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Division of Public Utilities

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ACTION REQUEST RESPONSE

TO: Public Service Commission

FROM: Division of Public Utilities:
Chris Parker, Director
Artie Powell, Energy Manager
Doug Wheelwright, Technical Consultant
Jeffrey S. Einfeldt, Utility Analyst
Lane Mecham, Utility Analyst

DATE: February 16, 2018

RE: Docket No. 17-057-26, Revenue Requirement impacts to Dominion Energy Utah 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" ("Tax Reform Act")

RECOMMENDATION (Create an immediate refund mechanism for tax benefits)

The Division of Public Utilities ("Division") recommends the Commission acknowledge the testimony of Kelly Mendenhall filed on January 31, 2018 enumerating Dominion Energy Utah's ("DEU" or "Company") plan to refund savings realized from the Tax Reform Act to rate-payers. While not specified by the Company, the Division recommends that savings from the reduction in the federal tax rate from 35% to 21% (currently being identified and deferred by DEU) be refunded to rate payers through a newly-created tax refund mechanism.

ISSUE

The Tax Reform Act was signed into law approximately December 22, 2017, giving rise to a reduction in corporate federal income taxes from 35% to 21%. This reduction translates to a significant reduction in DEU's revenue requirement and cost to provide service to its rate-payers.

The Commission issued a Notice of Comment Period on December 21, 2017, initiating this docket to investigate the revenue requirement impacts of the Tax Reform Act and directing DEU to respond by January 31, 2018. Kelly Mendenhall filed testimony on behalf of DEU on January 31, 2018, in response to the notice. This report is DPU's response to DEU's estimate and comments.

ANALYSIS

General

The Tax Reform Act decreased federal corporate income tax rates from 35% to 21% resulting in reduced income tax expense going forward and reduced deferred income tax liability that was previously calculated based on the higher 35% tax rate. This is a significant and unforeseen reduction in utility expenses.

Effect on Current Rates

DEU's currently approved base distribution non-gas ("DNG") rate includes imputed tax expense based on the 35% tax rate in place at the time of approval.[1] DEU calculates a tax savings related to DNG costs beginning in 2018 of $14,488,446[2] and has spread this savings to each class based on the Report and Order issued in Docket 13-057-19[3]. While DEU has estimated the savings, the Company did not provide a formal recommendation to return the cost savings to rate payers. The Company represented the estimated impact of this portion of the cost savings for a typical GS customer is a reduction of approximately $10.96 per year or 1.54%. The Division

[1] Docket 13-057-05 (most recent general rate case).
[2] Docket 17-057-26; testimony of Kelly Mendenhall. Line 62 and accompanying exhibit 1.2
[3] *Ibid* line 81

recommends the Commission approve a mechanism whereby this amount can be refunded to rate-payers expeditiously. The tax savings will need to be returned to rate-payers each year until base rates are reset in the next general rate proceeding. Applying a surcredit based on customer usage seems an appropriate way to ensure these savings are received by customers.

Infrastructure Rate Adjustment Impacts

In addition to the cost savings calculated in the base DNG rate, DEU calculates an additional savings to rate-payers of $2,518,628 related to infrastructure replacement. The Company has updated its most recent infrastructure rate adjustment filing in Docket No. 18-057-T01 (previously docket no.17-057-23) to reflect the reduction in the pretax return directly related to the income tax rate reduction to 21%. The Division reviewed DEU's application in the 18-057-T01 docket and recommended the Commission approve the proposed rates and tariff sheets reflecting the $2.518 million tax savings and make them effective March 1, 2018.

Deferred Income Tax

The reduction in the federal income tax rate will also cause a reduction to the Deferred Income Tax Liability carried on DEU's balance sheet. This liability represents the difference in tax expense recognized in prior years but not actually paid until future years. This liability was established based on the 35% tax rate. The reduction in the tax rate to 21% causes the liability to be overstated and will need to be adjusted. The calculation for this adjustment has not been completed and the Company has estimated that it may be several months (possibly as late as the fourth quarter of this year) before the full impact on deferred income tax is known.

The Internal Revenue Service tax code requires the Company to identify this excess Income Tax liability and account for it separately. This excess liability must then be amortized over the life of the assets associated with the original liability. This method is referred to by the IRS as the average rate assumption method ("ARAM")[4]. The Company incurs significant tax penalties if it

[4] "H.R.1 - An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." Accessed February 14, 2018. Section 1561(d). https://www.congress.gov/bill/115th-congress/house-bill/1/text

accelerates the amortization of the excess tax liability, including the inability to use accelerated depreciation for tax purposes for assets placed in service in the future, and a tax assessment equal to any tax savings the company might have realized by amortizing the excess tax liability more rapidly than permitted. By following ARAM, the company and rate-payers are effectively left in the same relative position financially as before the change in rates with any tax savings due rate-payers recognized over decades.

Cost-of-Service Gas from Wexpro

In addition to the saving from the decrease in the revenue requirement and the deferred income tax, the Company has indicated that the price of the cost-of-service gas produced by Wexpro will be affected by the new tax rates. While not mentioned in the Company's filing, a reduction in the cost-of-service gas price will be passed on to rate payers through the 191 account. The Division recommends the Company provide additional information to the Commission to determine the estimated savings from the tax law change that is estimated to be flowing through the 191 account.

Procedures being Considered by Other State Jurisdictions

Utilities and public service commissions in other state jurisdictions are also working through issues related to tax reform. The Division has reviewed many of the proposals and comments from those proceedings and found them to generally fall within three categories:

- the creation of a rate mechanism or rider to pass the savings through to ratepayers until a future general rate proceeding;
- the tax savings be addressed through a rate case currently in progress, or begin a general rate case to address the tax implications; and
- Florida is considering offsetting the savings from the new tax law against costs incurred from Hurricane Irma[5] (costs arising from a special circumstance).

[5] Robert Walton, "Florida Power & Light to use tax savings to pay for Irma damage", Utility Dive, January 17, 2018, https://www.utilitydive.com/news/florida-power-light-to-use-tax-savings-to-pay-for-irma-damage/514972/

The Division is in favor of creating a new mechanism to refund the $14.488 million related to DNG cost tax savings (discussed above) to ratepayers, similar in operation to the 191 account or the infrastructure tracker. This would create a separate line item on the customer bill to account for the annual tax savings going forward until these savings can be accounted for in a general rate case in the future. The Division envisions this mechanism would allocate the savings to rate classes based on the most recent cost of service study and apply a rate on a per-dekatherm basis for each class and credit customers' bills each month based on each customer's usage.

CONCLUSION

The Division recommends the Commission acknowledge DEU's filing and estimates regarding the benefits inured to rate-payers from the Tax Reform Act. The Division further recommends that a new mechanism be created to pass tax savings onto ratepayers. The Division also recommends DEU provide an estimate of the tax savings and articulate how the savings from the purchase of cost-of-service gas from Wexpro will be passed on to rate-payers.

cc: Michele Beck, Committee of Consumer Services
Kelly Mendenhall, Dominion Energy Utah