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

COMMENTS OF
THE DAYTON POWER AND LIGHT COMPANY

The Dayton Power and Light Company ("DP&L" or the "Company"), consistent with paragraph 4 of the Public Utilities Commission of Ohio's ("PUCO" or "Commission") Entry of January 10, 2018 ("Investigation Entry") hereby submits its initial comments with respect to the Commission's investigation of the Financial Impact of the Tax Cuts and Jobs Act of 2017 ("TCJA") on regulated Ohio utility companies.

The Commission has requested comments on "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."

I. INTRODUCTION AND SUMMARY OF COMMENTS.

The TCJA is only one cost element among a vast number of other costs and revenues that DP&L faces in 2018 that are different from the costs and revenues that were applied when DP&L's distribution base rates were last reset in 1993. A response to a single variable -- single-issue ratemaking -- is not authorized in Ohio except when explicitly authorized by statute.[1]

[1] Single-issue ratemaking is not permitted for base rates established under R.C. Chapter 4909 and it is only selectively permitted as part of an Electric Security Plan proceeding under R.C. 4928.143(B)(2)(h). *See Pike Natural Gas Co. v. Pub. Util. Com.*, 68 Ohio St.2d 181, 429 N.E.2d 444 (1981) (holding that an adjustment clause for changes in excise taxes were unauthorized by statute, that the power to change that rested with the General Assembly and that taking such

The approach that is set forth in statute is a comprehensive review of all test period costs and revenues.[2] Using a full base rate case process to review and implement any appropriate changes to DP&L's rates also meets the legal requirements of Ohio law to have due process and the opportunity for an evidentiary hearing before a change in rates is ordered. Under no circumstance, should the Commission issue an order as the result of this investigation case that would change rates with no opportunity for DP&L to provide evidence of the appropriate adjustments that should be made in light of DP&L specific circumstances and its other costs and revenues.

The use of a single issue adjustment in rates downward would be even more legally troubling in light of DP&L's application and pre-hearing testimony in PUCO Case No. 15-1830-EL-AIR that shows that DP&L is not earning a reasonable rate of return and would need a distribution base rate increase of $65.8 million based on a test period of June 1, 2015 through May 31, 2016 in order to earn a reasonable rate of return.[3] As a rough estimate, current regulatory tax expense at the 21% tax rate within the TCJA rather than the 35% that was in effect during the test period, would reduce the requested increase by about $11 million. Thus, a revenue increase of about $55 million would still be needed for DP&L to earn a reasonable rate of return; eliminating any justification that could be offered for a single-issue rate reduction associated with the TCJA.

As the Commission is aware, any rate increase resulting from PUCO Case No. 15-1830-EL-AIR will be put into effect on a prospective basis. Recording a liability back to January 1,

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changes into account without reference to other costs that may also be changing "could eliminate the regulatory framework, contained in R.C. 4909.15, that rates are to be based upon historic costs").

[2] R.C. 4909.15(A) and (C).

[3] See Application at ¶ 7 (Nov. 30, 2015), PUCO Case No. 15-1830-EL-AIR, et al.

2018, when DP&L was under-earning its authorized return, would raise serious questions regarding retroactive ratemaking and would be an outcome that is not supported by and, in fact, would be contrary to, evidence. Ohio law prohibits retroactive ratemaking.[4] Commission decisions must be the result of due process and be supported by substantial evidence.[5]

Additionally, taking the tax rate decrease into account absent a full rate case process interferes with and may violate the recently approved DP&L Electric Security Plan. In that proceeding, DPL Inc. "agree[d] that it will not make any contractually-required tax-sharing payments to AES Corporation."[6] DP&L stated that its plan was to "utiliz[e] cash available, after paying all costs and necessary capital investments, to reduce and retire debt at DP&L and DPL which enabled both to achieve specific financial metrics as described herein."[7] DP&L and DPL Inc. is using free cash flow, including tax payments that otherwise would be made to AES, to pay down debt at DP&L and DPL Inc., so that those entities can achieve and maintain an investment-grade credit rating. In its Opinion and Order approving the Amended Stipulation and

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[4] *Public Util. Comm. v. United Fuel Gas Co.*, 317 U.S. 456, 63 S.Ct. 369, 87 L.Ed. 396 (1943) (Statute gives Ohio commission power to prescribe rates prospectively only); *In re Review of the Alternative Energy Rider Contained in the Tariffs of Ohio Edison Co.*, et al, slip op No. 2018-Ohio-229 (Jan. 16, 2018) at ¶ 18 (citations omitted) (Utility must charge customers the filed rates in effect at the time and commission was prohibited from later ordering a disallowance or refund of the costs collected under those filed rates; and "[Where] application of the no-refund rule has been perceived as unfair and has even sometimes resulted in a windfall for a utility company . . . it is the statutory scheme that requires this result, and therefore, it is a matter for the General Assembly to remedy, not this court")

[5] R.C. 4909.15(D)(requiring a hearing and findings before modifying any rate or schedule); R.C. 4909.17 (no change in rates until commission by order determines the new rate to be just and reasonable).

[6] *In the Matter of the Application of The Dayton Power and Light Company for Approval of Its Electric Security Plan*, Case No. 16-0395-EL-SSO, et al., Amended Stipulation and Recommendation, § II. 1. B (March 13, 2017) ("2017 ESP Amended Stipulation").

[7] *In the Matter of the Application of The Dayton Power and Light Company for Approval of Its Electric Security Plan*, Case No. 16-0395-EL-SSO, et al., Direct Testimony of Craig Jackson, p. 4 (October 11, 2016).

Recommendation, the Commission noted that DP&L's ability to achieve an investment-grade credit rating was important to its ability to implement grid modernization.[8] Any reduction of free cash flow -- including a rate reduction associated with tax reductions -- will impair DP&L's ability to pay down debt, achieve an investment-grade credit rating, and implement grid modernization.

II. GENERAL REGULATORY PRINCIPLES AND CONSIDERATIONS.

A. Regulatory Tax Expense Is Only One of Many Costs that Are Calculated Or Estimated within a Rate Case. .

The TCJA will result in a reduction in federal corporate income taxes as traditionally computed on a stand-alone basis for the utility in the regulatory process. This reduction is not likely to equate to the actual size of the reduction in corporate income taxes paid. Actual corporate income taxes paid depend on many factors, including factors not taken into account during the regulatory process. For example, DP&L is a subsidiary of a parent corporation that files a consolidated federal income tax return, so the actual federal income taxes paid by the parent reflect costs and income from a large number of subsidiaries, not just DP&L. Even looking solely at DP&L, the federal income taxes included in distribution base rates were computed based on estimates of future sales, future costs, and future net income. These estimates are used to establish base rates and are not thereafter modified until another base rate case, i.e., base ratemaking in Ohio does not provide for future true ups for differences in estimated vs. actual expenses or kWh sales. As the TV commercials say about investment solicitations: "Actual results may vary."

[8] *In the Matter of the Application of The Dayton Power and Light Company for Approval of Its Electric Security Plan*, Case No. 16-0395-EL-SSO, et al., Opinion and Order, ¶¶ 36-38 (October 20, 2017) ("2017 ESP Order").

DP&L is not advocating that there should be no changes in how taxes are taken into consideration for regulatory purposes. It is pointing out only that the ratemaking process is not a purely mechanical exercise using actual numbers. The adjustments that are likely to arise out of this investigatory process and future proceedings are going to be substituting one set of tax-related numbers that are based on estimates with a different set of tax-related numbers that are based on different estimates.

The TCJA is also only one change to the projections underlying existing base rates that has occurred since base rates were last reset. Since that time, there have been hundreds of other changes, up and down, to DP&L's costs and revenues. In general, this Commission has recognized that modifying rates to make one change, while ignoring all other changes that have occurred, is "single-issue" ratemaking and a bad idea.[9] There are certain circumstances where a single-issue rate change may be warranted, but, where possible, the Commission should consider how feasible it may be to look at the broader picture and to make adjustments for all significant changes that have occurred.

B. Different Approaches May Be Appropriate Depending on the Type of Costs or Rates Under Review and the Circumstances of the Utility

In its Entry of January 10, 2018, the Commission requested comments on the logistics of executing changes to base rates, riders, and deferrals.[10] DP&L believes that the Commission has correctly suggested there could be differences depending on how such rate components were established. Thus, where an existing rider will automatically flow-through any reduced costs of calculated income taxes, there may be no need to create any new process. In contrast, a much

[9] *Pike Natural Gas Co. v. Pub. Util. Com.*, 68 Ohio St.2d 181, 429 N.E.2d 444 (1981).
[10] Investigation Entry at ¶¶ 4-5.

different process may be necessary for base rates that have "baked-in" the corporate federal income tax rates that existed prior to passage of the TCJA.

Additionally, the Commission should also be sensitive to differences between utilities. A utility that has reduced costs and increased sales relative to projections in its last base rate case is in a fundamentally different position than a utility like DP&L that is under-earning its authorized return as demonstrated in a case pending before the Commission.

Further, not all elements of the deferred tax reserve are required to be treated the same way. The Commission has long recognized there are two main categories of deferred tax reserves. First, the bulk of any utility's deferred tax reserve is likely to have as its source the book-tax timing difference associated with the use for federal income tax purposes of an accelerated tax depreciation method over a specified tax life, versus the use of straight-line depreciation for book purposes over, typically, a longer useful life. These book-tax timing differences are "restricted" or "protected" under federal tax law normalization rules that control how a state regulatory commission can reflect these differences in rates. These federal tax law normalization rules also apply to the treatment of changes in the deferred tax reserve created by changes in tax rates.

A second category exists, however, that is comprised of "unrestricted" or "unprotected" book-tax differences. Federal tax laws do not control the ratemaking treatment of such unprotected differences and, hence, the Commission has greater discretion with respect to the treatment of any associated deferrals and any associated excess deferred reserves. One example of this second category is the book-tax basis difference that is created when the utility is allowed under tax law to expense certain items while it may be required for rate purposes to capitalize the

expense and depreciate it over time.[11] Within this second category, this Commission looks deeper to determine how that category of costs has been reflected in rates and, thus, whether shareholders or ratepayers were the source of the funding of the deferred tax reserve. In other words, if customers never funded the asset that generated the deferred tax, the Commission would not require a rate base deduction for the deferred tax reserve and would not require any excess deferred tax reserve to be amortized in rates.

> The Commission also agrees with the company's rationale with regard to these three items. [OCC Witness] Mr. Effron argued that a tax adjustment to reflect the flow back of the excess deferred income tax balances associated with these items would be appropriate because the balances relate to costs which are components in the determination of the company's rates. However, because the costs associated with these items were not being reflected in rates at the time the tax deferrals were created, the company's customers were not providing the funds to create the balance. Therefore, they are not entitled to return of the existing deferred tax balance.
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> *In the Matter of the Applications of Columbia Gas of Ohio, Inc.*, Case Nos. 88-716-GA-AIR, et al., 1989 Ohio PUC LEXIS 1069, *115-116 (Oct. 17, 1989).[12]

Similarly, if a "flowthrough" method of accounting were used instead of a normalization method so that customers had already received the tax benefits associated with some item that is recorded on the utility's books within a deferred tax reserve, there is no justification for

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[11] Other examples where there may be a difference in treatment between how costs or revenues are recorded for federal income tax purposes versus their treatment for regulated purposes, which could result in an "unprotected" tax deferred account, include capitalized payroll taxes, and taxes expenses or deductions with respect to contributions in aid of construction, unbilled revenues, loss on reacquired debt, uncollectible accounts associated with low income programs, capitalized employee benefits, nuclear decommissioning costs, and other pre-paid nuclear expenses. *See generally, In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Gas Rates in its Service Area*, 90-390-GA-AIR, 1991 Ohio PUC LEXIS 15, 59-60 (Jan. 3, 1991)(" CGE Rate Case") and *In the Matter of the Application of The Cleveland Electric Illuminating Company for Authority to Amend and Increase Certain of Its Filed Schedules Fixing Rates and Charges for Electric Service*, 86-2025-EL-AIR, 89 P.U.R.4th 1, 85-88 (Dec. 16, 1987) ("CEI Rate Case").

[12] *See also CGE Rate Case* at 35-36 (disregarding the deferred tax reserve associated with the development costs of a customer information system that had not been included in rate base).

providing that benefit a second time through a rate base reduction or an amortization of any excess.[13]

However, if those tax benefits had been normalized in the ratemaking process such that the ratepayers only receive the tax benefits in the form of lower rates over some extended period of time, then the utility receives a cash flow benefit that is considered not to be funded by shareholders. In that circumstance, the Commission will treat that as a non-investor source of funding and permit a rate base deduction for the associated deferred tax reserve. Additionally, after reviewing record evidence and based on a finding that the ratepayers had been the source of funding a deferred tax reserve, the Commission has in the past often required any ratepayer-funded excess deferred tax reserve to be amortized back to ratepayers over some period of time.[14]

C. Technical Computational Aspects of the Tax Component in Rates.

Where there is a tax component established in rates, there are typically three main areas where that component applies.

First and foremost, regulated rates will include an amount sufficient to collect current federal income tax expense. That amount is typically calculated based on the statutory tax rate times the pre-tax profits that a utility is expected to earn as computed by the product of net rate base and the authorized return on rate base.[15]

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[13] *See CEI Rate Case* at 85 (discussing the differing treatment that would be appropriate depending on whether or not customers had already received some of the benefits of deferred taxes associated with interest on nuclear fuel purchases).

[14] *Id.*

[15] For income tax purposes, taxable income includes all the revenues that a utility receives in rates to recover its cost of service, but the utility deducts those costs as well. The result is that the tax expense that needs to be separately calculated and included in rates is a grossed-up amount (1 / (1 – tax rate)) multiplied against the earnings of the utility based on its authorized

Second, regulated rates will include an adjustment to rate base that reflects the size of the deferred tax reserve. In DP&L's case, it has a positive deferred tax reserve, which has the result of decreasing rate base (and hence, decreasing charges to customers). This decrease in rate base is one of the mechanisms that the IRS permits under its normalization rules.[16] The deferred tax reserve itself is often comprised of several components, the largest of which is usually the so-called book-tax timing differences between accelerated tax depreciation reflected on an income tax return and the book depreciation that is used in the regulatory computations of depreciation expense and regulated tax expense.[17] As previously discussed, there may be a myriad of other book and tax differences and associated deferred tax reserves that are not related to depreciation.

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return on investment. The gross-up computation results in the collection of revenue sufficient to pay taxes and have an after-tax remainder that equals the authorized return.

[16] 26 C.F.R. §1.167(l)-1(h)(6).

[17] It would violate normalization requirements to calculate regulatory depreciation expense assuming the asset has a 25-year useful life (4% depreciation rate) and a regulatory tax expense assuming a useful life of 10 years (10% depreciation rate), even though the IRS may allow the use of 10 years for tax return purposes and may even allow larger deductions to be taken in the first few years (accelerated depreciation) before switching over to straight-line depreciation. Instead, under this example, a regulatory commission that establishes a 25-year useful life for purposes of calculating depreciation expense for rate making purposes is required to use the same 4% depreciation rate consistently in the rate making process for tax expense. 26 U.S.C. § 168(i)(9)(B)(ii). The difference between the amount of regulatory tax expense computed using the 4% level depreciation level and the IRS tax return tax expense that may reflect depreciation of 10% or more, is reflected in the deferred tax account. Over time, these book-tax timing differences will reverse. That is, if the utility for tax return purposes fully depreciates the asset within 10 years, it will have zero tax return depreciation on that asset thereafter. But the regulatory books will continue to show a 4% depreciation rate for 15 more years as a decrease to regulated tax expense. Thus, at the end of the 25-year period, customer rates will get 100% of the benefits of tax depreciation and the deferred tax account for this asset would be back to zero. However, it is also recognized that the customers receive that benefit over 25 years, while the utility benefitted from accelerated tax depreciation in the first 10 years. Because the utility had that cash flow benefit, the amount of that cash flow benefit may be treated as a source of zero cost investment and its rate base may be reduced by the size of the deferred tax account without creating a normalization violation. 26 C.F.R. § 1.167(l)-1(h)(6). In reality, the process is somewhat more complex than this because the deferred tax reserve reflects multiple assets (not just one) and every year the deferred tax reserve will reflect the book-tax differences of all the assets within the account. Additional complexities arise because not all book-tax differences rise

Third, in the context of a tax rate change in law, the deferred tax reserve itself is likely to be over-funded or under-funded. The deferred tax reserve is created based on multiplying the statutory tax rate by the amount of differences between costs and deductions taken into consideration in the regulated books used for rate purposes and costs and deductions taken into consideration for income tax purposes. The assumption is that, over time, there will be a reversal of these book-tax differences and the deferred account for any particular asset will return to zero. That assumption fails, however, if the deferred tax reserve were built up at a time when the tax rate was 35% and is drawn down at a time when the tax rate is 21%. In such a situation, the deferred tax reserve is likely to be over-funded. Congress and the IRS have also created mechanisms known as the "Average Rate Assumption Method" or the "Reverse South Georgia Method" to permit a fair method of returning to customers any such over-funding. Under these methods, once the book-tax timing differences reverse (i.e., book depreciation exceeds tax depreciation), the excess between book and tax is passed back to customers and the excess deferred amount created by the change in tax rate is also passed through to customers. The return to customers of the excess deferral amount is done on a ratable basis over the average remaining book life of the assets.[18] Using the example in footnote 17, this means that if there were an overfunded reserve as of year 18 for the asset with a 25 year life, the excess would be returned along with the rest of the deferred tax amount over the remaining seven years of useful

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and then fall back to zero as described above. For example, federal tax law and regulatory accounting may have slightly different rules for what kind of costs get capitalized versus expensed. In such instances, there may be permanent differences between book and tax depreciation that also must be addressed in the regulatory process, typically, but not always, through a rate base adjustment.

[18] See TCJA § 13001(d) ("Normalization Requirements").

life.[19] These methods strictly limit how quickly any excess deferred tax associated with a "protected" book-tax timing difference could be reduced. While these methods are not required with respect to the "unprotected" portion of a deferred tax reserve, the use of a consistent method would reduce administrative burdens.

While the three categories above will comprise the bulk of any federal income tax related matters reflected in rates, some other federal tax-related components may exist. For example, although the Investment Tax Credit ("ITC") was largely repealed for tax years beginning after 1986, there were transition rules that permitted certain some assets that had long-lead times in planning and construction to remain eligible for the ITC. There were also normalization rules associated with how the benefits of the ITC were to be shared with customers. As a result, there may be some utility rates in existence that still reflect adjustments for ITC.

D. The Requirements of Due Process and a Decision Supported by Substantial Evidence Must Be Met Prior to Imposing a Base Rate Change.

A bedrock principle of Ohio administrative law generally and this Commission's authority specifically is that rate changes must be established by an order of the Commission that is rationally based and supported by substantial evidence. That evidence is to be acquired through an evidentiary hearing that meets due process standards and offers the utility and any authorized interveners the opportunity to be heard. *See* R.C. 4909.15(D)(requiring a hearing and

[19] As noted in footnote 17, the process is actually more complex than this because there is not likely to be a single-asset deferred account. Thus, the period of time over which the excess is returned is based on the average life of the pool of assets that are within the account. Where the deferred tax account is "vintaged" so that it is possible to segregate tax depreciation, book depreciation, and other differences based on the year assets were placed in service, the remaining life may be the average life of the assets of that vintage class rather than the entire pool of assets.

findings before modifying any rate or schedule); R.C. 4909.17 (no change in rates until Commission by order determines the new rate to be just and reasonable).

The Supreme Court of Ohio has held that "though an administrative authority has statutory power to make independent investigations, it is improper for it to base a decision or finding upon facts so obtained, unless such evidence is introduced at a hearing or otherwise brought to the knowledge of the interested parties prior to decision, with an opportunity to explain or rebut." *Forest Hills Utility Co. v. Pub. Util. Com.*, 39 Ohio St.2d 1, 3, 313 N.E.2d 801 (1974) (reversing a Commission decision based on a cost analysis that was not available at the time of rehearing and that the utility had no opportunity to examine). *Accord*: New *York C. R. Co. v. Pub. Util. Com.*, 157 Ohio St. 257, 264, 105 N.E.2d 410 (1952) (holding that due process requires that parties affected by Commission actions be "given a reasonable opportunity to be heard"); *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S. Ct. 652 (1950) ("The fundamental requisite of due process of law is the opportunity to be heard.").

E. The Commission Should Take Great Care to Comply with Ohio Law Regarding Filed Rates and Prospective Changes to Rates.

Under Ohio law, utilities are only permitted to charge customers the authorized filed rates that are in effect at the time and changes to those rates are to be made only prospectively. *Public Util. Comm. v. United Fuel Gas Co.*, 317 U.S. 456, 63 S.Ct. 369, 87 L.Ed. 396 (1943) (Statute gives Ohio commission power to prescribe rates prospectively only); *In re Review of the Alternative Energy Rider Contained in the Tariffs of Ohio Edison Co.*, et al, slip op No. 2018-Ohio-229 (Jan. 16, 2018) at ¶ 18 (citations omitted) (Utility must charge customers the filed rates in effect at the time and commission was prohibited from later ordering a disallowance or refund of the costs collected under those filed rates).

Given this long-standing legal principle, affirmed again only last month, the Commission should not require refunds or engage in retroactive ratemaking. This concern is heightened by some aspects of the Investigation Entry, which could be interpreted as starting from a premise that the restrictions of due process and retroactive ratemaking can be evaded by ordering, without a hearing, that utilities establish deferred regulatory liabilities back to January 1, 2018, and then, at some later point that may be months later, ordering that that accounting requirement be converted to a ratemaking outcome where all deferred amounts are refunded to customers.[20] This approach is contrary to the well-established precedent cited above and statutory provisions providing that the Commission's powers to reset rates are prospective only and must be based on findings that are supported by substantial evidence presented at a hearing that meets due process standards.

Prospective implementation of the tax rate change is particularly appropriate for DP&L because, as noted above, it is currently under-earning a reasonable return on its investment. Even if retroactive decreases in rates were allowed under Ohio law, it would not be appropriate here where the tax rate decrease only has the effect of reducing the size of the rate increase DP&L needs to earn a reasonable return.

F. The Commission Should Take Great Care Not to Violate IRS Normalization Requirements.

The Commission must also be sensitive to the requirements of the Internal Revenue Service tax normalization rules. In a nutshell, these rules require that for the "protected" categories of book-tax timing differences, when the Commission establishes regulated rates, it

[20] Similar concerns may arise with respect to any modifications to rates that would have the effect of flowing back deferred taxes in the form of lower rates to customers more quickly than would be the case under the treatment reflected in currently filed and approved rates.

must be consistent in applying the same federal corporate income tax rate and tax depreciation rates in computing regulated tax expense and regulated depreciation expense.[21] Special normalization rules also apply for the establishment of tax deferred reserve and the allowance of a rate base deduction for the size of the tax deferred reserve that is related to these protected book-tax timing differences. In the context of a tax-rate change,[22] the normalization requirements also control the speed at which any so-called "excess" deferred tax reserves related to the protected book-tax timing differences may be flowed back to ratepayers. The TCJA requires that any such flow back that would reduce the size of the reserve occur "no more rapidly or to a greater degree than such reserve would be reduced under the average rate assumption method."[23] The penalty for failure to comply with these normalization rules is that a utility may lose its right to accelerated depreciation deductions – a result that would be devastating to the financial well-being of the utility that would have grave consequences to its ability to continue to provide adequate service to customers.[24]

III. COMMENTS SPECIFICALLY RELATED TO DP&L'S PUCO JURISDICTIONAL RATES THAT INCLUDE A TAX-RELATED COMPONENT

Each utility is in a unique position that will dramatically affect how a tax liability should be incorporated into rates. DP&L's unique position stems from a number of factors – the Company is underearning due to the fact that it has not had a base rate increase since 1991, it has agreed to forego payment of any taxes up to its parent to use toward debt repayment, and has only one rider that is "grossed up" for taxes.

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[21] 26 U.S.C. § 168(i)(9)(A) and (B)(ii).
[22] 26 U.S.C. § 168(i)(9)(A)(ii).
[23] 26 U.S.C. §§ 168(f)(2) and 168(i)(9)(C).
[24] TCAJ § 13001(d)("Normalization Requirements").

A. DP&L's Current Distribution Base Rates.

1. DP&L Has Under-Recovered Tax Expense for Decades and Is Currently Underearning Its Authorized Return Overall.

DP&L distribution base rates were last reset using a test period of January 1 through December 31, 1991.[25] At that time, the federal corporate income tax rate for income in excess of $335,000 per year was 34%. The Omnibus Budget Reconciliation Act of 1993 established a higher tax rate for tax years beginning in 1994 of 35% for income between $10 million and $15 million, 38% for income between 15 million and $18.3 million, and 35% for income above $18.33 million.[26] That 38% rate was designed to recapture the effects of the lower tax rate on income below $10 million, so the effect on DP&L was a federal tax rate on all income of 35%.[27]

The Commission did not order and DP&L did not receive any additional revenue to recover the effects of this increase in federal income taxes from 34% to 35%. Thus, for 24 years DP&L has been "under recovering" its federal income taxes within its distribution base rates that were established based on a federal tax rate that was in effect in 1991 but was increased three years later. There was no single-issue rate adjustment upward to reflect this increase in federal tax rate.

Today, there are even more compelling reasons not to make a single-issue downward rate adjustment. As supported by DP&L's Application in Case No. 15-1830-EL-AIR, there have been other changes since 1991 in costs and revenues that more than offset the decreased tax liability from the TCJA and put DP&L in a position where it is currently not earning a fair rate of return.

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[25] PUCO Case No. 91-414-EL-AIR

[26] Omnibus Budget Reconciliation Act of 1993, P.L. 103-66, § 13221.

[27] Omnibus Budget Reconciliation Act of 1993, P.L. 103-66, Conference Report at 597.

This history puts DP&L in a unique position among Ohio utilities: 1) DP&L's distribution rates have had an implicit tax component that was understated for 24 years; and 2) in the interim period between January 1, 2018 when the change in federal tax rates become effective and the date that base rates are changed prospectively, DP&L is under-earning even after consideration of the tax rate changes.

Additionally, DP&L supports and reiterates the position it took as part of the Ohio Electric Utility Group filing of February 9, 2018, that the deferrals that the Commission has ordered in this tax investigation proceeding are for accounting purposes only and are not dispositive of the outcome of the finally-approved ratemaking process.

2. DP&L, Staff and Interveners Should Have the Opportunity to Propose Alternative Approaches for Applying the Benefits of the Tax Rate Change.

As noted in the above Summary of Comments section, DP&L or other parties may want to propose, and the Commission may want to consider, applying the reduced costs from a lower corporate income tax to benefit customers but in a way different from merely adjusting regulatory tax expense downward. In DP&L's ESP case, Case No. 16-395-EL-SSO, the Commission has already approved an explicit tax-related mechanism under which DP&L's ultimate parent company, AES Corporation, has agreed to allow DP&L's immediate parent DPL Inc. to retain revenues received from DP&L that would otherwise be paid further upstream to AES to cover DPL Inc.'s "Tax Sharing Liabilities" for the term that DP&L is collecting the Rider DMR. Further, the Stipulation provides that AES has agreed to convert the existing tax sharing liabilities and the additional tax sharing liabilities arising month by month into additional equity investment.[28] In approving this portion of the Stipulation, the Commission correctly

[28] 2017 ESP Amended Stipulation, supra, at II.1.b.

characterized such conversion as "the equivalent of an equity contribution under the Amended Stipulation, which will result in a significant improvement to DPL Inc.'s capitalization ratio."[29]

In this context, booking a deferred regulatory liability for the TCJA tax reduction and reducing DP&L's rates to reflect a reduced tax expense would operate at cross-purposes with the 2017 ESP Order. It would have the effect of reducing DP&L's cash flow that could otherwise be used to pay down debt at DPL Inc. That would correspondingly increase (or slow down the decrease in) the debt to equity ratio, which undercuts a fundamental objective underlying the 2017 ESP Stipulation and Order to deleverage and strengthen the financial health of DP&L so as to allow it the opportunity to achieve and maintain an investment grade credit rating, and continue to provide safe and stable service in Ohio.[30]

Rather than undercut the objectives of the 2017 ESP Order through a summary order issued as a result of the current Investigation proceeding, the Commission should at a minimum permit DP&L and others to present evidence as to why it may be in the public interest not to adjust DP&L's current tax expense in rates so as to continue to pay down debt at DPL Inc. and place the Company in a position to pursue grid modernization. Of course, any such proposal made by DP&L or another party would need to be supported by substantial evidence.

B. DP&L Riders

DP&L has identified only one rider with a rate that is calculated with an explicit federal income tax component. The Energy Efficiency Rider ("EER") uses a tax gross-up factor in computing the shared saving component. In its books and records for 2018 and thereafter, DP&L will calculate the shared savings component using a 21% federal income tax rate.

[29] 2017 ESP Order, supra at ¶41 and ¶51.
[30] 2017 ESP Order at ¶¶ 46-51.

Additionally, each year the EER is updated and reset with rates that reflect actual costs in the past year and projected forward looking costs. To the extent these forward-looking costs as reflected in its 2017 filing included a shared savings component calculated at a 35% federal income tax rate, the true-up and reset filing that will be made later in 2018, will result in an offsetting adjustment to reflect the actual 21% tax rate. No change to the tariff or the computational methods that underlie the tariff are necessary other than incorporating the 21% federal income tax rate into the calculation.

No other Rider or the calculations underlying the Rider need to be adjusted as the result of the TCJA. For completeness, however, DP&L notes that DP&L's Decoupling Rider is tied to base distribution revenues that do incorporate tax rates. The Decoupling Rider recovers revenues that were 'lost' because of energy efficiency programs during a period prior to the change in tax rates and will continue into 2018 until the distribution rate case is resolved. As previously discussed, DP&L is currently under-collecting its base distribution rates by a significant amount, which also means that DP&L is not collecting enough lost distribution revenues either. Accordingly, no adjustment is necessary or appropriate.

DP&L's other riders include those that are set at zero and, thus, are unaffected by the TCJA. Several other rate riders are designed to flow-through certain costs (excluding income taxes), but there is no return component and, hence, no tax component included in the rates. DP&L's Distribution Modernization Rider ("DMR") includes a flat amount of collections of $105M per year for reasons including the planned retirement of debt.[31] The debt that DP&L is working to retire does not decrease because of the tax change.

[31] In the Matter of the Application of The Dayton Power and Light Company for Approval of Its Electric Security Plan, Case No. 16-395-EL-SSO, et al., Amended Stipulation and Recommendation, § II.2 (March 13, 2017).

C. **Other Rate Components.**

DP&L's generation rate to supply a Standard Service Offer ("SSO") to customers is a flow-through rate that recovers the costs incurred to purchase power from third party suppliers who bid to supply this load. DP&L does not earn a return on this rate and, thus, currently and going forward, will pay no federal income taxes on this rate component. No adjustments to reflect the TCJA are necessary or appropriate.

The portion of DP&L's transmission rates which are regulated by the PUCO are established through a non-bypassible Transmission Cost Recovery Rider where the rates by customer class are established to aggregate to the same dollar amount that DP&L is charged by PJM for transmission service under the PJM Open Access Transmission Tariff approved by the Federal Energy Regulatory Commission ("FERC"). Any differences in costs and revenues are trued up in the following year. This Commission is a member of the Organization of PJM States, Inc. (OPSI), which has written to the FERC to take action to adjust FERC-jurisdictional transmission rates to take the TCJA tax rate change into effect.[32] DP&L agrees that FERC is the proper forum to discuss such changes and recommends here that the Commission monitor FERC's progress and take no action at this time with respect to transmission rates. Once it is clear whether and how the FERC addresses this issue, the Commission can revisit this decision and determine if any steps other than the annual true-up mechanism is appropriate.

Pole attachment rates were established in 2017 and include an income tax component. The pole attachment rates generate an extremely small amount of revenue, however, and the

[32] Letter of December 29, 2017, to the FERC by OPSI. http://www.opsi.us/filings.html

revenues associated with the tax component are similarly small. DP&L recommends that the Commission take no action at this time with respect to pole attachment rates.

Contributions In Aid of Construction ("CIAC") include an income tax component. DP&L has already modified its internal processes to compute the CIAC using the lower TCJA federal income tax. No action by the Commission in this area is required.

Respectfully submitted,

/s/ Randall V. Griffin
Michael J. Schuler (0082390)
*Counsel of Record
Randall V. Griffin (0080499)
The Dayton Power and Light Company
1065 Woodman Drive
Dayton, OH 45432
Telephone: (937) 259-7358 (Schuler)
Telephone: (937) 259-7221 (Griffin)
Facsimile: (937) 259-7178
Email: michael.schuler@aes.com
Email: randall.griffin@aes.com

Attorneys for The Dayton Power and Light Company

(willing to accept electronic service)

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Summary: Comments of The Dayton Power and Light Company electronically filed by Mr. Tyler A. Teuscher on behalf of The Dayton Power and Light Company