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

INITIAL BRIEF OF THE KROGER CO. ON THE JULY 10, 2018 HEARING

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I. Introduction

The Public Utilities Commission of Ohio (Commission) commenced this proceeding in order to "consider the impacts of the Tax Cuts and Jobs Act of 2017 and determine the appropriate course of action to pass benefits resulting from the legislation on to ratepayers."[1] Throughout this process, the Commission has been clear that this proceeding does not pose a question of whether or to what extent Ohio's regulated public utilities will pass the benefits resulting from the Tax Cuts and Jobs Act of 2017 (TCJA) on to customers, but how those rate-regulated utilities would do so.[2] As part of this process, the Commission ordered the regulated public utilities to record their tax savings resulting from the TCJA as deferred liabilities on their books, starting on January 1, 2018, until the Commission is able to best determine how to ensure that utility customers obtain TCJA savings.

On February 9, 2018, Duke Energy Ohio, Inc. (Duke), The Ohio Power Company (AEP Ohio), The Toledo Edison Company, The Cleveland Electric Illuminating Company, and the Ohio Edison Company (collectively, FirstEnergy), and the Dayton Power and Light Company (DP&L) (collectively, EDUs) filed a joint application for rehearing, challenging, among other things, the Commission's authority to issue the accounting order.[3] The Commission subsequently confirmed its authority to order the EDUs to establish deferred liabilities on April 25, 2019.[4] Specifically, in its Second Entry on Rehearing, the Commission reaffirmed its authority under R.C. 4905.13 to order the establishment of deferred liabilities without prior

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1 Entry (January 10, 2018).

2 See Second Entry on Rehearing at ¶ 15 (April 25, 2018) ("However, the Commission intends that all tax impacts resulting from the TCJA will be returned to customers . . .").

3 See Application for Rehearing (February 9, 2018).

4 Second Entry on Rehearing (April 25, 2018).

notice or a hearing and the lawfulness of the creation of deferred liabilities that may impact future base rate proceedings. In that Entry, the Commission also reiterated its intent to ensure that customers receive the full benefits of the TCJA.[5]

Nonetheless, the Commission granted the Joint Application for Rehearing for the limited purpose of holding a hearing on the narrow question of whether or not public utilities should be required to establish on their books deferred tax liabilities, effective January 1, 2018, and rejected all other assignments of error advanced by the EDUs.[6] The Commission held a hearing on this issue on July 10, 2018. Duke and AEP Ohio filed testimony on June 15, 2018, supporting their opposition to the Commission's ordered deferral,[7] and the Staff of the Commission, the Office of the Ohio Consumers' Counsel (OCC), Industrial Energy Users-Ohio (IEU-Ohio), the Ohio Energy Group (OEG), and the Ohio Cable Telecommunications Association filed testimony on June 29, 2018 in support of the Commission's authority to create regulatory liabilities for deferred tax liabilities.[8]

For the reasons discussed above and those articulated herein, the Commission should reject any attempt by the EDUs to unjustly and unreasonably deny their respective customers the tax relief to which the TCJA entitles customers. The Commission should reject the Joint Application for Rehearing filed by Ohio's EDUs and uphold its January 10, 2018 order that all regulated public utilities must record the tax impacts resulting from the TCJA on their books as deferred liabilities, effective January 1, 2018, and be returned to customers in the future.

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5 Id.

6 Id. at ¶ 34.

7 See Direct Testimony of William Don Wathen, Jr. (June 15, 2018); Direct Testimony of William A. Allen (June 15, 2018).

8 See Testimony of Jonathan J. Borer (June 29, 2018); Direct Testimony of Wm. Ross Willis (June 29, 2018); Direct Testimony of Joseph G. Bowser (June 29, 2018); Direct Testimony of Lane Kollen (June 29, 2018); Direct Testimony of Patricia D. Kravtin (June 29, 2018).

II. Legal Standard for Commission Establishment of a Deferral

As a general matter, regulated public utilities are directed by the generally accepted accounting principles (GAPP) (utilized by the Financial Accounting Standards Board (FASB)) to recognize and record deferred tax liabilities or assets for the estimated future tax effects attributable to provisional differences based on the law or changes in the law.[9]

The Commission has not established standards for reviewing the creation of deferrals associated with regulatory liabilities.[10] As Staff Witness Borer notes, there are, however, standards used to evaluate the creation of deferred assets that can be modified to assist in the consideration of deferred liabilities.[11] Those standards,[12] adjusted to fit the purposes of this case, are as follows:

1. Are the utility's current rates or revenues insufficient to cover the costs associated with the deferral?
2. Are the expense reductions material?
3. Is the reason for the deferral outside of the utility's control?
4. Are the expense reductions atypical and infrequent?
5. Will the deferral, if required, significantly affect the financial integrity of the utility?[13]

Although the Commission has not previously used these standards to evaluate the creation of a deferred liability, the standards are instructive in that inquiry and, when applied appropriately, the standards support the proposition that the Commission has the authority and correctly ordered the rate-regulated utilities to record their tax savings under the TCJA as a

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9 Borer Testimony at 3-4; Bowser Testimony at 5; Kollen Testimony at 3-4.

10 See Borer Testimony at 4.

11 See id. at 4-7.

12 In the context of deferred assets, these standards were relied on by the Commission in *In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods*, Case No. 17-2118-GA-AAM, Finding and Order (April 18, 2018).

13 Borer Testimony at 5-7.

deferred liability on their books, effective January 1, 2018. The Commission should reject any arguments to the contrary.

III. Argument

A. The Commission's Establishment of the Deferred Liability Is Proper Under Ohio Law.

As an initial matter, The Commission has already affirmed that it has statutory authority to issue the type of accounting order it issued in this case under R.C. 4905.13.[14] The Commission only granted rehearing "on the narrow question of whether the utilities *should* be required to establish a deferred tax liability, effective January 1, 2018."[15] Applying the factors discussed above confirms the Commission's decision to require the regulated public utilities to establish the deferred tax liability, effective January 1, 2018. Each of the five factors supports establishing the regulatory liabilities.

i. Public Utilities Have Sufficient Revenues to Cover the Deferred Liabilities.

Public utilities currently recover an approved revenue requirement that was developed based upon a 35% federal corporate income tax rate.[16] The TCJA lowered the federal corporate income tax rate to 21%. The utilities are currently collecting rates from customers based on an assumption that the federal corporate income tax rate is still 35%. Had Congress never enacted the TCJA and that assumption still held true, the utilities would be paying the entirety of the funds collected for their federal corporate income tax obligations to the federal government. Now, under the TCJA, the utilities are collecting the same amount, but paying 40% less to the federal government for income tax. As such, the utilities' current rates were designed to

[14] See Entry at ¶ 30 (April 25, 2018).

[15] Id. at ¶ 31 (emphasis added).

[16] Borer Testimony at 5.

compensate the utilities for the higher tax rate.[17] With the reduction in the federal income tax rate, the utilities have excess revenues collected from customers that are sufficient to cover the deferral associated with the federal income tax rate reduction.[18] Accordingly, the first criterion is satisfied.

ii. The Expense Reductions Are Material.

The expense reductions at issue are material. Regulated utilities recover the costs of their tax payments, including the federal income tax, from customers. The federal income tax rate, reduced by the TCJA, affects both current and deferred income taxes collected from customers by the utilities. While the expense reductions are quite large for some utilities, it is fair to say that a 40 percent reduction in the federal income tax rate alone is material.[19] On top of the federal income tax borne by customers, the revenues collected from customers also include funds associated with the accumulated deferred income tax (ADIT) balances and the gross revenue conversion factor (GRCF), which are impacted by the reduction in the tax rate.[20] The expense reductions associated with the reduction in the tax rate and other affected components of base rates are material, especially to customers who are paying these tax expenses. Staff explained that they too believe the expense reductions to be material.[21] Accordingly, the second criterion is satisfied.

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17 Id.; Willis Testimony at 5-6.

18 Id.

19 Borer Testimony at 5-6.

20 Id.; Bowser Testimony at 4; Willis Testimony at 5-6.

21 Borer Testimony at 6.

iii. The Reason for this Deferral is Outside the Utilities' Control.

The Commission explicitly opened this proceeding to deal with the impact of the TCJA,[22] and the TCJA is a cause that is definitively outside of the utilities' control, or the control of the Commission or any other party to this proceeding. It was passed by the United States Congress and signed into law by the President of the United States. No party or entity in this proceeding played a meaningful role in its enactment or in the fact that its changes to the federal tax law apply to all of Ohio's rate-regulated public utilities. As such, the third criterion is satisfied.[23]

iv. The Expense Reductions Associated with the TCJA are Atypical and Infrequent.

In addition to being beyond the utilities' control, the expense reductions enabled by the TCJA are also rare. The corporate income tax had not previously changed on this scale since 1986,[24] and there are no indications that the law will change any time in the near future. A 40% reduction in the utilities' federal corporate income tax liability is an event unlikely to repeat itself in the next several decades, let alone occur frequently or with any regularity. Therefore, the fourth criterion is satisfied.[25]

v. The Utilities' Financial Integrity Will Not Be Affected by this Deferral.

The Commission ordered regulated utilities to defer the *savings* they receive under the TCJA. Thus, the Commission has not asked the utilities to defer any monies that would have been part of their net revenues had the TCJA not been enacted. The Commission has a clearly stated goal to return all benefits of the TCJA to customers. Those benefits, by definition, would

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22 See Entry (January 10, 2018).

23 Borer Testimony at 6.

24 Id.

25 Id.

not have existed without the TCJA, so returning them to customers will leave the utilities in the same position that they would have occupied absent the new law. Therefore, the utilities will not be adversely affected by the deferral as they will have a reduction in their own liability through the TCJA, and the fifth criterion for the Commission's consideration for the creation of deferred liabilities will be satisfied.[26]

B. The Arguments Advanced by the EDUs Do Not Offer a Persuasive Justification for the Commission to Reverse Its Prior Order.

Although all of EDUs joined the Joint Application for Rehearing, only Duke and AEP Ohio ultimately filed testimony on this issue.[27] Neither FirstEnergy nor DP&L filed testimony, and FirstEnergy did not enter an appearance at the July 10, 2018 hearing. Moreover, Duke Witness Wathen and AEP Ohio Witness Allen fail to present a sufficient justification for the Commission to withdraw or revise its prior order requiring rate-regulated public utilities to defer their tax savings under the TCJA as a regulatory liability, effective January 1, 2018.

Like Mr. Borer, Mr. Wathen's testimony deploys the five-factor test that has been used by the Commission in the past to assess requests for the deferral of assets.[28] His testimony, however, improperly applies the standard for the creation of regulatory assets to the creation of regulatory liabilities. Mr. Wathen should have recognized the need to modify the test when considering the creation of deferred liabilities as opposed to deferred assets. His misapplication of the test to establish a regulatory liability lead to the incorrect conclusion that the deferral in this case is not justified. Regarding the first factor, Mr. Wathen states that because the Commission has not affirmatively concluded that the utilities' current revenues are sufficient to

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[26] Id. at 7

[27] See Direct Testimony of William Don Wathen, Jr. (June 15, 2018) (Wathen Testimony); Direct Testimony of William A. Allen (June 15, 2018) (Allen Testimony).

[28] Wathen Testimony at 8.

cover their expenses, the Commission cannot properly assess the first factor.[29] This is untrue. The Commission directed the utilities to defer their tax *savings*, or, in other words, to defer the amount of the funds received from customers to pay taxes that the utilities are no longer obligated to pay. As such, the deferral would not impact the utilities' revenues in the slightest. If Mr. Wathen is suggesting that other factors (which he does not specify or cite) could have rendered an EDU's revenues insufficient, the solution is not to allow utilities to fill their own coffers with money collected from customers for an expense that no longer exists. Instead, the solution is for a utility that feels its revenues are insufficient to file an application for an increase in base distribution rates. Further, Mr. Wathen cites no precedent for the proposition that the Commission must do a comprehensive analysis of a utility's revenues before issuing an accounting order on a limited issue to implement a reduction in the federal tax rate. Mr. Allen also focuses a good portion of his testimony on the need to ensure that the EDUs are generating a just and reasonable rate of return.[30] Similar to Mr. Wathen, Mr. Allen does not actually contend that AEP Ohio is not earning a just or reasonable rate of return.[31]

Regarding the second factor, Mr. Wathen suggests that the Commission must consider the materiality of the deferral in relation to the impact that the deferral will have on a utility's earnings to determine whether a material impact exists.[32] Mr. Wathen acknowledges that Duke has already deferred approximately $6 million for its jurisdictional electric distribution business and $4.4 million for its jurisdictional gas business.[33] This amount of money is material to the Duke customers who are paying it. Mr. Wathen cites a prior case in an attempt to establish that

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29 Id. at 9-10.

30 Allen Testimony at 4.

31 Id.

32 Wathen Testimony at 10-11.

33 Id. at 7.

any amount "below 1 percent of total operating expenditures" is "presumably immaterial."[34] But this is not what the Commission said in the cited case. Rather, the Commission cited a statement made by the Staff of the Commission that the deferral requested by Duke was less than one percent of total operating expenditures.[35] In ultimately concluding that the deferral requested in that specific case was not material for the purpose of creating a regulatory asset (not a regulatory liability), the Commission agreed with Staff that the requested amount of the deferral was immaterial due to it being a small amount relative to total base rates, but it did not cite to the one-percent figure referenced by Staff, and certainly did not establish that there is a one-percent threshold for materiality.[36] Moreover, that case concerned Duke's request for a deferred asset, so the proper inquiry was into whether the expense of the deferral would be material to the Company. Here, the Commission should consider materiality to customers who, without a deferral, would be left paying the utilities for a 35% federal corporate income tax, 40% of which is not actually needed by the utilities to cover those tax obligations. Additionally, in the case at bar, the Commission is not faced with the $3 million deferral request for the creation of a regulatory asset in the case Mr. Wathen cited,[37] but rather a deferral for the creation of a regulatory liability (to be returned to customers) that is already over $10 million for Duke's combined gas and electric operations, and continues to grow as this case progresses. In any event, it is noteworthy that neither Mr. Wathen nor Mr. Allen makes the outright contention that the deferral at issue in this case is not material.

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34 Id. at 10 (citing *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods*, Case No. 17-2118-GA-AAM, Finding and Order (April 18, 2018)).

35 *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods*, Case No. 17-2118-GA-AAM, Finding and Order at ¶ 18(2) (April 18, 2018).

36 Id. at 9.

37 Id. at 3.

Regarding the third and fourth factors, Mr. Wathen argues that the third factor may not be met because the Commission has control over the decision to request[38] deferral accounting.[39] This contention is peculiar given that Mr. Wathen acknowledges that the TCJA (the reason for the deferral) *is* beyond the control of both the utilities and the Commission. Of course, in any deferral request (either an asset or a liability), the utility or the Commission will be making the decision to request and create the deferral. So, by Mr. Wathen's standard, this factor could never be met because the party requesting the deferral always has a choice not to make the request. For the fourth factor, Mr. Wathen suggests that because federal income tax law could change again in the future, this change is not atypical or infrequent.[40] As discussed above, the last change in tax law of this magnitude took place over 30 years ago and Mr. Wathen does not offer a concrete basis to support the contention that another change is coming in the near future. His contention that it is possible for Congress to again change the law does not mean that this change is typical or frequent, especially considering that experience shows that this sort of change is exceedingly rare.

For the fifth factor, Mr. Wathen repeats the argument that the Commission should consider whether existing revenues are just and reasonable.[41] Again, the issue of the sufficiency of a utility's revenues is better addressed in a base distribution rate case. In fact, Duke is already addressing this very issue in its pending distribution rate case.[42] Any other utility could file a

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38 The Commission did not "request" deferral accounting, it *ordered* the deferral.

39 Id. at 11.

40 Id. at 11-12.

41 Id. at 12.

42 See *In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Electric Distribution Rates*, Case Nos. 17-32-EL-AIR, et al.

similar case should it desire to argue that it ought to be receiving higher revenues from customers for the distribution services that it provides.

Mr. Wathen concludes by saying that the Commission "should apply the existing deferral standard and allow due process to occur."[43] Due process is already occurring. The Commission is affording all utilities and other stakeholders the opportunity to be heard on this issue before making a decision addressing the impacts of the TCJA. As Kroger has noted at length at this point, the standard for granting a deferral for regulatory liabilities is met in this case. The Commission's ordered deferral is not a denial of due process, it is a measured approach to assure that customers actually receive the TCJA benefits to which they are entitled.

Finally, Mr. Allen's testimony about AEP Ohio's separate tax docket is immaterial to the determination that the Commission is making in this hearing. While AEP Ohio may believe that its TCJA-related issues are better addressed in a separate case, the docket where these issues will ultimately be addressed in the rates that consumers pay does not affect whether the Commission-ordered deferral is lawful as challenged by the EDUs. And for the reasons discussed herein, the deferral order in the January 10, 2018 Entry is authorized by law and the EDUs' remaining arguments on rehearing should be rejected.

[43] Wathen Testimony at 14.

IV. Conclusion

The Commission's order for rate-regulated Ohio utilities to defer TCJA savings as regulatory liabilities on their books was proper and within the Commission's authority under Ohio law. As such, the Commission should reject the EDUs' remaining arguments contained in the Joint Application for Rehearing.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was served upon all parties of record via electronic mail on August 13, 2018.

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Summary: Brief Posthearing Brief of The Kroger Co. electronically filed by Ms. Cheryl A Smith on behalf of The Kroger Co.