FILE

Ohio | Public Utilities Commission

Mike DeWine, Governor
Sam Randazzo, Chairman

March 4, 2020

Docketing Division
Public Utilities Commission of Ohio
180 East Broad Street
Columbus OH 43215

RE: *In the Matter of the Application of Northeast Ohio Gas Corp. For Approval of an Income Tax Credit Mechanism Rider, Case No. 20-146-GA-ATA*

Dear Docketing Division:

Enclosed please find the Review and Recommendations of the Staff of the Public Utilities Commission of Ohio (Staff) in the Matter of the Application of the Northeast Ohio Gas Corp. For Approval of an Income Tax Credit Mechanism Rider, Case No. 20-146-GA-ATA.

Tamara S. Turkenton
Director, Rates and Analysis Department
Public Utilities Commission of Ohio

David Lipthratt
Chief, Accounting and Finance Division
Public Utilities Commission of Ohio

Enclosure
Cc: Parties of Record

Northeast Ohio Gas Corp.
Case No. 20-146-GA-ATA

SUMMARY

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (TCJA) was signed into law. Among other changes, the TCJA lowered the federal corporate income tax rate from a maximum 35 percent to a flat 21 percent, effective January 1, 2018. Additionally, the reduction in the federal corporate tax rate may result in excess accumulated deferred income taxes (EDIT) balances because the amount of accumulated deferred income taxes that a public utility has recorded in its books will exceed the amount the public utility needs to pay its future federal income tax obligations.

On January 10, 2018, the Public Utilities Commission of Ohio (Commission) opened a Commission-ordered investigation (COI), Case No. 18-47-AU-COI, in order 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. By Entry issued January 10, 2018, the Commission invited all of the rate-regulated Ohio utilities, as well as other interested stakeholders, to file comments discussing the following: (i) those components of utility rates that the Commission will need to reconcile with the TCJA and (ii) the process and mechanics for how the Commission should do so.[1] Additionally, the Commission directed utilities to record on their books as a deferred liability, in an appropriate account, the estimated reduction in federal income tax resulting from the TCJA, effective January 1, 2018. The utilities were instructed to continue this treatment until otherwise ordered by the Commission.[2]

On January 23, 2020, Northeast Ohio Natural Gas Corp. (NEO or Company) submitted an application for approval of an Income Tax Credit Mechanism Rider (Application) requesting authority to implement the Income Tax Credit Mechanism Rider (ITCM) to flow back NEO's customers the tax benefits realized under the TCJA.

The ITCM will include the following parts:

A. Return of Normalized EDIT:

   i. Normalized EDIT of approximately $1.8 million will be amortized based on the average rate assumption method (ARAM) so as to conform to normalization rules. The amount refunded will be updated on an annual basis, with a projected level for the calendar year included in the ITCM. The Normalized EDIT refunded to customers will include a gross-up for federal income taxes using the applicable gross revenue conversion factor in the Company's most recent gas distribution rate case[3] (Rate Case).

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[1] *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, Entry at 1-2 (Jan. 10, 2018).
[2] *Id.* at 2.
[3] *In the Matter of the Application of Northeast Ohio Natural Gas Corp. for an Increase in Gas Rates,* Case Nos. 18-1720-GA-AIR, et al.

B. Return of Non-Normalized EDIT:

   i. Non-Normalized EDIT of $40,185 will be amortized over a period of 72 months (six years). The amount refunded annually will include the gross-up for federal income taxes using the applicable gross revenue conversions factor in the Rate Case.

C. Stub Period:

   i. The tax savings deferred from January 1, 2018 through September 30, 2019 (Stub Period), the date which new distribution rates became effective is estimated to be $467,895 as of September 30, 2019, will be refunded to customers over the first 12 months that the ITCM is in place. The Stub Period will accrue carrying charges, at the Company's cost of debt approved in the Rate Case, starting January 1, 2018 through the effective date of the ITCM.

D. Offset Amount for Incremental Return on Rate Base:

   i. To capture the return on rate base that would otherwise be unaccounted for by addressing the amortization and refund of EDIT resulting from the TCJA outside of base rates, the ITCM will include a return on the cumulative amortization of Normalized EDIT. The rate of return will be the pre-tax weighted average cost of capital authorized in the Rate Case.

The annual credit determined through the four components above will be returned to customers as a volumetric credit per Mcf. The split between rate classes will be based on the final split of revenue from base rates in the Rate Case. The ITCM charges will be updated annually with a projection of the amounts attributable to each component of tax savings, including a reconciliation component for the prior calendar year. Once the EDIT and Stub Period balances have been fully amortized, or when such component(s) has been recognized in base rates, the associated credit provided through the ITCM shall cease.

STAFF REVIEW

Staff performed a review of the Company's exhibits to the Application, including the proposed ITCM tariff sheet (Exhibit 1) and the supporting calculations for the proposed credit amount, including balances of EDIT, deferrals, and estimated ITCM rates (Exhibit 2). Additionally, based on discussions with the Company, Staff confirmed that the Company is no longer seeking recovery of Part D – Offset Amount for Incremental Return on Rate Base.[4]

STAFF RECOMMENDATION

Return of Normalized EDIT

Staff recommends that Normalized EDIT include only such balances that are required to be amortized in accordance with ARAM, with such balances being based on the balance as of December 31, 2017. Staff supports the Company's proposal that the refund of Normalized EDIT include a gross up for federal income taxes using the gross revenue conversion factor from the Rate Case.

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[4] See response to Staff DR #1

Return of Non-Normalized EDIT

Staff recommends that Non-Normalized EDIT be based on the balance as of December 31, 2017. Staff supports the Company's proposal to refund Non-Normalized EDIT over a period of 72 months (six years), and the refund include a gross up for federal income taxes using the gross revenue conversion factor from the Rate Case.

Stub Period

Staff supports the Company's proposal to refund tax over a period of 12 months the deferred tax savings from January 1, 2018 through the date in which the ITCM becomes effective. Additionally, Staff concurs with the Company's proposal to accrue carrying charges on the Stub Period balance, with such carrying charges based upon the long term debt approved in the Rate Case, and that the carrying charges shall cease to accrue once the ITCM becomes effective.

Offset Amount for Incremental Return on Rate Base

The Company is no longer requesting this component be included in as part of the ITCM; therefore, Staff supports the Company's withdrawal of the request to recover the incremental return on rate base associated with the amortization of EDIT.

Rate Design

Staff supports the Company's proposal to allocate the refund of Non-Normalized EDIT based upon the final split of revenue from base rates in the Rate Case. Additionally, Staff supports the Company's proposal to refund tax savings through the ITCM on a volumetric basis as a credit per Mcf.

True- Up of Pass Back Amounts and Actual TCJA Savings

Staff recommends that the ITCM be trued up annually in order to mitigate large variances between the amount refunded through the ITCM and the actual tax impact of the TCJA. This annual true up would assist in minimizing the resulting regulatory asset or liability that will be incorporated into the Company's next base rate case filing.