UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Effect of the Tax Cuts and Jobs Act on Commission-Jurisdictional Rates	)))	Docket No. RM18-12-000

COMMENTS OF THE AMERICAN PUBLIC POWER ASSOCIATION AND AMERICAN MUNICIPAL POWER, INC. IN RESPONSE TO NOTICE OF INQUIRY

Pursuant to the Notice of Inquiry ("NOI") issued by the Commission on March 15, 2018,[1] the American Public Power Association ("APPA") and American Municipal Power, Inc. ("AMP") provide the following comments regarding the effects of the Tax Cuts and Jobs Act of 2017 ("TCJA") on Commission-jurisdictional rates charged by, among others, public utilities regulated under the Federal Power Act. In particular, consistent with the NOI, APPA and AMP focus the bulk of their comments on the implications of the TCJA for the manner in which accumulated deferred income taxes ("ADIT") and bonus depreciation are reflected in the determination of just and reasonable rates for Commission-jurisdictional services.

I. EXECUTIVE SUMMARY

The NOI and the concurrent show cause orders recognize the significant effect of the TCJA on the determination of just and reasonable rates. Additional Commission actions are necessary, however, to ensure that the TCJA is fully and properly reflected in jurisdictional charges. Most notably, APPA and AMP believe that all public utilities should be required to make filings with the Commission that set forth in detail their plans for implementing all

[1] Notice of Inquiry, *Inquiry Regarding the Effect of the Tax Cuts and Jobs Act on Commission-Jurisdictional Rates*, 162 FERC ¶ 61,223 (2018).

pertinent provisions of the TCJA in their cost-based rates, especially their plans for flowing back to customers the ADIT balances that have become excess to the utilities' needs and for reflecting the effect of changes in the bonus depreciation rules. Those filings should reflect that unamortized excess ADIT balances will be included in rate base as an offset (reduction) consistent with Commission policy, which recognizes that such amounts are customer-contributed funds on which a public utility is not entitled to earn a rate of return. To the extent a public utility's existing rates or formulas must be modified to properly implement the flowback of these amounts, the utilities should formally propose the necessary modifications. (In the alternative, the utilities should show cause why their existing cost-based rates should not be modified to accomplish the necessary flowback of excess ADIT.) These filings should be supported by detailed workpapers showing the calculation of excess ADIT amounts (both "protected" and "unprotected") and demonstrating the operation of the utility's plan for flowing those excess ADIT amounts back to customers.

Following such utility filings, each utility and its customers should be permitted to engage in discussions aimed at reaching agreement on the flowback period for unprotected excess ADIT. If agreement is not reached, the Commission should establish the flowback period giving consideration to all relevant factors, but affording special weight to the fact that ADIT balances are customer-contributed funds that should be returned without unnecessary delay.

II. COMMENTS

Passage of the TCJA has a number of significant implications for the manner in which the Commission establishes just and reasonable rates for services provided by public utilities. Some of those implications are relatively straightforward; the TCJA's reduction in the corporate income tax rate from 35% to 21%, for example, should be reflected in a commensurate reduction in the federal income tax expense included in rates as of January 1, 2018, as the Commission recognizes in the NOI (at P 4). Other effects, however, entail somewhat more involved considerations. Notably, the TCJA's tax rate reduction has resulted in public utilities that use normalized accounting now holding customer-paid reserves for deferred income taxes that substantially exceed the companies' projected tax liabilities. While the statute itself dictates some of the terms of how those excess tax reserves must be treated, the details matter greatly for ratemaking purposes. The Commission therefore is to be commended for soliciting input from all industry stakeholders on these matters.

In the view of APPA and AMP, there are two minimum prerequisites for ensuring that the effects of the TCJA translate into just and reasonable rates for public utilities. First, each public utility should be required to make a filing with the Commission in which it demonstrates that its existing jurisdictional cost-based rates will properly and fully reflect the TCJA's effects without modification, or, if not, what modifications each utility proposes in order to achieve that result. To the extent that a public utility contends in its submittal that no modifications are necessary or appropriate for a particular cost-based rate, it should be required to show cause why that is the case.[2] Second, ensuring just and reasonable rates requires full transparency into how each public utility plans to account for the effects of the TCJA. The necessary level of transparency would be promoted, we submit, by requiring that the aforementioned filings by

[2] For shorthand, we refer to the recommended TCJA-implementation show cause filing to be made by each public utility as a "TISC filing." These filings would be in addition to any filings that a public utility may already have made to address the specific issue of the reduction in the corporate income tax rate pursuant to the Commission's two "show cause" orders issued concurrently with the NOI. *Alcoa Power Generating, Inc. – Long Sault Division, et al.*, Docket Nos. EL18-72-000, *et al.*, 162 FERC ¶ 61,224 (2018) (show cause order applicable to public utilities with stated transmission rates); and *AEP Appalachian Trans. Co., Inc., et al.*, Docket Nos. EL18-62-000, *et al.*, 162 FERC ¶ 61,225 (2018) (show cause order applicable to public utilities with formula transmission rates containing a stated 35% federal income tax rate).

each public utility include the detailed worksheets discussed in Section II.A.6 of our comments. We discuss these necessary prerequisites in more detail below.

Although APPA's and AMP's comments focus primarily on the ratemaking implications of the TCJA, the comments also discuss what we believe to be the appropriate accounting for certain of its effects. Because the accounting for costs or revenues is a separate matter from their ratemaking treatment, however,[3] the discussion of accounting matters presented below is intended solely to describe ways in which the appropriate accounting can promote transparency and accountability, as well as facilitating the correct ratemaking treatment.

A. Accumulated Deferred Income Taxes[4]

1. <u>Effect on Rate Base</u>

Paragraphs 14 and 15 of the NOI seek comment on three aspects of the impact of the TCJA on the determination of rate base: (1) how to ensure that rate base continues to be treated in a manner similar to that followed prior to the enactment of the TCJA until excess and deficient ADIT have been fully settled in a just and reasonable manner; (2) whether, and if so how, adjustments should be made to rate base to reflect excess ADIT and deficient ADIT; and (3) whether it would be appropriate for public utilities to include interest on excess and deficient ADIT for the time period from January 1, 2018 until any adjustments to rate base are implemented. APPA and AMP address these questions in turn.

[3] *Piedmont Mun. Pwr. Agency v. Duke Energy Carolinas, LLC*, 162 FERC ¶ 61,109, P 38 (2018) quoting *North Carolina Mun. Power Agency No. 1 v. Duke Power Co*., 40 FERC ¶ 61,138, *reh'g denied*, 41 FERC ¶ 61,060 (1987), *aff'd Duke Power Co. v. FERC*, 864 F.2d 823 (D.C. Cir. 1989) ("Commission approval of the accounting treatment does not automatically extend to approval of collecting the booked amounts for ratemaking purposes.").

[4] In order to facilitate the Commission's review of these comments, APPA and AMP structure the comments to follow the topics and format of the NOI itself, including topic headings and numbering.

(a) Preserving pre-TCJA rate base treatment

With regard to the first rate base-related question raised in the NOI, APPA and AMP note that most, if not all, FERC jurisdictional formula rates contain rate base components to account for ADIT related to FERC Accounts 190, 281, 282, and 283. Typically, the balances for these accounts are taken directly from a public utility's FERC Form 1 (pages 234, 273, 275 and 277) and are used as inputs to the formula rate where they operate to reduce the rate base. The reason the Commission requires public utilities to reflect additions (Account 190) and deductions (Accounts 281, 282 and 283) for ADIT balances as adjustments to rate base is that ADIT "effectively provides the company with cost-free capital."[5] As a result of the passage of the TCJA, ADIT balances as they existed on December 31, 2017 will be restated as of January 1, 2018 to reflect the TCJA's reduction in the corporate income tax rate from 35% to 21%. A significant portion of the existing deferred income tax reserve and the related ADIT balances now will be reclassified as "excess" in that the balances in total will exceed what a public utility requires to satisfy its projected tax liability.

In order to preserve rate base neutrality for purposes of formula rates, unamortized balances of excess ADIT must continue to be treated as an offset to (*i.e*., a deduction from) rate base until those balances are flowed back in their entirety to customers). If unamortized excess ADIT instead were not included as a reduction to rate base (not reflected as an offset), rate base would increase as a consequence of the TCJA's reduction in the tax rate. The inequitable result (assuming all other factors are held constant) would be higher charges to customers.

Useful guidance concerning the manner in which tax rate changes should be reflected in the accounting for ADIT balances was provided by FERC's Office of the Chief Accountant in an

5 *Midcontinent Indep. Sys. Operator, Inc.*, 163 FERC ¶ 61,061, P 3 (2018).

April 1993 issuance in Docket No. AI93-5-000. Among the matters addressed in that issuance was the manner in which public utilities should account for the effect of changes in tax law or rates. The issuance states in pertinent part as follows:

> The entity shall adjust its deferred tax liabilities and assets for the effect of the change in tax law or rates in the period that the change is enacted. The adjustment shall be recorded in the proper deferred tax balance sheet accounts (Accounts 190, 281, 282 and 283) based on the *nature* of the temporary difference and the related classification requirements of the accounts. If as a result of action by a regulator, it is probable that the future increase or decrease in taxes payable due to the change in tax law or rates will be recovered from or returned to customers through future rates an asset or liability shall be recognized in Account 182.3, Other Regulatory Assets, or Account 254, Other Regulatory Liabilities as appropriate, for that probable future revenue or reduction in future revenue. That asset or liability is also a temporary difference for which a deferred tax asset or liability shall be recognized in Account 190, Accumulated Deferred Income Taxes or Account 283, Accumulated Deferred Income Taxes Other, as appropriate.

Accounting for Income Taxes, Docket No. AI93-5-000 (Apr. 23, 1993) at pp. 8-9 (emphasis added).

Thus, for accounting purposes, the nature of the deferred income taxes or income tax reserve amounts that have been paid in by customers is a deferred asset that should be recorded in FERC Account 182.3. The proper recording of the excess ADIT adjustment requires that the excess ADIT balance amount be transferred from the Account 182.3 sub-account for deferred income taxes, or income tax reserve, to the new sub-account of Account 182.3 for this new excess ADIT regulatory asset for the portion of the deferred income tax reserve that after the re-measurement was in excess of the utility's projected tax liability. The utility would also then be required to transfer the excess ADIT liability amount associated with the new excess ADIT regulatory asset from Account 282 (since Account 282 is related to "Plant") to a new Account

283 sub-account (since it is now related to the excess ADIT regulatory asset, and Account 283 is for "Other" items not related to Plant).

This accounting facilitates the appropriate ratemaking result since Account 283 is included in rate base as a reduction. <u>Therefore, the unamortized portion of the excess ADIT would be included in rate base as an offset or reduction.</u> Authorization for the public utility to amortize the excess ADIT regulatory asset in Account 182.3 through its rates would come in the Commission's action on the required TISC filing APPA and AMP believe is necessary to ensure appropriate reflection of the TCJA's effects. As the excess ADIT regulatory asset is returned to customers through rates, the associated ADIT in Account 283 would be reduced. The balance of the excess ADIT regulatory asset in Account 182.3 and the related accumulated deferred income tax amount in Account 283 would remain on the utility's books until the flowback to customers is complete. In this way, the proper accounting for excess ADIT is consistent with and supports the ratemaking policy of subtracting deferred tax balances from rate base in calculating jurisdictional charges.

(b) <u>Adjustments to rate base</u>

Regarding the second rate base-related question raised in the NOI— whether and, if so, how adjustments should be made to rate base to reflect excess ADIT and deficient ADIT— APPA and AMP respond as follows.

As to "whether" such adjustments are appropriate, the answer is an emphatic "yes." Reflecting excess ADIT in rate base as an offset is essential to ensuring customers are properly compensated for their contributions to a utility's deferred tax reserves. Such adjustments ultimately may be unnecessary, however, because it appears that the established accounting for

ADIT and the proper accounting for excess ADIT will produce the desired result without need of adjustments.

As an alternative, any excess or deficient ADIT that results from the implementation of the TCJA should be recorded to the same ADIT accounts (*e.g.*, Accounts 190, 281, 282 and 283) where the original entries for the regulatory assets and regulatory liabilities were established. The excess amounts should be recorded in designated sub-accounts within these accounts until such time as they have been flowed back in their entirety to customers. If utilities record the excess or deficient ADIT to the same ADIT accounts, it is not necessary to add a separate line item to rate base to account for the adjustments related to the decrease (by any excess ADIT that is placed in Account 254) and related to the increase (by any deficient ADIT that is placed in Account 182.3), as suggested by the Commission. By keeping the excess or deficient ADIT in sub-accounts within the original ADIT accounts, it will be more transparent and easier to track as the balances are flowed back.

In their individual TISC filings, public utilities should confirm that the foregoing describes how they will account for excess ADIT, and that these amounts will continue to be a deduction from rate base. If a public utility cannot provide this confirmation, it should explain how it proposes to ensure that unamortized excess ADIT will continue to be a rate base deduction in calculating its cost-based rate(s).

(c) <u>Interest on excess and deficient ADIT</u>

The third rate base-related question posed in the NOI is whether it is appropriate for public utilities to include interest on excess and deficient ADIT for the time period from January 1, 2018 until any adjustments to rate base are implemented.

As noted above, APPA and AMP believe that established accounting and ratemaking practices can (with the addition of designated sub-accounts for excess or deficient ADIT) produce the desired result of treating all ADIT as customer-contributed capital for ratemaking purposes. If some set of adjustments turns out to be necessary to achieve the desired treatment, however, it is appropriate that customers be compensated with interest for the period from January 1, 2018 until the necessary adjustments are given effect. The payment of interest in such circumstances would recognize that, during that interval, customers will have been deprived of a portion of the rate base reduction (in the case of excess ADIT) to which they were entitled. In the formula rate context, the interest may be payable in connection with the "true-up" of charges for whatever rate period(s) encompasses January 1, 2018 and the date on which the rate base adjustments were reflected in charges. But regardless of how the interest comes to be paid, it *must* be paid if customers are to be made whole for having been deprived of the full rate base offset for some period of time.

2. Flowback or Recovery of Plant-Based ADIT

The NOI also raises several questions pertaining to the flowback of plant-based ADIT, and particularly ADIT that is rendered excess by the TCJA's reduction in the corporate income tax rate from 35% to 21% as of January 1, 2018. The Commission observes in the NOI that

> public utilities and interstate natural gas pipelines are generally not permitted, in computing costs of service for ratemaking purposes and reflecting operating results in their regulated books of account, to flow-back excess plant-based ADIT more rapidly or greater than the reductions permitted by the Average Rate Assumption Method, which requires amortization of the excess tax reserve over the remaining regulatory lives of the property that gave rise to the ADIT. Alternatively, if the books and records of public utilities and interstate pipelines do not contain the vintage data necessary to apply the Average Rate Assumption Method, they are required to use an alternative method, e.g., the Reverse South

> Georgia Method, to flow back excess plant-based ADIT over the remaining regulatory life of the property.

NOI at P 17 (footnotes omitted). The Commission therefore requested comment on how the Average Rate Assumption Method ("ARAM"), and alternatively the Reverse South Georgia Method ("RSGM") or South Georgia Method ("SGM"), as appropriate, will be implemented to adjust the tax allowance or expense included in cost-of-service rates to reflect the amortization of excess and deficient plant-based ADIT. In response, APPA and AMP offer the following.

The NOI states that "[u]nder the Tax Cuts and Jobs Act, public utilities and interstate natural gas pipelines may flow back the excess ADIT associated with utility plant assets (excess plant-based ADIT) no more rapidly than over the life of the underlying assets." NOI at P 17, *citing* TCJA § 1561(d). As an initial matter, the Commission should clarify that, under the TCJA, this limitation on the pace at which excess ADIT may be flowed back applies only to the "protected" portion of the excess or deficient plant-based ADIT. In other words, the Commission's statement is correct only insofar as it applies to the flowback of excess or deficient ADIT associated with accelerated tax depreciation on plant. "Unprotected" excess ADIT may be flowed back over a different time period without jeopardizing a utility's eligibility to use normalized accounting.

In implementing the flowback of excess plant-based ADIT, each public utility first must determine whether it has the detailed information that is required in order to implement the ARAM. The necessary information would include vintage account data within each guideline class (*see* IRS PLR 8910012, (Dec. 06, 1988)). If a utility lacks the detailed vintage information by individual plant assets, it may utilize one of the alternative methods—RSGM or SGM—to determine the appropriate amortization period for returning the excess protected ADIT, or the utility may have to use ARAM for certain assets for which it has the vintage records and RSGM for the older assets for which the utility does not have the vintage records.. In any case, the excess protected ADIT should be flowed back to ratepayers through the income tax calculation,[6] similar to the Investment Tax Credit ("ITC") adjustment, using either ARAM, RSGM or SGM as the basis for determining the amortization period and the resultant amount for the rate year.

3. Flowback or Recovery of Non-Plant Based ADIT

The Commission also observes in the NOI (at P 19) that the normalization requirement under the TCJA applies only to plant-based ADIT. With respect to non-plant based ADIT, the Commission requested comment on how quickly excess or deficient non-plant based ADIT should be flowed back to or recovered from customers. In particular, the Commission asks whether a regulatory asset or regulatory liability recorded by a public utility associated with non-plant based excess or deficient ADIT should be amortized over a shorter (*e.g.*, five-year) period than would be required for plant-based ADIT.

There is no hard and fast rule that governs the determination of a just and reasonable flowback period for the unprotected portion of excess ADIT (that is, excess ADIT not related to accelerated depreciation). It is not uncommon to see flowback periods for unprotected excess ADIT that range from as little as one to as many as ten years. The appropriate flowback period for unprotected excess ADIT will vary depending on several considerations, including:

- Impacts on public utility cash flow. Depending on the amount of excess ADIT to be flowed-back, a highly accelerated flowback could, in theory, impact a public utility's cash flow to the point of adversely affecting its credit rating.

- Temporal inequity. Depriving customers of the return of excess ADIT for an unduly lengthy period would create temporal inequities; due to normal turnover in the retail customer base, the customers that enjoy the benefits of flowback may not be the same as those who originally paid in the

[6] The Commission recognizes that the flowback of excess ADIT will be accomplished through an adjustment to the tax allowance or expense included in cost of service rates. *See* NOI at P 17.

excess tax reserves. While that mismatch is unavoidable in some degree, the inequity would grow over time if the flowback of unprotected excess ADIT is unnecessarily stretched out.

- Rate volatility. The flowback of excess ADIT can give rise to rate volatility that is disruptive to customers. As an example, assume that all unprotected excess ADIT were flowed back in a single year. In year 1, customers would see a significant reduction in rates (all other factors held constant) due to the flowback. In year 2, however, rates would swing upward due to the dual effect of cessation of the flowback and elimination of the previously available rate base offset. This level of rate volatility could create cash flow or other problems for customers.

The process of determining a just and reasonable flowback period for unprotected excess ADIT requires a careful balancing of these factors in light of the circumstances of each public utility and its customers. This determination, of necessity, will be a case-by-case process. A public utility and its customers should be afforded an opportunity to negotiate the flowback period following the utility's required TISC filing described above.[7] The Commission should step in and develop the necessary factual record to establish a just and reasonable flowback period if those negotiations are not successful. Special care should be taken in that circumstance to avoid the inequity that would result from unduly delaying the return to customers of funds they have provided to utilities to meet greater future tax liabilities than the utilities actually will incur.

In any event, regardless of the amortization period that ultimately is adopted for flowing back unprotected excess ADIT, the unamortized portion of the reserve must continue to operate as an offset to rate base. This is necessary so that customers are appropriately compensated for their contribution of cost-free capital for a public utility's use. See *Midcontinent Independent*

[7] The Commission should also encourage public utilities to discuss their TCJA compliance plans with affected customers prior to submitting their TISC filings to the Commission. Such discussions could include sharing of relevant supporting information and responding to reasonable information requests from customers and other interested parties.

System Operator, Inc., 163 FERC ¶ 61,061, P 3 (2018) ("Because the … balance in an ADIT account effectively provides the company with cost-free capital, the Commission generally requires companies to subtract the ADIT from rate base, thereby reducing customer charges."). Failure to treat the excess tax reserve in a manner which provides that compensation to customers would confer an undeserved windfall on the public utilities holding such reserves.

4. Assets Sold or Retired after December 31, 2017

The NOI points out that, under the Commission's accounting requirements, when assets are sold or retired the original cost and accumulated depreciation of those assets are removed from a public utility's books. Likewise, in those circumstances, any ADIT balance associated with the sold or retired asset is removed from the public utility's books because any previously deferred taxes would become payable to the IRS, and the deferred tax effects related to the assets would be part of the computation of gains or losses associated with the sale or retirement. *See* NOI at P 20. The Commission requested comment on whether, and if so how, it should address excess ADIT that is removed from the books of public utilities after December 31, 2017, as a result of assets being sold or retired.

In the case of a sale or early retirement of utility assets after December 31, 2017 for which there is an excess unprotected ADIT balance remaining on the books at the time of the transaction, fairness to customers would call for flowing the remaining excess ADIT balance back to the customers as soon as practicable after the sale or early retirement of the asset.[8] If a

[8] APPA and AMP are aware of an IRS Private Letter Ruling which indicates that the IRS's depreciation normalization rules would be violated by a return to ratepayers, after the sale date, of ADIT or excess ADIT attributable to accelerated depreciation on public utility property that is sold. *See* PLR-168537-02 (May 25, 2006). The linchpin of the PLR's reasoning is that methods for determining the permissible flowback period require a "regulatory life," and that "[o]nce the asset is sold, the regulatory life ceases to exist." *Id*. at 9. Even if this reasoning were accepted as to protected excess ADIT, however, it is important to note that the purported "cessation" of the regulatory life (i) could just as easily support the conclusion that any remaining balances may be flowed back in full to customers *simultaneous with the sale* as it would the conclusion that no flowback of any portion of the

[Footnote continued on following page]

utility uses a formula rate, the flowback should occur in the next formula rate update after the event; otherwise, the flowback should be in the form of a lump-sum payment or credit. If the excess ADIT is not flowed back to customers promptly, the utility making the sale or transfer would reap a significant windfall from continued use of the cost-free capital represented by excess ADIT. Making matters worse, in a sale transaction the acquiring utility would have no offsetting ADIT in its rate base related to the purchased or transferred assets, thereby causing an increase in charges attributable to the subject asset.

In the case of an early asset retirement, the excess ADIT related to the asset also should flow back to customers upon or shortly after the retirement rather than being returned over what remains of the expected life of the asset. Although the impact on a public utility's cash flow may be a factor the Commission would wish to consider, in general it should aim to return the excess ADIT to ratepayers as promptly as practicable.

5. Amortization of Excess and Deficient ADIT

The NOI requests comment on two specific questions regarding the amortization of ADIT that is rendered excess or deficient as a consequence of the TCJA. First, the NOI (at P 21) asks how public utilities with stated or formula rates should adjust their income tax allowance such that the allowance would be decreased or increased by the amortization of excess and deficient ADIT. Second, the NOI asks (at P 22) whether a public utility should reflect the amortization on its books by recording a reduction to the regulatory asset or regulatory liability

remaining balances is permissible; and (ii) should have no bearing on the flowback of unprotected excess ADIT balances. To be sure, given the nature of ADIT as customer-contributed capital, it would fly in the face of long-standing Commission policy to allow a public utility to pocket any excess ADIT balances as may exist on the date of sale of a utility asset. In any event, the PLR states that it "is directed only to the taxpayer requesting it" and that it "may not be used or cited as precedent."

account and recording an offsetting entry to Account 407.3 (Regulatory Debits) or Account 407.4 (Regulatory Credits).

Regarding the first inquiry, APPA and AMP believe that many public utilities will need to modify their rate formulas to include a mechanism that will allow for excess ADIT to be flowed back through the federal income tax expense calculation.[9] The Commission has previously approved such mechanisms for the flowback of the excess ADIT balance amortization in formula rates. For example, the Entergy-MISO Attachment O formula rate template includes such a mechanism to flow back excess ADIT balance amortization related to prior changes in the tax rates; that mechanism was approved by the Commission in Docket No. ER15-1436. Public utilities should propose whatever changes in their formula rates may be necessary to effectuate the flowback of excess ADIT in the TCJA compliance "show cause" filings we recommend above.

In more detail, the income tax calculation in formula rates will need to include an adjustment to account for the amortization of excess ADIT balances that is similar to the accepted adjustment for the amortization of Investment Tax Credits. Like the ITC adjustment, the amortization of excess ADIT balances also will need to be grossed up for taxes using the tax gross up factor (1/(1-T)). As APPA and AMP discuss below, it is important that utilities provide supporting documentation that clearly delineates the amortization of any excess ADIT balances separately for the portions that are "protected" and "unprotected" along with the respective

[9] It is not inconceivable that a public utility utilizing a detailed formula rate already will have provision for the flowback of excess ADIT given that the 1986 Tax Reform Act's reduction of the corporate tax rate from 46% to 40% to 34% created a situation similar to that produced by the TCJA's 35%-to-21% reduction. If the mechanism for flowing back excess ADIT created by the 1986 Tax Reform Act is unrestricted by its terms, such a mechanism might accommodate the flowback necessitated by the TCJA's tax rate change without modification. APPA and AMP have not ascertained how prevalent such open-ended flowback mechanisms are in jurisdictional formula rates, but we suspect they are rare.

amortization periods for each. While it is not necessary to separately account for the adjustments related to the protected and unprotected excess ADIT balances amortization within the income tax calculations, it should be fully transparent as to how the amortization amounts were derived, including by providing supporting workpapers for the derivation.

In the case of stated rates, which typically are negotiated on a "black box" basis, it may be difficult to identify the specific income tax components that were used to derive the resulting revenue requirements and stated rates. Depending on information that was publicly available at the time the filing was made, however—including such information as was included as part of the filing—it should be possible to determine the portion of the settled revenue requirement that can reasonably be attributed to income tax expense. From that information, an adjustment to the income tax component then could be derived to account for both the change in the federal income tax rate and the flowback of excess ADIT. Such an adjustment could be reflected either as an adjustment to the stated rate or separately as a rate rider.

As to the second amortization-related question—whether the amortization should be recorded as a reduction to the regulatory asset or regulatory liability account and recorded as an offsetting entry to Account 407.3 (Regulatory Debits) or Account 407.4 (Regulatory Credits)—APPA and AMP offer the following.

From a ratemaking perspective, it would be both appropriate and transparent to record the excess ADIT in the same ADIT accounts (*e.g.*, Accounts 190, 282 and 283) where the original entries for the ADIT assets and ADIT liabilities were established. The balances for excess ADIT would decrease over time as the excess is amortized and flowed back to customers. It would also be appropriate to record the reductions in the regulatory asset in Account 182.3 or regulatory liability in Account 254 to FERC Account 410.1 – Provision for deferred income taxes, utility operating income, or Account 411.1 – Provision for deferred income taxes – Credit, utility operating income.

6. Supporting Worksheets

The NOI (at P 23) seeks comment on whether the Commission should require public utilities to provide to the Commission, on a one-time basis, additional information, such as supporting worksheets, to show the computation of excess or deficient ADIT and the corresponding flowback of excess ADIT to customers or recovery of deficient ADIT from customers. The NOI also seeks specific input on the types of information that should be required.

APPA and AMP urge the Commission to require public utilities to submit detailed supporting information regarding excess or deficient ADIT as part of the mandatory TISC filings described above. This supporting information should not be limited, moreover, to ADIT-related material. Public utilities also should describe, with supporting schedules, any current or projected effects on their books associated with the TCJA's changes to the bonus depreciation provisions of the Tax Code, *see* NOI at PP 26-28, or any other potential rate-related impacts associated with the TCJA. Because there is unlikely to be any "one-size-fits-all" approach to addressing the rate-related impacts of the TCJA on public utilities' ADIT balances, bonus depreciation effects or other TCJA-related rate impacts, tackling these issues will require public utility-specific information that can be evaluated by affected customers and the Commission. Indeed, even if the Commission does not require individual public utility show-cause filings, it is imperative that the Commission at least direct public utilities to submit detailed information concerning the TCJA-related effects on rate inputs to ensure that the Commission and customers have a means to evaluate whether further action is necessary.

As to the specific information that should be provided in TISC filings, public utilities should submit detailed worksheets setting forth the computations of the excess ADIT balances. The information and calculations contained in the worksheets should be in sufficient detail to show the portions of the excess ADIT that are related to (1) Protected – Plant, (2) Unprotected – Plant, and (3) Unprotected – Non-Plant. The worksheets should also show how the amounts are allocated to the various utility functions (*e.g.*, production, transmission, distribution, and general). Further, to the extent that a public utility claims any deficient ADIT, the utility should be required to demonstrate that any deficiencies have not been previously recovered in customer rates.

For public utilities that utilize formula rates for transmission or other services, the utilities also should provide, as a part of their annual updates, calculations showing the excess ADIT amortization amounts that should be flowed-back to customers in the applicable rate period. Given that the amortization amounts that are derived under the ARAM and RSGM/SGM can vary from year to year, public utilities should modify their formula rate protocols or otherwise commit to provide detailed worksheets with their formula rate updates each year setting forth the calculations for that year's annual ADIT amortization amounts. For stated rates, public utilities should explain in the context of their TISC filings how the planned future amortization of ADIT will be addressed.

7. Treatment of ADIT for Partnerships

The Commission requests comment on the treatment of ADIT to the extent that the Commission eliminates the income tax allowance for pass-through entities other than master limited partnerships ("MLPs"). NOI at P 25. APPA/AMP take no position at this time as to whether the Commission should eliminate the income tax allowance for non-MLP pass-through entities. If, however, the Commission were to eliminate the income tax allowance for other pass-through entities, on either a generic or entity-specific basis, these entities should be treated in the same manner as corporations in the flowback of excess ADIT. The books of each pass-through entity should reflect the same treatment and recording of the excess ADIT that is to be flowed-back to the customers. Regardless of whether the entity is a corporation or pass-through entity, that entity's rates should have reflected the deferred income tax reserve and, therefore, the rates should also recognize the impact of the flowback of the excess ADIT reserve and the associated ADIT.

In order to ensure that the Commission and ratepayers have sufficient information to evaluate the potential impact of eliminating the income tax allowance for non-MLP pass-through entities, the Commission should direct each public utility to include in its TISC filing information regarding its form of organization and ownership structure. In particular, the public utility should explain whether it is structured as a pass-through entity and identity its upstream owners, specifying whether such upstream owners are corporations, non-profit entities, individuals, etc.

B. Bonus Depreciation

As the NOI discusses (at PP 26-27), the TCJA adopts significant changes to the existing law on bonus depreciation. The Commission therefore requested (at P 28) comment on whether, and if so how, the Commission should take action to address bonus depreciation-related issues, including what type of action the Commission should take and whom the Commission should target with its action.

As explained above, the Commission should require that each public utility include in its TISC filing an explanation and supporting exhibits showing how the TCJA's changes to the bonus depreciation tax incentive are expected to impact, if at all, the utility's current and future federal income tax expense.

Further, any ADIT related to bonus depreciation taken as of December 31, 2017 should be included and identified in the calculation of the excess ADIT balance as of December 31, 2017. Few, if any public utilities, will be eligible for bonus depreciation after September 27, 2017, according to the TCJA. IRS guidance is pending on whether some utility property that was already under construction prior to September 27, 2017 may still qualify for bonus depreciation for the balance in Construction Work in Progress ("CWIP") as of September 27, 2017, when it is placed into service. Final IRS guidelines will be required on how, or if, bonus depreciation will be applied towards CWIP balance as of September 27, 2017. Until the IRS final guidelines are issued, no bonus depreciation should be assumed to have been allowed for CWIP as of September 27, 2017, when projects are placed into service. IRS guidance provided on April 20, 2018, reflects that all "Electrical energy, water or sewage disposal services, gas or steam through a local distribution system or transportation of gas or steam by pipeline" are not eligible for bonus depreciation. Once the IRS final guidelines are issued, at that time, if such guidance results in additional excess ADIT, then that additional excess ADIT should be included in the unamortized balance of the previously determined excess ADIT. In addition, any resulting excess ADIT should be included in the flowback under the appropriate methodology (*i.e.*, ARAM, RSGM). The Commission should require public utilities to provide all supporting workpapers reflecting the additional excess ADIT related to any bonus depreciation.

C. Additional Inquiries

The NOI poses (at P 29) a somewhat open-ended question about the TCJA's effects on jurisdictional rates: "whether, and if so how, [the Commission] should take further action to address the change in the federal corporate income tax rate." The NOI suggests three areas for comment: (1) whether, in addition to the transmission rates addressed in the concurrently issued show cause orders, there are other jurisdictional transmission rates or non-transmission rates that should be revised to address the change in the federal income tax rate; (2) the effects (if any) of the TCJA on Commission-jurisdictional rates of non-public utilities; and (3) if there are any other effects of the Tax Cuts and Jobs Act, and whether, and if so how, the Commission should address them. APPA/AMP respond as follows.

1. Other Jurisdictional Rates

There are numerous jurisdictional cost-based public utility rates, such as ancillary services rates, that could be impacted by the reduction in the corporate income tax rate and other changes made in the TCJA. As explained above, the Commission should require jurisdictional public utilities to file to adjust each currently-filed cost-based rate to reflect TCJA-related changes or show cause why it should not be required to do so. Absent such a requirement, the TCJA changes could result in a windfall to public utilities at the expense of consumers.

Among the most notable cost-based rates that have not yet been addressed by the Commission's actions in response to the TCJA are the rates for reactive power service under Schedule 2 of the open access transmission tariffs. There are dozens, perhaps hundreds, of reactive power revenue requirements for taxable entities on file at the Commission. Most of these filings are in MISO and PJM, and virtually none of the reactive revenue requirement filings that have been approved or accepted by the Commission are formula based. Those filings generally include an annual fixed charge rate applied to the supplier's investment in the reactive equipment to determine the annual reactive revenue requirements which includes an income tax component for taxable entities. Generators in MISO and PJM, for example, are paid for reactive service based on a reactive investment cost of service method of determining annual reactive revenue requirements. For taxable entities that own generation, a federal tax rate of 35% has been embedded in reactive cost of service studies for years. While some public utilities have made filings at the Commission to adjust the reactive rates to reflect the new 21% corporate tax rate, the Commission should act to ensure that these cost-based rates are adjusted promptly, particularly since the impact of the tax rate change can be significant. AMP and APPA are aware of recent filings where the reduction in the corporate income tax reduces filed reactive revenue requirements on average by approximately 6.2%.[10]

AMP and APPA estimate that the total amount of reactive revenue requirements in PJM and MISO alone that are currently being charged under OATT Schedule 2 are as shown below:

PJM: approximately $325,000,000
MISO: approximately $174,000,000

Thus, just in PJM and MISO there is approximately $500 million in reactive revenue requirements currently in effect. Not all these reactive revenue requirements are related to taxable entities, but the vast majority of them are. Conservatively assuming three-quarters of the $500 million total as a proxy for the amount charged by taxable entities (or $375 million)

10

Applicant	Generator	Docket	Rev. Req. at 35% FIT	Rev. Req.at 21% FIT	Difference ($)	Difference (%)
Doswell LP	Doswell	ER17-1743	$3,932,830	$3,653,414	$279,416	7.1%
Entergy New Orleans	Union Power 1	ER17-1730	$1,723,219	$1,610,217	$113,002	6.6%
Entergy Arkansas	Union Power 2	ER17-1730	$1,780,766	$1,687,474	$93,292	5.2%
Entergy Louisiana	Union Power 3 & 4	ER17-1730	$2,492,098	$2,311,421	$180,677	7.2%
Panda Stonewall LLC	Panda Stonewall	ER17-1821	$6,186,617	$5,860,488	$326,129	5.3%
					Weighted Average Reduction	**6.2%**

suggests that those revenue requirements are now overstated and being over-collected by at least $23.3 million on an annual basis based on the 6.2% average reduction discussed above (*i.e.*, 6.2% of $375 million).

The Commission and customers must have an opportunity to evaluate such potential cost reductions on an individual utility basis, and, accordingly, the Commission should require public utilities to submit show cause filings for all their cost-based rates, whether formula or stated.

2. Jurisdictional Rates of Non-Public Utilities

The NOI requests comment "on effects of the Tax Cuts and Jobs Act on Commission-jurisdictional rates of non-public utilities." NOI at P 29. The Commission presumably is referring to the fact that the transmission revenue requirements of some non-public utilities are included in jurisdictional RTO and ISO transmission rates. Non-public utilities, such as public power and cooperative utilities, generally are exempt from federal, state, and local income tax. And as far as APPA and AMP are aware, the revenue requirements for non-public utilities recovered in FERC-jurisdictional rates do not include income tax expense, nor do these non-public utilities generate ADIT. Thus, the TCJA should have no effect on the revenue requirements of tax-exempt entities. Accordingly, the Commission should not take any action with respect to the non-public utility revenue requirements included in jurisdictional rates in the wake of the TCJA. In particular, the Commission should not require non-public utilities to make any TISC, informational, or other filings regarding the impact of the TCJA on their revenue requirements. There simply is no need for such filings.

3. Other TCJA Effects

AMP and APPA have identified the following additional issues relating to the TCJA's impact on FERC-jurisdictional rates that the Commission should address.

Tax gross-ups - There are certain instances where the Commission requires utilities to establish regulatory assets or regulatory liabilities that are recoverable in utility rates. Commission-authorized regulatory assets or liabilities that were established prior to the enactment of the TCJA may include an income tax gross-up that is based on the prior federal income tax rate of 35%. The income tax gross-up for such regulatory assets or liabilities will need to be adjusted to reflect the TCJA's federal income tax rate of 21%, rather than the pre-existing 35% federal income tax rate. In addition, to the extent there are any other cost of service components (*e.g.*, contribution in aid of construction) that include an income tax gross up based on the prior income tax factor of 35%, those cost of service components should also need to be adjusted to reflect an income tax gross up based on the now effective 21% federal income tax rate. As part of the individual show cause filings, the Commission should direct public utilities to identify any such tax gross-up effects included in FERC-jurisdictional cost-based rates and quantify the cost impact that would result from applying the reduced 21% federal corporate income tax rate.

Effects of other income tax rates on FERC-jurisdictional rates – In adjusting Commission-jurisdictional rates to address the change in the federal income tax rate and the associated impacts on ADIT, the Commission should consider directing public utilities to propose any formula rate modifications necessary to accommodate changes in state, local, and state franchise income tax rates, to the extent there is a component in the FERC jurisdictional rates that account for those other income taxes. For example, if a state income tax rate is lowered, it could potentially result in excess ADIT just like in the case of the reduced federal income tax rate. FERC-jurisdictional rates that include a component for the recovery of state income taxes should also be adjusted for any excess or deficient ADIT that result from changes in the state income tax rates.

III. CONCLUSION

WHEREFORE, AMP and APPA request that the Commission consider the foregoing comments and give effect to the above-stated recommendations in its deliberations in this proceeding.

Respectfully submitted,

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May 21, 2018

CERTIFICATE OF SERVICE

I hereby certify that I have on this date caused a copy of the foregoing document to be served on each person included on the official service list maintained for this proceeding by the Commission's Secretary, by electronic mail or such other means as a party may have requested, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010.

Dated this the 21st day of May, 2018 at Washington, D.C.

/s/ Anna Williamson
Anna Williamson
Administrative Legal Assistant