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State of Utah
DEPARTMENT OF COMMERCE
Office of Consumer Services

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To: Public Service Commission of Utah

From: Office of Consumer Services
Michele Beck, Director
Cheryl Murray, Utility Analyst

Date: May 2, 2018

Subject: 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" (Tax Reform Act). Docket No. 17-057-26

Background

On December 21, 2017, the Public Service Commission of Utah (Commission) opened dockets to investigate the 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." Dominion Energy Utah (DEU or Company), assigned as Docket No. 17-057-26, was required to file written comments by January 31, 2018, describing in detail, to the extent practical, the impacts on its revenue requirement. Other interested parties were to provide reply comments on or before February 16, 2018.

On January 2, 2018, the Utah Association of Energy Users (UAE) filed a Motion for Orders for Deferred Accounting Treatment of Benefits Associated with 2018 Tax Reconciliation Act (Motion) in the docket. The Division of Public Utilities (Division) and the Office of Consumer Services (Office) each filed comments supporting the Motion on January 12, 2018. DEU also filed comments requesting permission to respond to both UAE's motion and the Commission's order on January 31, 2018; indicating it anticipated its comments would address, among other things, a deferred accounting order.

On January 31, 2018, DEU submitted to the Commission its comments requesting that the Commission "issue a deferred accounting order permitting Dominion Energy to create a deferred liability permitting deferral of tax benefits arising from the 2018 Tax Reconciliation Act…until the effective date of new rates set in future ratemaking proceedings". Included with DEU's comments was the Direct Testimony of Kelly B. Mendenhall.

On February 21, 2018, the Commission issued an order granting deferred accounting.

On March 7, 2018, the Commission issued a Scheduling Order, which called for the Company to make a supplemental filing on April 2, 2018, followed by responsive comments from all parties on May 2, 2018 and reply comments on May 16, 2018.

In keeping with the Commission's March 7 scheduling order, on April 2, 2018, the Company submitted its supplemental filing and a motion to modify and replace its tariff schedules. DEU proposes to implement a surcredit effective June 1, 2018 to reflect the reduction in current revenue requirements being collected from customers due to the lowering of the federal corporate income tax rate from 35% to 21%. The Company further proposes to defer the pre-June 1, 2018 savings in a regulatory liability account until the 1st quarter of 2019, or earlier, depending on when it can determine the impact of excess deferred income taxes (EDIT).

Discussion

The Office enlisted the consulting services of revenue requirement expert and CPA, Donna Ramas, to assist us in our review of the Company's filing. This memo is informed by the review Ms. Ramas conducted for the Office.

Proposed June 1, 2018 Surcredit

DEU has calculated that the distribution non-gas revenues previously approved by the Commission would have been $14,519,623 lower had they been determined based on the current federal corporate income tax rate of 21% rather than 35% which was the income tax rate at the time rates were determined in Docket No. 13-057-19. The Company proposes to implement a surcredit effective June 1, 2018 to begin returning the $14,519,623 to ratepayers. The Office supports both the surcredit amount and the proposed surcredit effective date.

The Division has proposed that the surcredit appear as a separate line item on customer bills. However, the Company has expressed concern that this will result in increased customer questions and confusion, both with the implementation of the surcredit and when it ceases as the tax adjustment is incorporated into base rates following a general rate case. In addition, the Company asserts that this bill item would take time and resources to program and because of the short duration of the surcredit and the minor impact on customer bill requests that it not be required.

The Office supports the Division's recommendation that the refund be shown as a separate line item on customer's bills. We also note that the Commission recently approved the unopposed proposal to identify the federal income tax refund amount on Rocky Mountain Power customer bills as a separate line item. [Commission Order, April 27, 2018, page 19. Docket No. 17-035-69]

January 1, 2018 – May 31, 2018 Deferral

The Company proposes to defer the tax saving between January 1, 2018 and May 31, 2018 (pre-June 1) in a regulatory liability account until the 1st quarter of 2019, or earlier, depending on when it can determine the impact of excess deferred income taxes. DEU indicates that once it has determined the impact of the EDIT, it will make an additional filing to "…explain the impact of excess deferred income taxes and propose how to return the deferred benefits back to customers." The Company asserts that its proposal will balance the long-term and short-term financial impacts on the Company's credit metrics. Accompanying DEU's April filing was a January 19, 2018, Moody's Investors Service report in which the Company's ratings outlook was changed from stable to negative as a result of potential impacts on the Company's credit metrics resulting from the Tax Reform Act.

The Division recommends that the Company be required to refund the deferred tax savings by the end of 2018; either through a one-time rate credit or as a rate adjustment incorporated in tariffs designed to return the amounts by the end of 2018.

The Office generally supports returning deferred amounts owed to ratepayers as soon as possible, however we recognize the Company's concern regarding the impact of a cash refund on its credit metrics in light of the change in Moody's Credit Investors rating. The Office notes that the Company, identified as "Questar Gas Company" in Moody's report, was listed as one of 24 US regulated utilities for which Moody's projected that the financial metrics were either already weak or expected to become weak prior to the impacts of the reduction in the federal income tax rate.

Because of the credit ratings concerns, the Office is not opposed to allowing the Company to continue to defer the regulatory liability that accumulates between January 1 and May 31, 2018. This will allow the Company more time to evaluate the impacts on its financial metrics and to consider changes to its financial policies to offset impacts. If the Commission allows the Company to continue this deferral, the Office asserts that an appropriate carrying charge should be applied to the balance of retained ratepayer funds. The Office notes that in the Rocky Mountain Power docket on this issue the Commission approved "a carrying charge applicable to the non-refunded balance equal to the most recently approved customer deposit interest rate.[1]

Excess Deferred Income Tax Balances

In its April 2, 2018 filing the Company states that "…when it accurately defines the full extent of this impact, it will file an additional revision to account for any changes related to the ADIT balance" and it anticipates that "…the impact of deferred income taxes will be known and a filing will be made in the 1st quarter of 2019 or earlier." The annual flow-back of the EDIT balances would substantially increase the revenue requirement benefits to customers associated with the Tax Reform Act.

[1] Commission Order dated April 27, 2018 at page 22; Docket No. 17-035-69.

The Company's 2017 Form 10-K filed with the Securities and Exchange Commission, in the notes to the financial statements, under Note 4 – Income Taxes, states, in part, as follows:

> "Reductions in accumulated deferred income tax balances due to the reduction in the corporate income tax rates to 21% under the provisions of the 2017 Tax Reform Act may result in amounts previously collected from utility customers for these deferred taxes to be refundable to such customers, generally through reductions in future rates. The 2017 Tax Reform Act includes provisions that stipulate how these excess deferred taxes are to be passed back to customers for certain accelerated tax depreciation benefits. Potential refunds of other deferred taxes will be determined by Questar Gas' state regulators."
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> Note 9 – Regulatory Assets and Liabilities of the same Form 10-K show that the Company established a regulatory liability of $244.9 million as a result of the Tax Reform Act for "Income taxes refundable through future rates."

The Tax Reform Act results in a sizable EDIT balance, at least part of which the Company has transferred to a regulatory liability account on its books.

The Company has not yet provided the final EDIT balances either on a total Company or on a Utah jurisdictional basis. Nor has the Company provided a breakdown of the EDIT balances between the various EDIT types. The Office recommends that the Commission require the Company to provide a breakdown of the EDIT balance and regulatory liability balances for the EDIT amounts that have already been transferred to a regulatory liability account on a Utah jurisdictional basis between: 1) protected property-related EDIT; 2) unprotected property-related EDIT; and 3) non-property related EDIT.

The Office is somewhat concerned by language used in the Company's Form 10-K quoted above, such as "may result in" and "potential refunds" of deferred taxes. The Office asserts that the full amount of excess deferred income taxes resulting from the reduction in the federal corporate income tax rate that was funded by ratepayers should be returned to ratepayers.

Cost-of-Service Gas from Wexpro

In Reply Comments dated April 25, 2018, the Division points out that the price of the cost-of-service gas produced by Wexpro will also be affected by the new income tax rates, and that reduction will be passed on to ratepayers through the 191 balancing account. The comments indicate, "The Division continues to recommend the Company provide additional information to the Commission to account for the savings related to the Wexpro cost-of-service gas."

The Office concurs with and supports that recommendation. The Office further recommends that as part of the additional information the Company identify the impacts of the Tax Reform Act on Wexpro's Accumulated Deferred Income Tax (ADIT) balances and explain how the cost-of-service gas price ultimately paid by DEU's ratepayers is impacted by Wexpro's ADIT balances and changes made thereto.

Recommendations

The Office recommends that the Commission approve the Company's request to return the $14.5 million to ratepayers through a rate reduction in the form of a surcredit effective June 1, 2018.

The Office further recommends that the Commission require that the Company to:

- Provide a breakdown of the EDIT balance and associated regulatory liability balance on a Utah basis broken down between: 1) protected property-related EDIT: 2) unprotected property-related EDIT; and 3) non-property related EDIT.

- Provide an accounting of the tax savings related to the Wexpro cost-of-service gas to be passed on to ratepayers. The Company should also identify the impacts of the Tax Reform Act on Wexpro's ADIT balances and explain the impacts of the ADIT balance on the cost-of-service gas price paid by DEU's ratepayers.

- Apply the appropriate carrying costs to the regulatory liability accrued from January 1, 2018 through May 31, 2018, if the Company is permitted to continue to the deferral.

Finally, the Commission should make clear that the full amount of excess deferred income taxes resulting from the reduction in the federal corporate income tax rate will ultimately be returned to ratepayers.

CC: Kelly Mendenhall, Dominion Energy Utah
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Gary Dodge, UAE