

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: December 4, 2018**

REGULAR X CONSENT _____ EFFECTIVE DATE January 1, 2019

DATE: November 21, 2018

TO: Public Utility Commission

FROM: John Fox *JF*
JF

THROUGH: Jason Eisdorfer and John Crider *Jc*

SUBJECT: PORTLAND GENERAL ELECTRIC: (Docket No. UM 1920) Requests authorization to Defer Benefits Associated with the US Tax Reconciliation Act. (Public Hearing and Commissioner Work Session)

STAFF RECOMMENDATION:

Approve PGE's (Company) application for the Deferral of 2018 Net Benefits Associated with the U.S. Tax Reconciliation Act, docketed as UM 1920, for the twelve-month period beginning December 31, 2017, calculated to be \$45 million.

DISCUSSION:

Issue

Whether the Commission should approve PGE's Application for the Deferral of 2018 Net Benefits Associated with the U.S. Tax Reconciliation Act (Application) for the 12-month period beginning December 31, 2017.

Applicable Rule or Law

Beginning with the date of the application, the Commission may approve the deferral of identifiable utility expenses or revenues, the recovery or refund of which the Commission finds should be deferred in order to minimize the frequency of rate changes for the fluctuation of rate levels or to match appropriately the costs borne by and benefits received by ratepayers. ORS 757.269(2)(e) and (4). Unless subject to an automatic adjustment clause under ORS 757.210(1), amounts deferred are allowed in rates to the extent authorized by the Commission in a proceeding under ORS 757.210 to change rates and upon review of the utility's earnings at the time of application to

amortize the deferral. ORS 757.259(4); OAR 860-027-0300(9). The Commission's final determination on the amount of deferrals allowable in the rates of the utility is subject to a finding by the Commission that the amount was prudently incurred by the utility. ORS 757.259(5).

Analysis

Tax Act Deferral Background

On December 22, 2017, President Donald Trump signed H.R.1 – Tax Cuts and Job Act (Tax Act), with most provisions going into effect on January 1, 2018. The Tax Act amends sections of the 1986 code, most notably the reduction in the federal corporate income tax rate from 35 percent to 21 percent. The change in the corporate income tax rate also results in excess deferred income tax (EDIT) assets and liabilities that must be reversed.

On December 29, 2017, Portland General Electric (PGE or Company) filed a deferral application (Docket No. UM 1920) "to defer for later rate-making treatment the 2018 expected net benefits associated with the tax rules and provisions implemented through the current Tax Reconciliation Act, Public Law Number 115-97 (Tax Plan)," with the intent of tracking the net impacts of the Tax Act to pass onto to customers. At the time the Application was filed, the impacts of the Tax Act were unknown.

On April 13, 2018, the Company supplemented its Application, identifying PGE's initial anticipated implications of the Tax Act for PGE, and providing a preliminary estimate of the net amount to refund to customers of between \$25 million and \$30 million using forecasted 2018 results of operations "with" and "without" the Tax Act impacts. The Company also stated these estimates do not include any adjustments which may result from application of an earnings review in accordance with ORS 757.259(5).

On December 29, 2017, Staff also filed an application (UM 1926) to defer the changes in PGE's federal tax obligations resulting from H.R.1 — Tax Cuts and Jobs Act (Application). Staff filed similar applications for all six energy utilities to ensure ratepayers would benefit from the tax reduction beginning January 1, 2018. PGE responded on April 30, 2018, referring back to the contemporaneous docket and stating the Company's intention to provide information through UM 1920, the Company's belief that the UM 1926 docket is "redundant and unnecessary," and requesting Staff withdraw its application. As discussed more fully below, Staff has agreed to withdraw its application upon Commission approval of UM 1920.

Subsequent to the filing of these applications, PGE, Staff, other utilities and stakeholders participated in a workshop to understand the Tax Act implications, and

began working through methodologies to calculate benefits to ratepayers and for passing such benefits on to customers. Since that time, Staff has continued to work with each utility informally to address the deferral and amortization of Tax Act benefits.

Taxes in Current Rates and UE 335 Third Partial Stipulation

The income tax expense currently included in PGE's base rates was approved in its last general rate case (Docket No. UE 319) and does not reflect any of the provisions of the Tax Act. Therefore, the Tax Act benefits are not currently reflected in PGE's base rates.

The Company filed its currently pending Request for a General Rate Revision (Docket No. UE 335) on February 15, 2018, with a 2019 test year and requested rate-effective date of January 1, 2019. In UE 335, the Third Partial Stipulation addresses the Company's taxes beginning January 1, 2019, including the new 21 percent federal tax rate and "protected" EDIT amounts.¹ The Third Partial Stipulation also addresses the treatment of UM 1920, wherein the stipulating parties agreed to estimate the 2018 interim deferral amount in Docket UM 1920 and to begin amortizing those benefits over two-years beginning January 1, 2019 subject to a final determination of the benefit amounts and a true up in the second year.

Settlement Agreement in UM 1920

In accordance with the terms of the Docket No. UE 335 Third Partial Stipulation, PGE hosted two workshops/settlement conferences to discuss the appropriate amount of tax benefits to be deferred.

Staff and other parties also issued discovery in both this docket and UE 335 in order to investigate and analyze amounts that are appropriately deferred. The Company responded to the parties' discovery.

All parties (PGE, Staff, AWEC, Calpine Solutions, Fred Meyer, and CUB), after reviewing the Company's detailed calculations and having further discussed issues of concern at the settlement conference, agree to a final deferral amount of \$45 million, representing the 2018 interim period tax benefits, and to amortize those amounts over a two-year period beginning on January 1, 2019 without a true-up in the second year. The full agreement of the parties is set forth in the Term Sheet, which is included as Attachment A to this memo.

As stated above, each party had varying assumptions and calculations underlying their respective positions, and therefore, no party has agreed to the particular methodology used or assumed by any other party in deriving the \$45 million to be deferred in this case. However, all parties agree that the amounts estimated to be returned to

¹ See PORTLAND GENERAL ELECTRIC COMPANY, Request for a General Rate Revision, Third Partial Stipulation filed September 6, 2018 at 2c and 2f.

customers in this case would result in just and reasonable rates. Although this proceeding is for the approval of deferred amounts only, each item in the term sheet is discussed below, including terms related to ratemaking, in order to ensure that the Commission understands the relationship between deferral and amortization agreed to by the parties.

1. PGE will refund a total of \$45 million dollars for the 2017-2018 net benefits associated with the tax rules and provisions implemented through the current Tax Reconciliation Act, Public Law Number 115-97 ("Tax Cuts and Jobs Act" or "TCJA").

Both the cost of service (i.e., change from 35 percent to 21 percent) and the rate base effects of the tax change for 2018 are fully resolved in the \$45 million settlement agreement. The cost of service and rate base effects of the tax change for 2019 and beyond are resolved in the pending rate case (Docket No. UE 335).

Attachment B to this memo sets forth the calculations that Staff relied on to support the \$45 million settlement amount.

2. The refund will begin on January 1, 2019 such that the \$45 million will be amortized over two years with interest being applied to the unamortized regulatory liability in accordance with Commission Order No. 08-263.

In the UE 335 Third Partial Stipulation, the stipulating parties agreed to refund of the interim tax benefits beginning January 1, 2019 and spread over two years. This term is consistent with the Third Partial Stipulation in UE 335.

Commission Order No. 08-263 requires use of the modified Blended Treasury Rate for all deferred accounts in amortization.² This rate is published annually³ and is currently 2.92 percent.

3. Upon Commission approval of this agreement, and consistent with the third partial stipulation filed on September 6, 2018 in Docket No. UE 335, PGE will submit a compliance filing to begin amortization on January 1, 2019. The \$45 million refund will be allocated to each schedule on an equal percentage basis using the applicable schedule's forecasted revenues at current prices excluding net variable power costs.

PGE anticipates filing the appropriate advice filing with the Commission shortly after the release of this Report. Staff anticipates requesting Commission approval of the

² See PUBLIC UTILITY COMMISSION OF OREGON, Staff Request to Open an Investigation Related to Deferred Accounting, Commission Order 08-263, page 15.

³ https://www.puc.state.or.us/electric_gas/UM%201147%20MBT%20MBE%20UG%20221%20PURE%20Rates.pdf

advice filing at the December 18, 2018, regular public meeting. All parties will have the opportunity to review the advice filing and Staff's recommendation prior to the public meeting.

4. Although the Parties used various methods to derive total tax liabilities in 2018 with the TCJA as compared to total tax liabilities that would have occurred absent the TCJA, the Parties agree that the \$45 million refund represents a reasonable compromise of the methods employed and the range of estimated results derived from those methods.

Staff's basis for supporting the \$45 million refund is discussed more fully below and in Appendix B to this memo. Because the parties had varying proposals and methodologies, no party has agreed to the particular methodology of any other party, as is standard in a settlement agreement. However, all parties agree that the resulting \$45 million refund represents a reasonable outcome and ensures that 2018 Tax Act benefits are appropriately passed back to PGE customers.

5. Parties acknowledge that the Commission must review earnings as specified by ORS 757.259(5), however PGE agrees that the \$45 million refund will result in earnings that are within an acceptable level relative to the rate authorized by Commission Order No. 17-511 in PGE's 2018 general rate case, Docket No. UE 319.

The Commission has wide discretion in the design of an earnings test, including discretion to apply or not apply an earnings threshold, and therefore, it is not possible to quantify the amount of 2018 Tax Act benefits that would have been passed back to customers after the application of an earnings test. Because the earnings test is an issue for amortization (rather than deferral approval), Staff will more fully discuss this issue in its public meeting memo addressing PGE's advice filing. It is not possible to determine the benefit to customers by the Company agreeing that the earnings test will be met, as the Commission has wide discretion in designing an earnings test and the parties may have made different proposals as to what would be appropriate. However, Staff finds that the most conservative earnings test that could be applied, which would set the earnings threshold at the Company's currently authorized Return on Equity (ROE) for 2018, could result in some level of calculated tax benefits not being returned to customers. Therefore, Oregon customers benefit from PGE's agreement that earnings inclusive of deferred amounts will result in earnings that are within an acceptable level of authorized rates for 2018.

6. Consistent with the partial stipulation regarding direct access filed on August 20, 2018, in Docket No. UE 335, Parties agree that the transition adjustment calculated for long-term opt out program customers will include an allocation of the \$45 million amortized in rates consistent with Paragraph 3 above. For purposes of allocation, one-year opt-out customers will be treated as cost-of-service.

The provision regarding long-term opt out program customers is necessary to produce an equitable allocation of tax benefits among all customer classes. Because rate spread is an issue for amortization, Staff anticipates discussing this issue more fully in the public meeting memo addressing PGE's advice filing.

7. This resolves all issues in Docket UM 1920 regarding the application of the TCJA for the 2017-2018 operating periods, and Staff will withdraw its similar application for deferral in Docket UM 1926.

Because customers will receive the appropriate level of Tax Act benefits under the parties' agreement in UM 1920 and through amortization of deferred amounts, Staff's deferral application in Docket UM 1926 would no longer be necessary upon Commission approval PGE's deferral application in this case. Therefore, upon Commission approval of this order, Staff agrees to withdraw its deferral application.

Staff Findings and Discussion

The purpose of this proceeding is to identify the amount of tax benefits to be deferred, for the benefit of PGE's ratepayers. Full consideration of the tax benefits includes the following computational elements:

- The decrease in the annual revenue requirement due to changes in how taxable income from operations is determined, the effect of reducing the statutory federal rate from 35 percent to 21 percent, and changes in allowable tax credits, etc.
- Changes to the value of accumulated deferred income taxes included in the Company's rate base.
- Revaluation of deferred tax obligations at the new lower statutory rate resulting in excess deferred income taxes (EDIT).
 - Federal law provides that the return to ratepayers of EDIT related to utility plant must generally comply with the Average Rate Assumption Method (ARAM). Failure to adhere to the ARAM methodology would terminate the Company's ability to use accelerated depreciation methods for tax purposes. These amounts are generally referred to as "protected" EDIT.
 - EDIT unrelated to utility plant and plant related EDIT not subject to the ARAM methodology may be returned to customers using any reasonable

amortization method. These amounts are generally referred to as “unprotected” EDIT.

As noted above, for 2019 and beyond, effects of the change in the federal tax rate and taxpayer benefits from protected EDIT will be included in Docket No. UE 335 base rates.

Estimates of the 2017-2018 net benefits vary widely depending on the methods employed. Some estimates provided by the parties ranged between \$23 million and \$70 million.

Staff’s review of these estimates indicates estimates on the high end of the range are based on changing the tax assumptions in the most recent rate case without regard to actual operating results. Estimates on the low end of the range are based on actual operating results without regard to ratemaking adjustments. In other words, the former approach ignores regulatory lag and cost increases incurred by the Company since the last rate case, and the latter approach would result in tax benefits being reduced by costs that would be otherwise unallowable in a general rate case.

Additionally, the year used as a proxy year to calculate a “with” and “without” scenario will impact the calculation as well. The Company provided calculations based on projected results for 2018 and actual reported results for 2017. Final actual results for 2018 will not be known with certainty until the Company files its Regulated Results of Operations report on May 1, 2019. Staff believes that, based on review of projected results for 2018 and the actual reported results for 2017, there is minimal risk of the final results being substantially different and agreement on a sum certain at this time is in the best interest of ratepayers.

Finally, the Tax Act contains multiple complex provisions effecting how the Company calculates its taxable income. For example, the Company’s deferred tax calculations include almost 200 separate deferral items for which the parties have differing opinions as to what should and should not be included in the calculation of tax benefits. All parties have had the opportunity to review the information provided by the Company and have agreed, with full knowledge, to enter into a reasonable settlement of these technical issues.

Staff’s preferred methodology calculated 2017 *pro forma* operating income for purposes of determining the tax benefit, including Type I and Type 2 adjustments required in the Company’s annually filed Regulated Results of Operations Reports (Docket No. RE 119). In Staff’s view, this method provides the most accurate measure of the Company’s income with respect to the revenue requirement in a general rate case based on the most recently available actual data, and provides a reasonable and

appropriate proxy for 2018 Tax Act benefits. This method also yields a result between the two more extreme methods discussed above. Appendix B presents Staff's method of calculating the change in taxable income in accordance with the provisions of ORS 757.269 and the \$45 million benefit using 2017 results.

Conclusion

For the reasons stated above, Staff concludes that the agreement among the parties related to the deferral and future amortization of PGE's 2018 Tax Act impacts, as set forth in the attached Term Sheet, will allow PGE to timely pass the appropriate amount of tax benefits on to its customers in an equitable manner.

PROPOSED COMMISSION MOTION:

Approve PGE's (Company) application for the Deferral of 2018 Net Benefits Associated with the U.S. Tax Reconciliation Act, docketed as UM 1920, for the twelve-month period beginning December 31, 2017, calculated to be \$45 million.

ATTACHMENT A

Term Sheet for UM 1920 Settlement

Portland General Electric Company (“PGE”), Public Utility Commission of Oregon Staff, Oregon Citizens’ Utility Board, Alliance of Western Energy Consumers, Fred Meyer Stores and Quality Food Centers, Divisions of The Kroger Co., and Calpine Energy Solutions LLC (collectively “Parties”) have reached a settlement resolving all issues in this proceeding.

Settlement Details:

1. PGE will refund a total of \$45 million dollars for the 2017-2018 net benefits associated with the tax rules and provisions implemented through the current Tax Reconciliation Act, Public Law Number 115-97 (“Tax Cuts and Jobs Act” or “TCJA”).
2. The refund will begin on January 1, 2019 such that the \$45 million will be amortized over two years with interest being applied to the unamortized regulatory liability in accordance with Commission Order No. 08-263.
3. Upon Commission approval of this agreement, and consistent with the third partial stipulation filed on September 6, 2018 in Docket No. UE 335, PGE will submit a compliance filing to begin amortization on January 1, 2019. The \$45 million refund will be allocated to each schedule on an equal percentage basis using the applicable schedule’s forecasted revenues at current prices excluding net variable power costs.
4. Although the Parties used various methods to derive total tax liabilities in 2018 with the TCJA as compared to total tax liabilities that would have occurred absent the TCJA, the Parties agree that the \$45 million refund represents a reasonable compromise of the methods employed and the range of estimated results derived from those methods.
5. Parties acknowledge that the Commission must review earnings as specified by ORS 757.259(5), however PGE agrees that the \$45 million refund will result in earnings that are within an acceptable level relative to the rate authorized by Commission Order No. 17-511 in PGE’s 2018 general rate case, Docket No. UE 319.
6. Consistent with the partial stipulation regarding direct access filed on August 20, 2018 in Docket No. UE 335, Parties agree that the transition adjustment calculated for long-term opt out program customers will include an allocation of the \$45 million amortized in rates consistent with Paragraph 3 above. For purposes of allocation, one-year opt-out customers will be treated as cost-of-service.
7. This resolves all issues in Docket UM 1920 regarding the application of the TCJA for the 2017-2018 operating periods and Staff will withdraw its similar application for deferral in Docket UM 1926.

Portland General Electric
Staff Calculation of Ratepayer Benefits from Federal Tax Reform

| Summary of Tax Cut and Jobs Act (TCJA) Benefits (2017 proxy method, in 000's) | Before Tax Reform | After Tax Reform | Ratepayer Benefit |
|--|----------------------|---------------------|----------------------|
| Utility Operating Income (Docket RE 119(7) page 1) | \$ 313,128 | \$ 313,128 | |
| Adjust to Ratemaking Taxable Income | | | |
| Long Term Interest Expense | (119,637) | (119,637) | |
| Income Taxes | 97,056 | 97,056 | |
| Non Recurring Events | 9,055 | 9,055 | |
| | <u>299,602</u> | <u>299,602</u> | |
| Composite Tax Rate | 39.93% | 26.99% | |
| Operational Tax Savings | 119,622 | 80,857 | 38,765 |
| Other Tax Savings | | | |
| Amortization of Protected EDIT (ARAM method) | | (7,979) | 7,979 |
| Net Effect of Other Tax Act Changes * | | 14,970 | (14,970) |
| | <u>119,622</u> | <u>87,849</u> | <u>31,773</u> |
| Revenue Gross-Up | 1.416 | 1.416 | |
| Stipulated 2018 Tax Savings | <u>\$ 169,418</u> | <u>\$ 124,418</u> | <u>\$ 45,000</u> |

* includes technical changes related to meals and entertainment, fringe benefits, flow through depreciation, production tax credits, and unprotected EDIT.