

**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

COMMENTS OF INDUSTRIAL ENERGY USERS-OHIO

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I. INTRODUCTION

On January 1, 2018, provisions of the Tax Cuts and Jobs Act of 2017 ("TCJA") became effective. One of those provisions lowers the federal corporate income tax rate to 21%. The TCJA also constrains the methods to amortize excess accumulated tax deferral amounts if amortization is ordered.

The Public Utilities Commission of Ohio ("Commission") opened this investigation on January 10, 2018 "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." Entry, ¶ 1 (Jan. 10, 2018). It also ordered all utilities to establish a deferred liability to record the estimated reduction in federal income tax. *Id.*, ¶ 7.

Rate reductions are an obvious way of assuring that customers benefit from the lower federal corporate income tax rate, but using the tax reduction benefits to reduce regulatory assets and the related carrying charges that are accruing on those assets may also benefit customers. The Commission should also participate in proceedings in other jurisdictions that may assist in assuring that customers benefit from the tax rate reduction.

II. PROVISIONS OF THE TCJA CHANGE THE CORPORATE FEDERAL INCOME TAX RATE AND LIMIT THE METHODS AVAILABLE TO AMORTIZE EXCESS DEFERRED TAXES

The TCJA has three important effects on tax calculations applicable to public utilities.

First, the tax rate change in the TCJA reduces the corporate tax rate to a flat 21%, effective January 1, 2018. Pub. L. 115-97, § 13001(a).

Second, the reduction in the tax rate under the TCJA affects the level of accumulated deferred income tax liabilities and assets (“ADIT”) that public utilities recognize. This is relevant because utility-related ADIT liabilities are typically treated as rate base reductions for ratemaking purposes while ADIT assets are treated as additions to rate base.

Third, the reduction in the tax rate also results in “excess deferred income taxes” as the ADIT liabilities and assets that were established at a 35% tax rate must be reduced to reflect the fact that the ADIT balances must be restated based on the 21% tax rate. This difference between the ADIT amounts calculated at 35% and the amounts calculated at 21% are the excess deferred income taxes.

The genesis of ADIT liabilities frequently lies in tax laws that permit accelerated depreciation rates for certain assets. For instance, for federal income tax purposes, a public utility may have assets that are eligible to utilize accelerated depreciation. For ratemaking, however, the public utility uses straight-line depreciation. As a result, for a new asset, the tax return depreciation expense allowed may initially be significantly higher than the ratemaking depreciation allowed. Over time, the ratemaking depreciation

expense for the asset will become greater than the tax return depreciation expense. These differences are referred to as “timing differences.”

The difference between the tax depreciation expense and the ratemaking depreciation expense leads to the creation of ADIT liabilities, which are later reversed as the ratemaking depreciation expense exceeds the tax return depreciation expense for the asset. Essentially, the ADIT liability amount is a point-in-time difference between income tax depreciation expense and the depreciation expense typically used to compute the utility’s revenue requirement. With accelerated depreciation, the depreciation-related tax expense is front-end loaded and declines during the depreciable life of the asset. Ratemaking generally uses straight line depreciation to compute the utility’s revenue requirement; the depreciation rate remains the same over the life of the asset. When the income tax depreciation expense is higher than the ratemaking depreciation expense, generally accepted accounting rules call for this difference (a timing difference), times the tax rate, to be recorded as an ADIT liability.

Prior to January 1, 2018, deferred tax assets and liabilities identified due to timing differences were calculated based on the prior tax rates. With the enactment of the TCJA, however, the process of amortizing the deferred assets and liabilities should also be adjusted because of the change in the federal income tax rate.

If the tax rate decreases, as is the case with the TCJA, then the ADIT liability must be reduced, resulting in excess deferred income taxes. To amortize the excess deferred income tax amount, the Commission may direct the public utility to identify the excess amount and then amortize it over some period. Additionally, the Commission may adjust the public utility’s rate base to account for the change in the deferred tax liability.

Federal law does not require the sharing of excess deferred income taxes with customers, but if the Commission orders a sharing, these changes in the amortization of the excess could be accomplished in a number of ways. The TCJA, however, limits the manner by which the excess deferred taxes as of December 31, 2017 may be shared with customers to one of two methods. *Id.*, § 13001(d). Under one method, called the Average Rate Assumption Method, the amount cannot be returned any faster than the remaining regulatory life of the asset that gave rise to the excess deferred taxes. Under an “alternative method,” the utility would amortize the excess amount over the remaining life of all public utility property included in the plant account or a composite rate used to compute depreciation. *Id.*

In the following simple example to illustrate an adjustment for excess deferred taxes, it is assumed that the public utility has a single asset. The utility has identified an ADIT liability at December 31, 2017 of \$1,400 on a timing difference of \$4,000 at a tax rate of 35%. The asset is assumed to have 15 years of remaining life. At a 21% income tax rate, the deferred tax liability would have been \$840 on December 31, 2017 ($\$4,000 \times 21\%$). The difference in the deferred tax liability, \$560 ($\$1,400$ minus $\$840$), is the excess deferred income tax. The annual amount to amortize the difference over the remaining 15 years of the life of the asset would be a reduction in federal income tax expense of \$37.33. To account for the excess deferred income taxes, rate base is increased by \$560.

In summary, the lower tax rate must be recognized and adjusted for, for purposes of computing a revenue requirement. Further, rider-specific revenue requirements that

are grossed up for taxes or are subject to carrying charges that include a component for federal income tax expense must also be adjusted for the lower tax rate.

III. PAST COMMISSION PRACTICE HAS BEEN TO ADDRESS THE EFFECT OF A TAX CHANGE ON A CASE-BY-CASE BASIS

In 1987, the Commission addressed a situation similar to that presented by the recently enacted reduction in the federal corporate income tax rate when Congress passed the Tax Reform Act of 1986. In response to the enactment, the Chairman of the Commission sought by letter information on the effect of the tax rate reduction from all public utilities. Subsequently, the Commission opened an investigation. *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, Entry (June 9, 1987). In the first entry in the case, the Commission noted that it was addressing or had addressed the tax rate reduction in several rate cases, that several public utilities' rates were unaffected by the tax rate change, and that three telephone companies were losing revenue due to reductions in intra-LATA toll rates and were exempted from further review. *Id.*, ¶ 3. Because some public utilities failed to respond to the Chairman's letter, the Commission ordered that the non-responding companies file for a reduction in rates or show cause why they should not.

In a subsequent entry, the Commission noted that the Staff had reviewed financial information for an additional 40 companies and recommended no changes in rates for 28 of them. The reasons for no action included low estimated annual income, lack of jurisdiction over rates, and inclusion of the tax change in ordinance rates. *Id.*, Finding and Order ¶ 3 (Sept. 9, 1987). Twelve rural phone companies remained under investigation.

The Commission closed out its review with a Finding and Order that permitted rates to remain in effect for several small telephone companies and a late-identified water company on the basis, in part, that projected rates of return would not be unreasonable. *Id.*, Finding and Order at ¶ 5 (Dec. 23, 1987). In regard to two companies, the Commission also recognized that the companies had filed applications for modifications to depreciation accounting that would reduce future revenue requirements. *Id.*

Whatever the unstated reasons were for adopting a company-by-company approach, such an approach may be even more appropriate for utilities that remain subject to cost-based rate regulation.¹ With the adoption of House Bill 476 in 1996, which introduced alternative regulation plans and the wide-spread use of riders that include federal income tax cost recovery, the General Assembly substantially altered gas regulation. Electric rate-making changed in a similar way when the General Assembly enacted Senate Bill 3 and Senate Bill 221. Because of the diversity in rate structures and proceedings used to adjust rates, the discovery of a uniform method of addressing the effects of the TCJA appears unlikely. The Commission's company-by-company approach in 1987 should serve as a guide.

IV. RECOMMENDATIONS

In its order initiating this proceeding, the Commission sought comments from "jurisdictional rate-regulated utilities." Given the change in rate regulation of gas, electric, and telephone services, the Commission should clarify that the scope of this proceeding is directed at and will affect the rates of those utilities over which the Commission sets

¹ With the adoption of Senate Bill 162, the rates of telephone companies are not subject to cost-based regulation.

rates based on cost-recovery. To that end, the Commission should identify the set of utilities that should respond with rate adjustment proposals.

To recognize the positive effects that the TCJA should have on the prices customers pay for price regulated public utility services, the Commission should begin incorporating the tax reduction into rates and riders that contain adjustments for federal income tax (this includes both the more traditional riders that recover costs of providing a service and “shared savings” and other revenue enhancements that are not cost-based but which are “grossed up” for taxes) as those opportunities arise. For instance, most riders are updated at least annually and therefore lend themselves to being updated for the reduced tax rate.

Already that process of updating charges has begun. There are currently several rate cases and rider proceedings before the Commission. In a few, the utilities have sought to initiate the implementation of the tax changes. See, e.g., *In the Matter of the Application of Ohio Gas Company for an Increase in Gas Distribution Rates*, Case Nos. 17-1139-GA-AIR, *et al.*, Joint Stipulation and Recommendation (Jan. 26, 2018); *In the Matter of the Update to the Distribution Modernization Rider Contained in the Tariffs of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company*, Case No. 17-2280-EL-RDR, Staff Review and Recommendation (Feb. 1, 2018); *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Modify Rider FBS and Rider EFBS*, Case No. 18-40-GA-RDR, Letter from Elizabeth H. Watts to Barcy McNeal (Feb. 6, 2018) (seeking delay in rate adjustment because rates from Columbia Gas Transmission described in the application were subject to change due to the enactment of the TCJA). Similarly, the Commission should use open

proceedings and those that will be filed to begin to incorporate the change in the federal income tax rate in to tariffed rates.

A more difficult problem is the ratemaking treatment for excess deferred income taxes. The Commission should provide guidance on whether it will require public utilities to share the excess deferred income taxes with customers and whether there is a preferred methodology.

While an obvious approach to providing customer benefits would be to seek the implementation of rate reductions, customers may also benefit if utilities with regulatory assets are authorized to apply the tax savings, if any, to reduce those assets.

The Commission should also monitor to assure that impacts of the TCJA on so-called formula rates under the FERC's jurisdiction, such as transmission formula rates, are reflected in the rates of retail customers when appropriate. The revenue requirement for FERC-regulated Network Integration Transmission Services ("NITS") is increasing sharply as a result of capital allocation decisions made by transmission owners. FERC's ratemaking formula for NITS offers little or no lag between investment and cash flow and includes an attractive equity return that is relatively high given the degree of business and financial risk in this line of business. With little or no growth in demand, the large increases in the NITS revenue requirements are, in turn, producing large bill increases for Ohio customers. Embedded in these formula rates are provisions to recover federal income tax costs.² As these rates are reviewed annually, the Commission should assure that they are correctly updated for the changes in federal corporate tax law.

² For example, FirstEnergy's FERC formula rate for NITS in the ATSI zone is based on forecasted data for the upcoming calendar year. The NITS costs are a major component of transmission costs in the FirstEnergy retail transmission cost recovery rider. The formula rate contains components for determining the NITS revenue requirement for ADIT in the rate base calculation and a component for federal income

V. CONCLUSION

The enactment of the TCJA presents the Commission an opportunity to lower rates for customers of Ohio's rate-regulated utilities. Through this investigation and related rate proceedings, the Commission should provide guidance on how public utilities should proceed to modify rates that incorporate the tax changes or to reduce outstanding deferrals. Both are possible outcomes, and the Commission should be open to finding a means to reduce the overall cost of utility service in the way that best advantages customers. Further, the Commission should also monitor to assure that impacts of the TCJA on formula rates under the FERC's jurisdiction, such as transmission formula rates, are reflected in the rates of retail customers where appropriate.

Respectfully submitted,

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tax rates. *American Transmission Systems, Inc.*, FERC Docket No. ER15-303, Projected Transmission Revenue Requirement for Rate Year 2018 (Oct. 16, 2017).

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 interested parties on February 15, 2018.

/s/ Matthew R. Pritchard

Matthew R. Pritchard

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Summary: Comments Comments of Industrial Energy Users-Ohio electronically filed by Mr. Matthew R. Pritchard on behalf of Industrial Energy Users-Ohio