

**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 Utility Companies.) Case No. 18-47-AU-COI

**NORTHEAST OHIO PUBLIC ENERGY COUNCIL’S
MERIT BRIEF**

I. INTRODUCTION

The Northeast Ohio Public Energy Council (“NOPEC”) filed initial comments in this proceeding on February 15, 2018, agreeing with the PUCO that the windfall resulting from the Tax Cuts and Jobs Act of 2017 (“TCJA”) should be passed on to the utilities’ customers, who provide the funds to pay the utilities’ federal tax obligation. NOPEC also filed reply comments on March 7, 2018, opposing some utilities’ attempts to delay a reduction in customers’ federal tax expense. NOPEC proposed that the utilities immediately file applications not for an increase in rates under R.C. 4909.18 to flow through the tax reductions to consumers or, alternatively, that the PUCO initiate actions under R.C. 4905.26 to reduce the utilities’ rates in the amount of their reduced tax obligations, or adjust the rates under the emergency powers granted by R.C. 4909.16, without hearing.

On May 24, 2018, the PUCO ordered that a hearing be conducted in this matter on the narrow issue of whether Ohio utilities should be required to establish a deferred tax liability, effective January 1, 2018, to effectuate the return of excess federal income taxes to the utilities’ customers. Hearing was held on July 10, 2018, and the evidence conclusively demonstrates that the deferrals not only are appropriate, but required.

NOPEC notes that only two utilities¹ appeared and offered testimony as to their efforts to comply with the PUCO's order to establish a deferred tax liability.² NOPEC renews its request that the PUCO use its vast regulatory authority to ensure that ALL utilities, including the FirstEnergy operating companies, comply with the January 10, 2018, accounting order and ensure that all customers, including those in FirstEnergy's service territory, receive the full benefit of the tax reduction from to January 1, 2018 forward.

II. PUBLIC POLICY REQUIRES THE DEFERRALS

It cannot be disputed that the TCJA reduced Ohio's regulated utilities' federal income tax rate from 35 percent to 21 percent effective January 1, 2018. Nor can it be disputed that, absent an adjustment in rates, Ohio's utility customers will continue to provide the utilities funds to pay the 35 percent income tax, while utilities will be required to pay the federal government only a 21 percent tax on their income. Absent a deferral on the utilities' books, the rightful return of this windfall to customers is in jeopardy under the Ohio Supreme Court's precedent that prohibits retroactive ratemaking.³ See, e.g., *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254, 257, 141 N.E.2d 465(1957). Accordingly, public policy requires that Ohio's utilities be required to establish a deferred tax liability on their books to ensure that the enormous windfall resulting from the TCJA is passed on to utilities' customers, as the PUCO clearly intends.⁴

¹ Ohio Power Company and Duke Energy Ohio, Inc.

² *In Re Tax Cuts and Jobs Act of 2017*, Case No. 18-47-AU-COI, Entry (January 10, 2018) ("*TCJA 17*").

³ Ohio Energy Group ("OEG") Exhibit 1 (Kollen Direct), at 9 (The PUCO's January 10, 2018 Entry in *TCJA 17* "effectively precludes any claim in a future ratemaking proceeding that refunds constitute improper retroactive ratemaking.")

⁴ *TCJA 17*, Entry (January 10, 2018 at 1; *TCJA 17*, Second Entry on Rehearing (April 25, 2018), at 6.

III. OHIO STATUTES AND ACCOUNTING PRACTICES REQUIRE THE CREATION OF THE ACCOUNTING DEFERRAL

The PUCO's order that Ohio's utilities recognize the TCJA by creating a deferred tax liability on their books is authorized under R.C. 4905.13, and the PUCO's precedent establishes that no hearing is required on the accounting order. See *e.g.*, *In re Dayton Power and Light Co.*, Case No. 04-1645-EL-AAM, Finding and Order (June 1, 2005), Entry on Rehearing (July 12, 2005); *In re Duke Energy Ohio, Inc.*, Case No. 09-712-GA-AAM, Finding and Order (November 12, 2009); *In re Columbus S. Power Co. and Ohio Power Co.*, Case No 08-1338-EL-AAM, Finding and Order (January 7, 2009).

Nevertheless, the PUCO used its discretion in ordering a hearing on this limited issue in this case. The evidence of record shows that accounting standards require the utilities to account for changes in the tax law. Under the Generally Accepted Accounting Principles ("GAAP"), Accounting Standards Codification ("ASC") 980-regulated operations, 740-incomes taxes, utilities are required to record deferred tax liabilities or assets.⁵

IV. THE PUCO'S ESTABLISHED GUIDELINES SUPPORT THE ORDER TO ESTABLISH THE DEFERRED TAX LIABILITY

The PUCO has created guidelines to assist it in determining whether utilities should create deferred regulatory *assets* on their books. PUCO Staff witness Borer used these guidelines, as modified for deferred regulatory *liabilities*, to conclude that the utilities must create a deferred tax liability on their book as a result of the TCJA. The guidelines and their application to this proceeding are as follows.

⁵ Industrial Energy Users-Ohio Exhibit 1 (Bowser Direct), at 5; see, also, Staff Exhibit 1 (Borer Direct), at 3, OEG Exhibit 1, at 8-9 (ASC 980-405-25-1 provides, "Rate actions of a regulator can impose a liability on a regulated entity. Such liabilities are usually obligations to the entity's customers.")

A. Are the utility's current rates or revenues insufficient to cover the costs associated with the deferral?

Utilities' current rates were developed in their last base rate proceeding (or rider filings) and used a 35 percent federal income tax rate. Because the utilities continue to collect these rates while paying a 21 percent tax, current rates would be sufficient to cover the deferred liability created by the reduction in the federal taxes.⁶

B. Are the expense reductions material?

Yes. Ohio's ratemaking formula allows federal income taxes to be recovered on a dollar-for-dollar basis in the revenue requirements of base rates and riders. The expense reductions are material because changing the tax rate from 35% to 21% represents a reduction of 40%. In addition, there is an approximate reduction of 18% to the Gross Revenue Conversion Factor, exclusive of other taxes. Further, Staff's analysis shows that the balance of the excess accumulated deferred income tax is material, amounting to tens or even hundreds of millions of dollars.⁷

C. Is the reason for requesting the deferral outside the utilities' control?

Yes. The decision to reduce federal income taxes was an act of Congress and signed by the President of the United States.⁸

D. Are these expense reductions atypical and infrequent?

Yes. Major overhauls to federal income tax rates are rare. The last major change to

⁶ Staff Exhibit 1 (Borer Direct) at 5; Tr. at 142-143.

⁷ Staff Exhibit 1 (Borer Direct) at 5-6.

⁸ Staff Exhibit 1 (Borer Direct) at 6.

the corporate tax rate occurred in 1986,⁹ which was the last time the PUCO required utilities to reflect a decrease in taxes in consumers' rates outside of a rate proceeding.¹⁰

E. Will the financial integrity of the utility be significantly and adversely affected if the deferral is required?

No. Utilities' revenues are not impacted by the TCJA. Cash inflows will otherwise remain the same as they would have had the TCJA not been enacted. Conversely, cash outflows to the federal government have *decreased*. All else being equal, this means the utilities are seeing an increase in net income. As a result, the PUCO is ordering the utilities to defer an amount such that net income at the current 21% federal income tax rate would be the same as net income at the previous 35% rate.¹¹

V. CONCLUSION

The evidence in this proceeding shows that, as a matter of policy and law, Ohio's utilities are required to establish a deferred tax liability to account for the reduction in their federal income tax obligations from 35 percent to 21 percent.

NOPEC renews its request that the PUCO ensure that ALL utilities, including the FirstEnergy operating companies, are complying with its directive to establish the deferred tax liability, and to initiate proceedings as soon as possible to adjust ALL customers' rates, including those in FirstEnergy's service territory, to ensure that they receive the full benefit of the TCJA tax reduction from January 1, 2018 forward.

⁹ Staff Exhibit 1 (Borer Direct) at 6.

¹⁰ See *In Re Financial Impact of the Tax Reform Act of 1986 on Regulated Ohio Utility Companies*, Case NO. 87-831-AU-COI.

¹¹ Staff Exhibit 1 (Borer Direct) at 6.

Respectfully submitted,

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