Exh. RF-1T
Docket UE-19____
Witness: Ryan Fuller

BEFORE THE WASHINGTON

UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PACIFICORP dba PACIFIC POWER & LIGHT COMPANY Respondent.	Docket UE-19____

PACIFICORP

DIRECT TESTIMONY OF RYAN FULLER

December 2019

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ATTACHED EXHIBITS

Q. Please state your name, business address and present position with PacifiCorp.

A. My name is Ryan Fuller and my business address is 825 NE Multnomah Street, Suite 1900, Portland, Oregon 97232. My present position is Senior Tax Director. I am testifying for PacifiCorp dba Pacific Power & Light Company (PacifiCorp or the Company).

QUALIFICATIONS

Q. Please describe your education and professional background.

A. I graduated from the University of Idaho in 1997 with a Bachelor of Science Degree in Accounting. I am a licensed CPA. Before joining the PacifiCorp tax department in 2003, I worked in public accounting for six years, first with Talbot, Korvola and Warwick LLP and then for PricewaterhouseCoopers LLP. From November 2016 through May 2018, I was employed as a Tax Director for Avangrid Renewables, LLC, before rejoining PacifiCorp as Senior Tax Director in May 2018.

Q. What are your responsibilities as Senior Tax Director?

A. I am responsible for management and oversight of the Company's tax function.

Q. Have you testified in previous regulatory proceedings?

A. Yes. I have testified in regulatory proceedings in each of the Company's six state jurisdictions on various tax related matters.

PURPOSE AND SUMMARY

Q. What is the purpose of your direct testimony?

A. My direct testimony addresses the calculation of the income tax portion of the Washington-allocated revenue requirement requested in this case. More specifically:

- I discuss how the benefits from the Tax Cuts and Jobs Act (TCJA) will be implemented in rates.
- I provide testimony on the Company's use of the Reverse South Georgia Method (RSGM) to amortize the TCJA Excess Deferred Income Tax (EDIT), retroactively to January 1, 2018.
- I request approval of the Company's use of a normalized method of accounting for all *property-related* book-tax differences, with the single exception of equity Allowance for Funds Used During Construction (AFUDC) on a prospective basis beginning January 1, 2021.
- Separately, I recommend approval of the use of a normalized method of accounting for all *non-property* book-tax differences on a prospective basis beginning January 1, 2021.
- Finally, I provide testimony on the exclusion of state income taxes from rates under the Washington Inter-Jurisdictional Allocation Method (WIJAM).

IMPLEMENTATION OF TCJA TAX BENEFITS IN RATES

Q. How does the Company propose to include the benefits of the TCJA's lower tax rate in this proceeding?

A. The Company will include the tax benefits by: (1) embedding the lower tax rate in base rates, (2) including a rate base deduction for unamortized protected EDIT and lowering income tax expense for the annual level of amortization, and (3) as discussed in the testimony of Ms. Shelley E. McCoy, returning the tax benefits deferred between January 1, 2018, and December 31, 2020, to customers.

Q. Is this consistent with the Order 01 from the Company's petition for an accounting order regarding the TCJA in docket UE-171219?

A. Yes. In docket UE-171219, the Company filed a petition requesting that the Commission authorize the refund to customers of the immediate impact associated with the lower corporate income tax rate through a newly proposed tariff (Schedule 197). In addition, the Company requested authority to continue deferring EDIT until this general rate case filing where it could potentially be used to offset other cost increases in this general rate case, including changes in depreciation expense.[1]

Q. Did the Commission grant the Company's petition to refund the immediate impacts of the TCJA to customers and for an accounting order?

A. Yes. With respect to the current tax benefit the Commission concluded that it "agree[d] with Staff that Pacific Power's proposed mechanism is a reasonable way to timely return the benefits of the lower tax rate to customers outside of a general rate case."[2] And, with respect to EDIT, the Commission concluded that it "agree[d] with Staff that the Company's proposal to continue deferring EDIT is reasonable, and that outstanding EDIT balances can be most comprehensively addressed in the Company's next general rate case. Thus, the Commission found "that the petition for an accounting order is fair and reasonable and should be granted, and that proposed tariff Schedule 197 should be allowed to go into effect by operation of law."[3]

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[1] *In the Matter of the Petition of Pac. Power & Light Co., Petitioner, For an Accounting Order Regarding the Tax Cuts and Jobs Act (TCJA)*, Docket No. UE-171219, Order 01, ¶ 12 (Dec. 28, 2018).
[2] *Id*. The approved mechanism is a separate tariff rider applied on a rolling basis until the lower tax rate is built into base rates (*i.e.*, 2018 current tax benefits are refunded to customers in 2019).
[3] *Id*.

Q. Please quantify the TCJA balances that will be refunded to customers.

A. As presented in Exhibit No. RF-2, the total amount of deferred TCJA tax benefits projected as of December 31, 2020, is approximately $50.6 million, consisting of the deferral of current tax benefits for the calendar year ending December 31, 2020, of approximately $9.5 million, including interest, and non-protected EDIT of approximately $41.1 million, including deferred amortization of protected EDIT that has occurred during 2018 and that is projected to occur during 2019 and 2020. The Company proposal to return this balance to customers is explained in the direct testimony of Ms. McCoy.

Q. Are the deferred EDIT balances in Exhibit No. RF-2 consistent with the balances provided in by the Company in docket UE-171219?

A. Generally, yes, but there are three changes. First, the Company originally contemplated amortizing all property-related EDIT, protected and non-protected, using the Average Rate Assumption Method (ARAM). However, the Company has since extracted non-protected property EDIT from its tax fixed asset system so that it can now be returned to customers over a period of time approved by the Commission. Second, while total EDIT has not changed, there has been a small correction in classification between protected and non-protected since the balances presented in docket UE-171219. The misclassification was identified during the process of extracting the non-protected property EDIT balances from the Company's tax fixed asset system. Please see Exhibit No. RF-3 for a summary of the change. Third, PacifiCorp will be using the RSGM to amortize protected EDIT because its books and underlying records do not contain the necessary vintage account data to use the ARAM.

THE REVERSE SOUTH GEORGIA METHOD

Q. Please explain why PacifiCorp's books and underlying records do not contain the necessary vintage account data to use the ARAM.

A. The underlying reason is situs book depreciation on system-allocated assets. PacifiCorp depreciates system-allocated assets using a base composite life; this base level of book depreciation is system-allocated. An incremental amount of book depreciation is calculated for jurisdictions that approve a composite life different from the base or otherwise approve accelerated book depreciation for system-allocated assets; this incremental amount of book depreciation is situs allocated.

Book depreciation is required at a jurisdictional level by vintage and tax class to have the necessary vintage account data to utilize the ARAM. Because it is not maintained at this level for book accounting purposes, PacifiCorp relies on its tax fixed asset system to produce the necessary vintage account data for tax purposes by performing a procedure to allocate book depreciation.

As presently configured, the book depreciation allocation procedure cannot process situs book depreciation on system-allocated assets in a manner that impacts only the vintage account data of the respective jurisdiction with the situs book depreciation. As a result, the situs book depreciation must be accounted for separately as a tax class of its own, thereby rendering the jurisdictional vintage account data to which the EDIT is actually attached incomplete for the purposes of using the ARAM.

Q. How are the issues with situs book depreciation addressed by the RSGM?

A. Unlike the ARAM, book depreciation is not required at the jurisdictional level by vintage and tax class for the amortization of EDIT when using the RSGM. The RSGM requires only the use of a remaining regulatory life for an asset or group of assets to amortize the EDIT straight line.

To implement the RSGM, the Company categorized Washington-allocated protected EDIT at the level of detail presented in our most recently filed depreciation study.[4] The protected EDIT is then amortized straight-line over Washington's approved remaining regulatory life for each respective asset or group of assets. For tax years 2018 to 2020, the remaining lives are based on Washington's most recently approved depreciation study.[5] Beginning in 2021, the remaining lives will be updated to match those approved in the presently pending depreciation study and then again for each depreciation study approved thereafter. If the Commission approves regulatory lives different from those proposed by the Company in this case and the ongoing depreciation study, the protected EDIT amortization included in this general rate case will need to be updated accordingly. Please see Exhibit No. RF-4 for the annual amortization of protected EDIT using the RSGM.

Q. Do PacifiCorp's facts meet the statutory requirements for using the RSGM?

A. Although there are uncertainties with respect to the proper application of section 13001(d) of the TCJA, the Company has carefully considered this matter and, based

[4] *See In the Matter of the Petition of Pac. Power & Light Co. for an Order Approving a Change in Depreciation Rates Applicable to Electric Property*, Docket No. UE-180778, Petition (Sept. 13, 2018).

[5] *See In the Matter of the Petition of Pac. Power & Light Co. for an Accounting Order Authorizing a Revision to Depreciation Rates*, Docket No. UE-130052, Order 01 (Dec. 27, 2013).

on our facts and circumstances, have concluded that PacifiCorp's use of the RSGM is permitted as a normalization method of accounting.

Q. Does the Internal Revenue Service (IRS) recognize the need for clarity with regard to the EDIT normalization requirements in light of the TCJA?

A. Yes. In Notice 2019-33, the IRS announced its intent to issue guidance to clarify the EDIT normalization requirements, which may include guidance on the use of the RSGM; the Company anticipates this guidance will be issued in 2020. In comments submitted in response to Notice 2019-33, the Edison Electric Institute has requested that the IRS issue transitional guidance that allows taxpayers to correct potential normalization violations on a prospective basis and that the violations be forgiven without penalty. If uncertainties still exist after the guidance is issued, the Company will evaluate the need to file a private letter ruling request.

NORMALIZED METHOD OF ACCOUNTING FOR NON-PROPERTY-RELATED BOOK-TAX DIFFERENCES

Q. Is the Company requesting the Commission's approval of its use of a normalized method of accounting for property-related book tax differences?

A. Yes. Because complete vintage account data is also necessary for flow-through accounting, the Company is requesting the Commission's approval to use a normalized method of accounting for all property-related book-tax differences, with the exception of equity AFUDC, on a prospective basis beginning January 1, 2021.

Q. How will the Company reverse the related pre-TCJA regulatory asset?

A. The Company will amortize the pre-TCJA regulatory asset using the RSGM. Because the majority of regulatory asset is associated with book-tax differences that reverse over the remaining regulatory life of the asset (*i.e.*, book depreciation), use of the RSGM should closely mirror the reversal that would otherwise occur.

Q. Why is the Company proposing to exempt the book-tax difference related to equity AFUDC from its proposal for full normalization?

A. Because equity AFUDC more closely resembles a permanent difference for ratemaking purposes, continued use of flow-through accounting for this book-tax difference is more appropriate than normalization.

Equity AFUDC increases the book basis of assets. It originates as book income and reverses as an expense through book depreciation. Over the book life of the related asset, equity AFUDC has no net impact on book income. Equity AFUDC also has no impact on taxable income because the income created by equity AFUDC is never taxable and the book depreciation attributable to equity AFUDC is never deductible for income tax purposes. Items of book income or expense that are never taxable or never deductible for income tax purposes are typically considered permanent book-tax differences for income tax accounting purposes. Permanent book-tax differences do not generate deferred income tax expense because there is no corresponding future event that will generate a tax receivable or payable on an income tax return.

However, because of the unique "in-and-out" aspect of equity AFUDC for book purposes, accounting guidance recommends that equity AFUDC be tracked as a temporary book-tax difference for income tax accounting purposes. Equity AFUDC is a temporary book-tax difference in the sense that it ultimately has the same impact on book income and taxable income – zero. For income tax accounting purposes, the temporary book-tax difference for equity AFUDC generates deferred income tax liability upon origination, with a corresponding debit to deferred income tax expense. As the temporary book-tax difference reverses over the book life of the related asset, the income tax accounting entry is to debit the deferred income tax liability and credit deferred income tax expense until the deferred income tax liability is brought down to zero.

Accordingly, because deferred income taxes are included in revenue requirement for normalized book-tax differences, normalization of this item in rates effectively results in a loan to the company from customers that is returned over time, with interest. Under flow-through accounting, the deferred income taxes generated by equity AFUDC never impact revenue requirement, which is appropriate since there is no corresponding income tax payable or receivable.

Q. Does the Company's request here address the issues that were raised by the Commission when it rejected the company's earlier request to use normalization accounting in its 2010 general rate case, docket UE-100749 (2010 Rate Case)?

A. Yes. In the 2010 Rate Case, the Company requested full normalization for policy reasons, noting that normalization is consistent with the matching principle and intergenerational equity.[6] In response to these policy arguments, the Commission observed that a "decision to allow full normalization is a significant policy decision" because the Commission has used flow-through accounting "since liberalized depreciation was first introduced into tax law."[7] Therefore, the Commission "must carefully evaluate the merits of this proposed policy change and first decide if there is

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[6] *WUTC v. Pac. Power & Light Co*., Docket No. UE-100749, Order 06, ¶ 266 (Mar. 25, 2011).
[7] *Id.* at ¶ 277.

ample evidence in the record to demonstrate that it will not harm ratepayers and not generate unwarranted revenue for the Company."[8]

Here, the Company's proposal is not based on a policy argument. Instead, the Company's request is based on accounting considerations in response to a system limitation. The Company simply cannot continue to use flow-through accounting for property-related book-tax differences due to software limitations and the complexities resulting from different states, including Washington, pursuing different policy objectives related to the depreciable lives of the Company's assets.

NORMALIZED METHOD OF ACCOUNTING FOR PROPERTY-RELATED BOOK-TAX DIFFERENCES

Q. Is the Company requesting the Commission's approval to use a normalized method of accounting for non-property book tax differences?

A. Yes. The Company proposes to use a normalized method of accounting for all non-property book-tax differences on a prospective basis beginning January 1, 2021. As calculated in Exhibit No. RF-5, using a normalized method of accounting for property-related book-tax differences increases revenue requirement by $778,971. Accordingly, the Company is also requesting a normalized method of accounting for non-property book-tax differences because doing so has an offsetting impact, reducing revenue requirement by $817,098 for a net overall decrease to revenue requirement of $38,127. This is similar to the projected impact in the 2010 Rate Case, where the proposed normalization of property-related book-tax differences would have increased revenue requirement by $753,467, and the proposed normalization of non-property book-tax differences would have reduced revenue

[8] *Id*.

requirement by $759,433, for a net overall decrease to revenue requirement of $5,966.

Q. In the 2010 Rate Case, Staff was concerned that if the Commission allowed PacifiCorp to use normalized accounting, it would necessarily need to do so for all companies.[9] How do you respond to this concern?

A. The Company is differently situated than other utilities in Washington, and, therefore, approving its request here is not precedential for other companies. As noted above, the Company's need for normalized accounting stems directly from the fact that each state, including Washington, has independent regulatory authority to advance state-specific energy policy, such as state-specific depreciation schedules for the Company's coal plants. As a consequence of diverging state-specific policies, the Company's accounting system simply cannot support continued flow-through accounting and normalized accounting is now necessary.

STATE INCOME TAX

Q. Are there any other tax specific matters the company would like to address in this proceeding?

A. Yes. Under the WIJAM, state income taxes are situs allocated. Because Washington does not have a state income tax, no state income taxes should be included in the Company's Washington revenue requirement calculations. This is the same as the treatment of state income tax under the West Control Area Inter-Jurisdictional Allocation Methodology (WCA).

[9] *Id*. at ¶ 268.

Q. How have state income taxes been treated since the adoption of the WCA in the Company's 2006 general rate case, docket UE-061546 (2006 Rate Case)?

A. Including the 2006 Rate Case, the Company has filed seven general rate cases and one limited-issue rate case since the adoption of the WCA. As illustrated in Exhibit No. RF-6, current income tax expense has excluded state income tax in all eight filings, but deferred income tax expense included state income tax through the Company's 2009 general rate case, docket UE-090205, and accumulated deferred income tax has included state income tax in all eight filings.

Q. How have state income taxes been treated in this proceeding?

A. As presented in adjustment 7.6, in this filing, the Company has excluded state income tax from all elements of the revenue requirement calculations, consistent with the intent of the WCA and the WIJAM.

Q. Does this conclude your direct testimony?

A. Yes.