Docket No. 17-035-69

Investigation of Revenue Requirement Impacts of the New Federal Tax Legislation Titled: "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution of the budget for fiscal year 2018"

Donna Ramas for the Office of Consumer Services

April 9, 2018

Background

On February 7, 2018, Rocky Mountain Power ("RMP") submitted comments providing information on the estimated revenue requirement impacts and proposed ratemaking treatment associated with "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution of the budget for fiscal year 2018," hereinafter referred to as the "Tax Reform Act." On March 16, 2018, RMP submitted an application for approval of proposed Tariff Schedule 197 to begin delivering a small percentage of the total estimated benefits resulting from the Tax Reform Act to customers. In the March 16, 2018 application, RMP further elaborated on its recommendations regarding treatment of the impacts of the Tax Reform Act on its revenue requirements.

On February 28, 2018, the Commission issued an Order Granting Motion for Deferred Accounting Order and Notice of Scheduling Conference. In the Order, at page 3, the PSC requires RMP to defer as a regulatory liability all revenue requirement impacts of the Tax Reform Act beginning January 1, 2018. The Order also indicated that the Commission will consider parties' positions concerning the duration of the deferred accounting treatment, quantification of impacts on revenue requirement, and any appropriate refund mechanism.

The Tax Reform Act significantly impacts the revenue requirements of RMP in several ways. The most obvious impact is the reduction to federal income tax expense caused by the reduction in the federal corporate income tax rate from 35% to 21%. The Tax Reform Act also resulted in the repeal of the domestic production activities deduction. RMP's most recent base rate case filing did not include the domestic production activities deduction as the Company did not project that it would qualify for the deduction in the forecasted test year. However, RMP's June 2018 Utah Results of Operations did include impacts associated with the domestic production activities deduction.

The Tax Reform Act also has a significant impact on the Company's accumulated deferred income tax (ADIT) balance, resulting in a substantial excess deferred income tax ("EDIT") balance. Essentially, the Company pre-collected federal income taxes from ratepayers at the 35% federal income tax rate. This is how the ADIT balance built up. In other words, the ADIT balance represents the net income taxes collected from customers before the taxes are actually paid to the federal government. The resulting ADIT balance is a source of cost-free capital to the Company that was funded by ratepayers. The Company will now pay the tax

obligation to the government at a lower 21% federal income tax rate. Thus, the Company was required to re-value its accumulated deferred income taxes based on the current 21% FIT rate, with the difference being recorded as excess deferred income taxes. The EDIT is essentially the over-collection of income taxes from customers that needs to be returned.

Under the IRS normalization rules, the portion of the property-related EDIT balance that pertains to depreciation tax timing differences, also referred to as the "protected" property related EDIT, must be flowed back using the Average Rate Assumption Method ("ARAM"). This method is described in RMP's February 7, 2018 comments and has very specific calculations required under the IRS normalization rules. Under the ARAM, the flow-back amount varies from year to year. Parties will be reliant on RMP to calculate and provide the correct flow-back of the "protected" property related EDIT. In very general/simplistic terms, the timeframe would be over the remaining life of the property.

The remaining EDIT balance is not covered by the normalization rules. Thus, there is a great deal of flexibility in determining the amortization or flow-back of the non-property related EDIT balance as well as the unprotected property-related EDIT. An example of unprotected property-related EDIT would pertain to tax-book differences caused by the use of the repairs deduction for federal income tax purposes in which 100% of certain project costs were expensed in the year incurred for tax purposes but depreciated for book and revenue requirement purposes.

Estimated Impacts

As of the present date, RMP has estimated the revenue requirement impact using its June 2017 Results of Operations ("ROO") on a Utah Normalized basis as $76,222,011 annually. In calculating the estimated $76,222,011 impact, the Company modified its June 2017 ROO to: 1) include the impact of the reduction of the federal corporate income tax rate to 21% on the current and deferred income tax expense; 2) include the impacts of the repeal of the domestic production activities deduction; and 3) retain the same rate of return on equity included in the June 2017 ROO on a Utah Normalized basis.

The Company did not provide the amount of EDIT resulting from the Tax Reform Act in its February 7th and March 16th filings in this docket. While the total EDIT balance resulting from the Tax Reform Act is known to RMP, the Company has indicated that it has not yet calculated the Utah portion of the EDIT balance. The filings also did not include the estimated annual flow-back associated with the EDIT balances. Thus, as of the present date, the Company has not provide the reduction in its revenue requirements that will result from flowing-back to ratepayers the EDIT balances owed to them. The annual flow-back of the EDIT balances would substantially increase the revenue requirement impacts associated with Tax Reform Act.

The total EDIT balance for the Company resulting from the Tax Reform Act was $1.725 billion (or $1,725 million).[1] Based on the June 2017 ROO, Utah's portion of the total

[1] Responses to OCS Data Requests 2.1 and 2.2.

normalized ADIT balance was approximately 44.19%. While the Utah portion of the $1.725 billion EDIT balance has not yet been provided by RMP, if the 44.19% based on the June 2017 ROO were applied, the result would be an EDIT of $762 million owed to Utah ratepayers. While the actual Utah amount would likely not be the $762 million, the above calculation can give the Commission a rough feel for the magnitude of the existing EDIT balance to be flowed back to RMP's Utah customers.

Of the $1.725 billion EDIT balance, RMP has estimated that the protected property-related EDIT is $1.324 billion, the unprotected property-related EDIT is $353 million and the non-property related EDIT is $47 million.[2] As previously indicated, the Company is required to use the ARAM in flowing-back the protected property-related EDIT balances (i.e., the $1.324 billion), while the Commission has discretion regarding the flow-back period for the remaining EDIT balances.

RMP Proposal

The Company proposes to reduce rates charged to Utah customers by approximately $20 million (or 1%) effective May 1, 2018 while the final impacts from the Tax Reform Act are being determined. The proposed May 1, 2018 reduction is approximately 26% of the $76,222,011 estimate provided by RMP thus far, and a much smaller percentage of the total impact on revenue requirements once the flow-back of the excess deferred income taxes is considered.

RMP proposes to base the final impacts on the December 2017 Results of Operation Report, which will be filed by April 30, 2018. The Company indicates that it will submit its final Tax Reform impact filing by June 15, 2018 based on the December 2017 ROO incorporating the most recent data available. As part of its proposal, RMP would leave the rate reduction at the $20 million or 1% it proposes to implement on May 1, 2018 and "…continue to defer the balance of the Tax Reform Act regulatory liability that remains after accounting for the reduction to rates proposed in this Application and will propose to offset future costs once they are known for rate stability purposes."[3] Thus, under RMP's proposal, it will retain most of the excessive federal income taxes currently being paid by ratepayers and hold onto the ratepayer funded EDIT balance that would otherwise begin to flow-back to ratepayers until a future date.

The Company indicates that the future offsets to the deferral balance would be subject to the Commission's approval and would occur "…no later than the effective date of approved rates from the Company's next rate case."[4] If there are any remaining amounts owed to customers under the new Tax Reform Act regulatory liability after the potential "offsets," the remaining amount would then be refunded to customers in the next rate case. The Company has indicated in another proceeding that it currently anticipates filing a general rate case in 2020 utilizing a

[2] Responses to OCS Data Requests 2.2 and 3.1.
[3] RMP's March 16, 2018 comments, page 3, paragraph 7.
[4] *Ibid.*

2021 test year.[5] Additionally, the Company has publicly committed that it will not increase base rates charged to customers before 2021. Thus, RMP's ratepayers would continue to pay rates that were set based on the previous 35% federal income tax rate until sometime in 2021, over 2 ½ years from now, with only a small portion of the Tax Reform Act impacts (i.e., $20 million) being reflected in rates they pay to RMP for electric services. Ratepayers would also not receive any of the flow-back of the EDIT that they funded until 2021 or later under the Company's proposal. The 1% reduction in current base rates is a small fraction of the impact of the Tax Reform Act on RMP's revenue requirements. The Company claims that they are doing this to provide customers long-term rate stability. Thus, the Company would hold onto amounts otherwise due to ratepayers for 2 ½ years or longer so that rates presumably would not increase by as much in 2021 or later.

In its March 16th filing, the Company identifies several examples causing "…upward cost pressures." One example is a new depreciation study to be filed in September 2018 for rates effective no later than January 1, 2020. Since the depreciation study has not yet been filed or provided by RMP, it is not yet known if the net result of the study will be an increase in depreciation expense as compared to depreciation expense based on current deprecation rates, or if there is a resulting increase in the composite depreciation rate, the magnitude of the resulting expense increase. Another example identified by the Company is that the preferred portfolio of the 2017 Integrated Resource Plan identifies potential early closure of several coal plants. To date, I am not aware of the Company announcing that it will be closing the coal plants early. Additionally, the Company has provided no information indicating that the stranded costs associated with early closures will exceed the Sustainable Transportation and Energy Plan (STEP) funds balances projected as of the early closure dates.

RMP has also proposed using the Tax Reform Act regulatory liability to offset costs in other dockets. For example, the Company indicates that it proposes removing recovery of the unamortized Deer Creek mine plant from the 2018 EBA and offsetting it instead with the deferred tax benefits. The Company is also seeking in Docket No. 17-035-39 to recover some of the proposed wind repowering revenue requirements by offsetting the Tax Reform Act regulatory liability. These proposals add unnecessary complexities to not only this docket, but also to the other dockets currently before the Commission.

Recommendation

Rates should be reduced to reflect the impacts of the Tax Reform Act on revenue requirements as soon as possible. Ratepayers should not be required to continue to pay rates that are premised on a 35% federal income tax rate. Additionally, the excess deferred income taxes that have been funded by ratepayers over many years that will no longer be paid to the federal government as a result of the reduction in the federal corporate income tax rate should also be returned to ratepayers.

[5] RMP's response to OCS Data Request 13.12 in Docket No. 17-035-39.

I recommend that customer rates be reduced by $76 million through a phase 1 rate reduction effective May 1, 2018. Any impacts of the Tax Reform Act above the amount flowing through the phase 1 rate reduction would continue to be deferred in the regulatory liability. The amount of final rate reduction to be implemented as a result of this docket should be determined at a future date after the Company submits its June 15, 2018 update that provides more detailed impacts of the Tax Reform Act on revenue requirements using the December 2017 ROO and the amount of EDIT on a Utah jurisdictional basis. As part of its June 2018 filing, RMP should be required to provide a breakdown of the EDIT balance on a Utah jurisdictional basis between: 1) protected property-related EDIT; 2) unprotected property-related EDIT; and 3) non-property related EDIT. Using this information, the Commission could then determine the amount of permanent reduction in rates to ensure that ratepayers receive the benefits of the reduction in revenue requirements caused by the Tax Reform Act.

The Commission could determine the period over which the EDIT balances should be flowed-back to customers at this interim phase so that the Company can reflect the Commission ordered flow-back period in its June 2018 filing. While the protected property-related EDIT of $1.325 billion on a total Company must be amortized based on the ARAM method, the Commission has discretion in the period to use for the remaining EDIT balances. As an example, the Commission could require that the unprotected property-related EDIT of $353 million on a total Company basis be flowed back over a five or ten year period and that the non-property related EDIT of $47 million on a total Company basis be flowed-back over a five year period. Alternatively, the Commission could leave the determination of the flow-back period for the unprotected EDIT balances for after the June 2018 filing, allowing the Commission and the parties in this docket to get a better picture of the total impacts of the Tax Reform Act on RMP's revenue requirements before opining on the appropriate flow-back periods. As the EDIT consists of amounts funded by ratepayers, I recommend that a short amortization period be used for the non-protected EDIT balances to return the funds to ratepayers within a reasonable time-frame.

Since the regulatory liability at issue in this proceeding was to be established effective January 1, 2018, there will also be a regulatory liability balance to be addressed even with the phased 1 and final rate reductions being implemented in this case. This is because amounts will be deferred for period January 1, 2018 through April 30, 2018, as well as additional amounts to be deferred between the phase 1 rate effective date and the permanent rate effective date. Assuming the $76,222,011 estimated impact provided by the Company is reasonably accurate, this would result in a regulatory liability balance associated with the period January 1, 2018 through April 30, 2018 of approximately $25.4 million ($76,222,011 x 4/12ths). This estimated amount is before the flow-back of the EDIT is considered, which would cause the $25.4 million to be even larger. There are several options the Commission could consider for this regulatory liability. As an example, the Commission could decide to amortize the regulatory liability and include the amortization in the permanent reduction in the next phase of this docket. The Commission could also require a one-time credit to customer's bills to return this amount to customers. Alternatively, the Commission could require that this regulatory liability balance be addressed in the Company's next general rate case. If: 1) the May 1, 2018 phase 1decrease is

set at a reasonable level; and 2) the vast majority of the impacts on revenue requirements from the Tax Reform Act are reflected in customer rates through the permanent rate decrease to be determined in the next phase of this docket, it is my opinion that it would be reasonable to address the treatment of the regulatory liability that builds-up between January 1, 2018 and the effective date of the permanent rate reduction from this docket in RMP's next rate case. At that time the parties could opine on whether the balance should be amortized and the appropriate amortization period, or if the balance should be used to offset an existing regulatory asset.