

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: January 15, 2019

REGULAR X CONSENT EFFECTIVE DATE February 1, 2019

DATE: December 18, 2018

TO: Public Utility Commission

FROM: John Fox *JF*
E

THROUGH: Jason Eisdorfer and Marianne Gardner *MG*

SUBJECT: PACIFIC POWER: (Docket No. UM 1917) Requests approval of Deferred Accounting Related to the Federal Tax Act

STAFF RECOMMENDATION:

Approve PacifiCorp's (or Company) Application for Approval of Deferred Accounting Related to Federal Tax Act, docketed as UM 1917, for the twelve month period beginning December 31, 2017 calculated to be \$198 million (Oregon-allocated) for 2018.

DISCUSSION:

Issue

Whether the Commission should approve PacifiCorp's Application for Approval of Deferred Accounting Related to Federal Tax Act, for the twelve month period beginning December 31, 2017, for later ratemaking treatment, calculated to be \$198 million for 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 28, 2017, the Company filed a deferral application (UM 1917) to defer the expected impacts associated with the income tax provisions of the Tax Act. Because the legislation was newly enacted, the Company did not have an estimate of the total impacts at the time its application was filed.

On April 13, 2018, the Company filed a supplemental application, estimating Oregon-allocated deferred amounts to be between \$42 million and \$48 million, based on its 2017 Results of Operations with Type 3 adjustments, calculated both “with” and “without” the effects of the Tax Act.

On September 20, 2018 the Company filed a second supplemental application including the following revised estimates:

- “[T]he annual Oregon deferral will be approximately \$46.7 million for current taxes, exclusive of 2018 production tax credit (PTC) impacts and excess deferred income taxes that must be normalized using the average rate assumption method (ARAM) of accounting.
- 2018 PTC impact is a negative benefit of \$3.0 million.
- ARAM amortization is a benefit of \$14.6 million.

On December 29, 2017, Staff also filed an application (UM 1925) to defer the changes in PacifiCorp’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.

Subsequent to the filing of both PacifiCorp’s and Staff’s initial applications, PacifiCorp, Staff, other utilities and stakeholders participated in a workshop to understand the Tax

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

Taxes in Current Rates

The income tax expense currently included in PacifiCorp's base rates was approved in its last general rate case (UE 263) and does not reflect any of the provisions of the Tax Act. Therefore, the Tax Act benefits are not currently reflected in PacifiCorp's base rates.

Staff Discussion and Findings

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

Work papers were provided to Staff and stakeholders in conjunction with the Company's September 20th update filing in UM 1917. Staff subsequently issued several rounds of data requests. Staff generally concurs with the Company's calculation of tax act benefits with the exception that Staff believes a higher gross up factor of 1.371 should be applied to determine the revenue requirement associated the with return of the EDIT

benefits.¹ PacifiCorp has agreed to include the higher gross up factor as requested by Staff.

The portion of benefits that are currently subject to deferral for 2018 (Oregon-allocated) are \$198 million, including gross up, and consists of the following amounts:

- 2018 operational tax savings \$46.7 million.
- 2018 TAM PTC impact (\$3.0) million.
- 2018 amortization of protected EDIT \$10.4 million.²
- Unprotected EDIT that can be amortized using any reasonable method \$144.2 million.³

Annual Tax Benefits: The Company requests a deferral \$46.7 million for 2018. This amount includes the change in the federal tax rate from 35% to 21% and the tax effect of other technical changes as noted in Attachment A. Staff recommends the Commission approve deferral of this amount.

The Company proposes to use the same amount, \$46.7 million, for 2019 and 2020, however the final determination will be subject to subsequent annual deferral filings for those years and the amount thereof is not being approved by the Commission at this time.

Production Tax Credits: The economic value of unused tax credits is reduced when tax rates decrease. The reduced economic value of PTC's would normally be recovered from ratepayers as an increase in power costs. The Company has proposed that these costs be offset against 2019 annual benefits from the Tax Act.⁴ However, the change in valuation of the tax credits arose from passage of the tax act itself and therefore must be included in the deferral approved for 2018. Staff recommends the Commission approve deferral of the \$3.0 million benefit due to the Company.

Protected (ARAM) EDIT: Staff recommends the Commission approve deferral of 2018 ARAM EDIT benefits in the amount of \$10.4 million as discussed above. Return of ARAM EDIT will occur over many years and the amount to be returned to ratepayers in any particular year is limited by IRS normalization rules. The Company has provided estimates of the amounts to be returned in 2019 and 2020. Benefits for 2021 and

¹ Includes revenue sensitive operating deductions 3.251% of revenue, nominal state tax rate of 4.54%, and nominal federal tax rate of 21%. Resulting gross up factor of 1.371 calculated using Oregon rate case principles and methodology as applied in the Company's historical rate cases.

² Protected EDIT amortization of \$7.597 million for 2018 multiplied by regulatory gross up factor of 1.371.

³ Unprotected EDIT totaling \$105.2 million multiplied by regulatory gross up factor of 1.371.

⁴ See *In the Matter of PacifiCorp dba Pacific Power, 2019 Transition Adjustment Mechanism*, Docket No. UE 339, PAC/100, Wilding/7-8 (Mar. 30, 2018).

thereafter will be included in the calculation of tax expense in base rates subsequent to the anticipated filing of a general rate case in 2020.

The estimated amount of ARAM benefits due to Oregon ratepayers for all future years is \$321 million before gross up, or \$440 million including a gross up factor of 1.371. Although the total amount of ARAM EDIT tax benefits arose from passage of the tax act itself, amounts due for return in any particular year will vary based on application of the ARAM methodology and cannot be predicted with certainty. Accordingly, Staff recommends approval of specific amounts for 2019 and 2020 occur as part of the subsequent annual deferral filings for those years.

Unprotected EDIT: Return of unprotected EDIT is not subject to IRS normalization rules; as such, the entire balance of unprotected EDIT may be returned to ratepayers upon Commission approval of amortization. Staff notes that the Company's estimate of those benefits is \$139.5 million based on application of a 1.326 gross up factor. As discussed above, Staff calculates the correct gross up factor using traditional ratemaking principles to be 1.371 resulting in a deferral amount of \$144.2 million as calculated in Attachment A. Staff recommends the Commission approve a deferral amount of \$144.2 million for Oregon-allocated unprotected EDIT.

Future Ratemaking Treatment: On December 7, 2018 the Company filed a separate application for amortization.⁵ The method and timing of return for the various benefits of the Tax Act will be considered in that proceeding. The purpose of this deferral application is to identify amounts deferred for 2018.

Conclusion

Staff concludes the proposed tax benefits are fair, just, and reasonable for the following reasons:

- Amounts included in the tax benefit calculation are consistent with, and reconcile to, the Company's various financial and regulatory filings.
- The tax benefit calculation, after inclusion of regulatory adjustments, is consistent with principles of ratemaking applied by the Commission.
- The Company has not proposed application of an earnings test under the provisions of ORS 757.259(5) and intends to return the full amount of tax benefits to ratepayers.
- The benefits are within a reasonable range of outcomes compared to the risks associated with resolving the refund amount through litigation.

⁵ UM 1985 – PacifiCorp's Application for an Accounting Order and Request for Amortization Related to the Federal Tax Act (December 7, 2018).

PROPOSED COMMISSION MOTION:

Approve PacifiCorp's Application for Approval of Deferred Accounting Related to Federal Tax Act, docketed as UM 1917, for the twelve month period beginning December 31, 2017 calculated to be \$198 million (Oregon-allocated) for 2018.

UM 1917

PacifiCorp
Summary 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 After Regulatory Adjustments	\$ 263,478	\$ 309,398	
Adjust to Ratemaking Taxable Income			
Long Term Interest Expense	80,863	82,696	
Income Taxes	107,353	60,534	
	<u>451,694</u>	<u>452,629</u>	
Composite Tax Rate	39.49%	26.45%	
Operational Tax Savings	178,356	119,731	58,625
Net Effect of Other Tax Act Changes *		24,528	(24,528)
	<u>178,356</u>	<u>144,259</u>	<u>34,097</u>
Gross Up Factor	1.371	1.371	
2018 Annual Tax Benefit / UM 1985 initial filing	<u>\$ 244,457</u>	<u>\$ 197,723</u>	<u>\$ 46,734</u>
2019 Annual Tax Benefit			\$ 46,734
Change in value of PTC not included in UE 339 TAM			(3,040)
2020 Annual Tax Benefit			46,734
UM 1985 initial filing			<u>\$ 90,428</u>

* includes technical changes related to hydro decommissioning, interest expenses, cash working capital, bonus depreciation, amortization, AFUDC equity, manufacturing deduction, meals and entertainment, and transit passes.

Summary of Excess Deferred Income Taxes (EDIT) (in 000's)	Protected	Unprotected	Total
2018 ARAM EDIT	\$ 7,597		\$ 7,597
2019 ARAM EDIT	6,457		6,457
2020 ARAM EDIT	6,589		6,589
Non-protected property		93,326	93,326
Non-protected non-property		11,892	11,892
	<u>20,643</u>	<u>105,217</u>	<u>125,860</u>
Gross Up Factor	1.371	1.371	
3 Year Tax Benefit (2018-2020)	<u>\$ 28,293</u>	<u>\$ 144,212</u>	<u>\$ 172,505</u>
Memo: UM 1985 initial filing	<u>\$ 30,300</u>	<u>\$ 139,500</u>	<u>\$ 169,800</u>
Memo: ARAM EDIT total including 1.371 Gross Up	<u>\$ 439,851</u>		