

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: September 10, 2019**

REGULAR X CONSENT _____ EFFECTIVE DATE November 1, 2019

DATE: August 27, 2019

TO: Public Utility Commission

FROM: John Fox

THROUGH: Jason Eisdorfer and Marianne Gardner **SIGNED**

SUBJECT: CASCADE NATURAL GAS CORPORATION: (Docket Nos. UM 1927 / UM 1927(1)) Application for Deferral of Net Benefits Associated with the US Tax Cuts and Jobs Act.

STAFF RECOMMENDATION:

Approve Cascade Natural Gas Corporation's (Cascade or Company) Application for Deferral of 2018 Net Benefits Associated with the US Tax Cuts and Jobs Act, docketed as UM 1927, for the twelve-month period beginning December 31, 2017 and Application for Reauthorization to Defer 2018 Net Benefits Associated with the US Tax Cuts and Jobs Act, docketed as UM 1927(1), for the twelve-month period beginning December 31, 2018, in the amount of \$1.4 million total.

DISCUSSION:

Issue

Whether the Commission should approve Cascade's Application for Deferral of 2018 Net Benefits Associated with the US Tax Cuts and Jobs Act, docketed as UM 1927, for the twelve-month period beginning December 31, 2017, and Application for Reauthorization to Defer 2018 Net Benefits Associated with the US Tax Cuts and Jobs Act, docketed as UM 1927(1), for the twelve-month period beginning December 31, 2018.

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, the Company filed a deferral application (Docket No. UM 1927) for “authorization to defer for later rate-making treatment the 2018 expected net benefits associated with the tax rules and provisions implemented through the current U.S. Tax Cuts and Jobs Act (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 December 29, 2017, Staff also filed an application (UM 1922) to defer the changes in Cascade Natural Gas Company'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. Cascade responded on May 2, 2018, referring back to the contemporaneous docket and stating that Staff's application is duplicative and the Company did not believe the Commission need rule on Staff's separate application.

Subsequent to the filing of these applications, Cascade, 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.

On April 17, 2018, the Company supplemented its Application, estimating the annual Oregon deferral would be between \$1.0 million and \$1.6 million dollars.

On October 31, 2018, the Company supplemented its Application, revising its estimate for 2018 downward to a range between \$150 thousand and \$250 thousand dollars based on its 2018 projected results of operations.

On December 31, 2018, the Company supplemented its Application requesting reauthorization to defer for later rate-making treatment the expected net benefits associated with the tax rules and provisions implemented through the current U.S. Tax Cuts and Jobs Act (Tax Plan) for the twelve-month period beginning January 1, 2019.

On January 15, 2019, the Company supplemented its Application, revising its estimate for 2018 upward to an amount of \$924,941.88 based on its 2018 projected results of operations.

On April 10, 2019, the Company supplemented its Application, providing a 15 month estimate amount of \$1,010,005 for the period January 1, 2018 through March 31, 2019.

On August 1, 2019, the Company filed a tariff (Docket No. UG 386, Advice No. O19-08-05) requesting to return 2018 deferred tax benefits in the amount of \$203,287 over a twelve-month period effective November 1, 2019, to October 31, 2020.

Taxes in Current Rates

The income tax expense currently included in Cascade's base rates were approved in its last general rate case (Docket No. UG 347) and include the following Tax Act benefits starting on April 1, 2019:

- Reduction in the statutory federal rate from 35 percent to 21 percent.
- Amortization of all unprotected EDIT over a period of 5 years beginning April 1, 2019.
- Ongoing amortization of protected EDIT on a prospective basis.

Therefore, the Tax Act benefits remaining to be resolved in this docket, UM 1927, are limited to the reduction in the statutory federal rate and amortization of protected EDIT for the interim period from December 31, 2017, through March 31, 2019.

Staff Findings and Discussion

The purpose of this proceeding is to identify the amount of tax benefits to be deferred, for the benefit of Cascade'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.

On August 22, 2019, Staff hosted a settlement workshop including the Company, Alliance of Western Energy Consumers (AWEC), and the Oregon Citizens' Utility Board (CUB) to discuss calculation of interim Tax Act benefits using the Company's reported results of operations for 2018.¹

The parties agreed the Company would return a total of \$1.4 million to rate-payers over a 12 month period beginning November 1, 2019. This amount is inclusive of all remaining interim Tax Act benefits and is comprised of \$1.2 million dollars for the 2018 deferral period and \$200 thousand dollars for the January – March 2019 deferral period.

The parties acknowledge that the Commission must review earnings as specified by ORS 757.259(5), however Cascade has agreed that the \$1.4 million refund will result in earnings that are within an acceptable level relative to the rate authorized by Commission Order Nos. 16-477 and 16-481 in Cascade's 2016 general rate case, Docket No. UG 305.

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 \$1.4 million to be deferred in this docket. However, all parties agreed that the amounts estimated to be returned to customers in this case would result in just and reasonable rates.

¹ See *In the Matter of CASCADE NATURAL GAS CORPORATION Annual Spring Earnings Review, Results of Operations and Rate of Return Report*, Docket No. RG 36(7), filed April 23, 2019.

Appendix A presents Staff's method of calculating the change in taxable income in accordance with the provisions of ORS 757.269 and the \$1.2 million benefit using 2018 results in accordance with Oregon ratemaking principles, including the conversion factor of 1.411 which is inclusive of all revenue sensitive costs in the UG 347 rate case and adjusted to reflect the new 21 percent tax rate.

Conclusion

Staff concludes that the agreement of the parties as discussed above, regarding the amount due to ratepayers from the Tax Act is a fair, just, and reasonable result, and recommends the Commission approve the Company's request for deferral in the amount of \$1.2 million dollars for the 2018 deferral period and \$200 thousand dollars for the January – March 2019 deferral period.

PROPOSED COMMISSION MOTION:

Approve Cascade's Application for Deferral of 2018 Net Benefits Associated with the US Tax Cuts and Jobs Act, docketed as UM 1927, for the twelve-month period beginning December 31, 2017 and Application for Reauthorization to Defer 2018 Net Benefits Associated with the US Tax Cuts and Jobs Act, docketed as UM 1927(1), for the twelve-month period beginning December 31, 2018, in the amount of \$1.4 million. .

Cascade Natural Gas Corporation
Summary of 2018 Ratepayer Benefits from Federal Tax Reform

Summary of Tax Cut and Jobs Act (TCJA) Benefits (Actual Results revenue requirement, in 000's)	Before Tax Reform	After Tax Reform	Ratepayer Benefit
Utility Operating Income (Excl. Tax Reform Deferral)	\$ 6,489	\$ 6,489	
Adjust to Ratemaking Taxable Income			
Long Term Interest Expense	(2,434)	(2,434)	
Income Taxes	1,981	1,472	
	<u>5,554</u>	<u>5,527</u>	
Composite Tax Rate	35.68%	26.63%	
Operational Tax Savings	1,981	1,472	509
Other Tax Savings			
Amortization of Protected EDIT (ARAM method)		(368)	368
Net Effect of Other Tax Act Changes		27	(27)
	<u>1,981</u>	<u>1,131</u>	<u>850</u>
Gross Up Factor	1.411	1.411	
2018 Tax Savings	<u>\$ 2,796</u>	<u>\$ 1,596</u>	<u>\$ 1,200</u>

**Summary of Excess Deferred Income Taxes (EDIT)
(in 000's)**

	Protected	Unprotected	Total
Regulatory Liability - 2017 Financial Statements	\$ 9,062	\$ 1,777	\$ 10,840
Unprotected EDIT returned over 5 years (Order No. 19-088)		(1,777)	(1,777)
2018 Amortization of Protected EDIT (above)	(368)		(368)
ARAM EDIT to be amortized in future years *	<u>\$ 8,694</u>	<u>\$ -</u>	<u>\$ 8,694</u>

* Oregon portion only - not including gross up for taxes