ratemaking effort is pursued in a manner that is lawful and reasonable. Although some parties may claim that the EDUs are getting ahead and addressing merit issues, the reality is that implementing the accounting directive involves some understanding (or assumptions) about the manner and extent of how tax reform impacts will be reflected in rates. As a legal and practical matter, the Commission should affirmatively declare that the accounting directive is without prejudice to the outcome of this proceeding as well as any other rider or ratemaking proceeding.

The EDUs also seek to ensure that the details and timing of reflecting tax reform benefits in retail rates is achieved in a manner that is consistent with each EDU's individual circumstances. This means that the Commission should seek to adopt a flexible (but consistent) approach rather than a one-size-fits-all approach. Like the approach that was used to reflect

1980s era tax reform in retail rates, today's effort may be best achieved through mutually-acceptable efforts.

LAW AND ARGUMENT

I. The Commission should clarify on rehearing that the accounting directive contained in Paragraph 7 of its January 10 Entry is preliminary, temporary, and without prejudice to the outcome of this proceeding or any subsequent related proceeding and only pertains to retail rates subject to the Commission's jurisdiction.

After inviting all "jurisdictional rate-regulated utilities, and any other interested stakeholders * * * to file public comment discussing both * * * those components of utility rates that the Commission will need to reconcile with the TCJA * * * [and] the process and mechanics for how the Commission should do so" (*see* January 10 Entry at ¶ 4), the Commission's January 10 Entry provides:

> However, in the interim, effective January 1, 2018, the Commission directs the utilities, pursuant to our authority under R.C. 4905.13, to record on their books as a deferred liability, in an appropriate account, the estimated reduction in federal income tax resulting from the TCJA. Utilities should continue this treatment, until otherwise ordered by the Commission.

Id. at ¶ 7. The EDUs respectfully request that the Commission grant rehearing to clarify these broad instructions.

Under R.C. 4905.13, the Commission "may, after hearing had upon its own motion or complaint, prescribe by order the accounts in which particular outlays and receipts shall be entered, charged, or credited." The EDUs infer from the Commission's characterization of its accounting directive as "interim" that the Commission's accounting directive is temporary and subject to revision after the process contemplated in the statute takes place. Otherwise, the Entry's retrospective directive to establish a regulatory liability effective January 1, 2018 would violate R.C. 4905.13, as the EDUs did not receive advance notice or a hearing regarding that

directive. The Commission should confirm on rehearing that its accounting directive is temporary.[1]

The Commission should also clarify that its directive to utilities to record a deferred liability that estimates the "total reduction in federal income tax resulting from the TCJA" is limited to tax savings reflected in retail utility rates regulated by the Commission. *See* January 10 Entry at ¶ 7. As such, EDUs should only include in the deferrals tax impacts associated with utility retail rate components subject to the Commission jurisdiction and their Commission approved retail rate plans. . The deferrals should be updated as appropriate based upon actual tax impact information during the pendency of this proceeding, and should be implemented in a manner consistent with GAAP accounting rules and Internal Revenue Service requirements (*e.g.*, those related to normalization). These clarifications are necessary to implement the Commission's directive.

II. The Commission should clarify on rehearing that the accounting directive does not predetermine the outcome of any future rate or rate proceeding.

The Commission should confirm on rehearing that it is not, through its accounting directive, making any determination regarding whether the amounts that utilities record as a deferred liability during the pendency of this proceeding will be returned to customers. The Commission's accounting orders are distinct from its substantive ratemaking authority under R.C. Chapter 4909. *See, e.g. Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164, 871 N.E.2d 1176, ¶ 19. The ratemaking effect of an accounting order typically must be reviewed and determined in a later rate proceeding. *Id.*; *Consumers' Counsel v. Pub.*

[1] While clarification of the directive is needed, the EDUs also believe that because no hearing was held that the directive at ¶ 7 should be removed from the Commission's January 10, 2018 Entry altogether.

Util. Comm., 63 Ohio St.3d 522, 524-525, 589 N.E.2d 1267 (1992). The impacts of the TCJA on utility rates will vary based upon the unique circumstances and rate structure of each utility.

Moreover, were the Commission's accounting directive intended to exercise ratemaking authority in some fashion, the Commission's January 10, 2018 Entry would deprive the EDUs of due process and violate the prohibition against retroactive ratemaking in addition to violating R.C. 4905.13. *See, e.g., Lucas Cty. Commrs. v. Pub. Util. Comm.*, 80 Ohio St.3d 344, 348, 686 N.E.2d 501 (1997) (recognizing that "utility ratemaking * * * is prospective only. * * * Retroactive ratemaking is not permitted under Ohio's comprehensive statutory scheme"). The Commission cannot retroactively establish rates as of January 1, 2018. For these reasons, the Commission should confirm and clarify on rehearing that its Entry does not prejudge the substantive ratemaking impact of the TCJA or contemplate that amounts utilities record as a deferred liability now either will or will not be returned to customers in the future.

III. To the extent the Commission's accounting directive in this generic industry-wide proceeding without advanced notice or hearing forms the basis for changing base rates or approved riders for individual EDUs, the Entry is unreasonable and unlawful. Financial impacts of the TCJA should only be prospectively reflected in rates: (1) if a rider mechanism and associated tariff already provides for such reconciliation, or (2) as part of a future base rate proceeding that results in comprehensive prospective rate changes.

Utilities are permitted only to charge the filed and approved rates, and the Commission is authorized to change those rates only prospectively. *Keco Industries, Inc. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254, 257, 141 N.E.2d 465 (1957). Therefore, it can only modify rates and riders prospectively in a rate proceeding (not a generic industry proceeding) and, in the meantime, the rates and riders are implemented using the terms and conditions that were previously approved by the Commission. Once rates are established, they are not adjusted until new rates are set in a future proceeding. *Cleveland Elec. Illuminating Co. v. Pub. Util.*

Comm., 46 Ohio St.2d 105, 346 N.E.2d 778 (1976). The Commission should not engage in ratemaking in this industry-wide proceeding. To the extent the Commission's accounting directive in this generic industry-wide proceeding, without advanced notice or hearing, forms the basis for changing base rates or approved riders for individual EDUs, the Entry is unreasonable and unlawful.

A. Some TCJA impacts will automatically flow through riders but only in accordance with the terms of the approved rider mechanism and tariffs.

While the existing terms and conditions of many riders may automatically reflect some of the TCJA impacts, there is a statutorily-defined process to make additional changes to rates (including rates in riders) that binds utilities and the Commission. Absent a hearing process and findings supported by substantial evidence there is no unilateral power to modify riders that, for example, were approved with fixed carrying charges in order to reflect the lower tax rate. *In re Rev. of Alternative Energy Rider Contained in Tariffs of Ohio Edison Co.*, Slip Opinion No. 2018-Ohio-229 at Pars. 17-19. Depending on the nature of the rider, the terms and conditions under which it was approved – and whether it was created as part of a comprehensive Electric Security Plan – the Commission may lack authority to selectively modify one component of the rider (*e.g.*, requiring that a rider be modified to reflect tax reform impacts) without an existing basis in the rider tariff.

Further, the financial impacts of the TCJA may vary when it comes to being reflected in retail rates. For example, while excess normalized ADIT or the loss of bonus depreciation may be automatically reflected in a particular rider, tax expense or a gross revenue conversion factor may not be automatically reflected under the terms and conditions adopted by the Commission when creating that rider. The TCJA impacts must also be reflected in retail rates in a manner that is consistent with the TCJA, Ohio law and existing Commission rate orders. To the extent

the January 10 Entry's accounting directive requires EDUs to create a regulatory liability associated with riders that modifies the existing terms and conditions of the affected riders, it would be unlawful and unreasonable.

B. Changes in rider rates established under the ESP process must conform to the requirements established for the ESP process.

As the Commission is aware, many EDU riders that exist today were created as part of an Electric Security Plan proceeding under R.C. 4928.143. It would violate the ESP statute to modify riders adopted in an ESP without the utility's consent or outside of the comprehensive ESP process. *See* R.C. 4928.143; *In re Ohio Power Co.*, 144 Ohio St.3d 1, 2015-Ohio-2056, 40 N.E.3d 1060, ¶30. As part of the ESP statute, there is a significantly excessive earnings test (SEET) that forms the basis for any potential customer refunds relating to significantly excessive over-earnings associated with ESP rate adjustments; in that context, the Commission can only refund TCJA impacts that drive significantly excessive over-earnings and the accounting directive may violate the SEET statute. In any event, the Commission can only modify how TCJA impacts are reflected in the terms and conditions of riders through a separate ratemaking proceeding (*i.e.*, outside the context of this generic investigation) that is prospective in nature and comprehensively reviews offsetting changes in other expense or carrying charge components. To the extent the Commission's accounting directive in this generic industry-wide proceeding without advanced notice or hearing forms the basis for changing the terms or conditions of approved riders for individual EDUs, the Entry is unreasonable and unlawful.

C. Base rates for EDUs can only be changed prospectively as part of a proceeding under R.C. 4909.18.

With respect to base rates that were established under R.C. 4909, the Commission is not permitted to unilaterally engage in single-issue ratemaking or change base rates without

following the statutory process required in R.C. Chapter 4909. While the General Assembly has delegated authority to the PUCO to set just and reasonable rates for public utilities under its jurisdiction, it has done so by providing a detailed, comprehensive and, as construed by this court, mandatory ratemaking formula under R.C. 4909.15 and an EDU's base rates may only be established through a full cost of service study in a base rate proceeding. *Columbus Southern Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 537-538 (1993). To the extent the accounting directive (implemented in a generic industry-wide proceeding without notice or hearing) modifies the requirements and process associated with changing base rates, it is unlawful and unreasonable.

If expenses rise, an EDU cannot raise base rates until it establishes the need to do so in a base rate proceeding that follows the process and requirements of R.C. 4909. Had the recent tax law change resulted in a tax increase, the EDUs have little doubt that this same principle would have been enforced against them in response to any attempt to use the tax increase as a basis for single-issue ratemaking of base rates. Likewise, it would be unreasonable and unlawful for the Commission to unilaterally force base rate reductions based on a single expense reduction.

While the creation of a regulatory liability as an accounting measure is separate from a future exercise of ratemaking that reflects the regulatory liability, establishing base rates under R.C. Chapter 4909 must be done prospectively and as part of a comprehensive review of the EDU's costs in accordance with the traditional ratemaking formula and process found in R.C. Chapter 4909. Only upon investigation, hearing, and determination that existing rates of public utility are unjust or unreasonable, can the Commission establish new rates to be substituted for existing rates and the new rates shall have prospective effect only. *Lucas County Comm'rs v. Pub. Util. Comm.*, 80 Ohio St.3d 344, 686 N.E.2d 501 (1997).

In practical terms, this means that the regulatory liability required by the January 10 Entry must be considered in a future, separate rate case filed in a subsequent proceeding (or may be considered in a pending rate case if the company consents and no staff report had been filed prior to the issuance of the Commission's January 10 Entry), subject to due process protections, that provides a comprehensive review of the EDU's costs and in accordance with the formula and process requirements of R.C. 4909. In terms of rate impact, the net impact of the gross dollar amount created in the regulatory liability will be determined with the other cost changes presented at the time of the future rate case. Significantly, the Commission also needs to respect existing commitments made by EDUs within settlements or as part of a prior rate proceeding, including, for example, the timing of future base rate cases. Such commitments (being accepted by the Commission) remain binding and should not be unilaterally modified.

To the extent the Commission's accounting directive requires EDUs to create a regulatory liability associated with base rates that violates an existing regulatory commitment or would be considered for inclusion in base rates outside of the utility's next base rate case in a manner that violates R.C. Chapter 4909, it is unlawful and unreasonable.

D. The accounting directive in the Entry must be applied in a way that is consistent with normalization rules.

The Congressionally-enacted and IRS-enforced penalty for violating normalization rules is the loss of accelerated depreciation; a consequence that would be devastating to the financial viability of the utilities. A key requirement of the normalization rules is that a regulatory authority use and apply consistent assumptions in establishing regulated depreciation expense, regulated tax expense including the amount of depreciation expense taken into account, and a consistent approach with respect to rate base effects of the deferred tax account. Additionally, normalized excess ADIT must be amortized over the remaining lives of the property as used in

the utility's regulated books of account which gave rise to the reserve for deferred taxes. *See* TCJA Subtitle C, Part 1, Sec. 13001(d)(3)(B). The comprehensive review and hearing process recommended above is critically important in ensuring that this consistency requirement is met.

CONCLUSION

As a practical matter, the Commission should follow the precedent from the 1980s tax reform and encourage utilities and stakeholders to take proactive efforts in order to mutually resolve these issues. In any case, how tax savings are treated in retail rates will vary depending on the nature of the costs and the mechanism through which they are collected. While the overall approach among EDUs should be fundamentally consistent and convey tax benefits to retail customers, the Commission's process and approach should permit each EDU some flexibility and latitude in the mechanics and timing of doing so. Regardless, the Commission should grant rehearing and clarify or modify its January 10, 2018 Entry consistent with Joint Applicants' recommendations set forth above.

Respectfully submitted,

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CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing *Joint Application* was sent by, or on behalf of, the undersigned counsel to the following parties of record this 9th day of February 2018, via electronic transmission.

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