Service Date: January 26, 2018

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. AVISTA CORPORATION d/b/a AVISTA UTILITIES Respondent.	)	DOCKETS UE-170485 and UG-170486 (*Consolidated*) **INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES' AND NORTHWEST INDUSTRIAL GAS USERS' RESPONSE TO BENCH REQUEST NO. 1**

1. The Industrial Customers of Northwest Utilities ("ICNU") and the Northwest Industrial Customers ("NWIGU"), collectively the "Joint Parties," appreciate this opportunity to respond to Bench Request 1 in the above-captioned matter. The Tax Cuts and Jobs Act ("TCJA"), HR 1 of the 115th Congress, was signed into law on December 22, 2017. The TCJA became effective on January 1, 2018, and provides benefits to Avista Corporation ("Avista or Company") and its ratepayers.

2. Among other things, the TCJA resulted in a reduction to the Federal corporate income tax rate from 35% to 21%. The Joint Parties respectfully request that the Commission act without delay to incorporate the impact of that, and other changes resulting from the TCJA, into the base rates for both the gas and electric services at issue in this proceeding. The Joint Parties look forward to the hearing on this matter, at a date to be determined by the Commission.

RESPONSE

I. Introduction

3. The Joint Parties' response to Bench Request 1 is based upon the analysis performed by Mr. Bradley G. Mullins, who has reviewed the TCJA and its impact upon Avista's

rates at issue in this proceeding.[1] Based upon Mr. Mullins' analysis, the Joint Parties represent to the Commission that the impact of the TCJA will reduce Avista's revenue requirement for its electric and gas utilities by $32,594,466 and $5,489,628, respectively, shown in Table 1, below. Mr. Mullins' revenue requirement calculations, spreadsheets and workpapers are provided with this Response and identified as part of and relevant to the various subparts of Bench Request 1.

Table 1
Revenue Requirement Impacts of Implementing the
TCJA on Avista's Revenue Requirement
Revenue Deficiency / (Sufficiency) ($000)

	Electric	Gas
Mullins Response Testimony (Traditional)	**193**	**(530)**
Impact of TCJA Restating Adjustments		
TCJA-1: Restate Income Tax Expense	(26,263)	(4,213)
TCJA-2: Restate EDFIT	(6,297)	(1,370)
TCJA-3: TCJA Deferral (1/1/18 - 4/30/18)*	-	-
TCJA-4: Conversion Factor	(35)	94
Total TCJA Adjustments	**(32,594)**	**(5,490)**
Updated For TCJA	**(32,401)**	**(6,020)**

** Propose to delay amortization until rate effective date of next rate case*

4. In hearings held in this matter on January 16, 2018 and January 17, 2018, the Commission requested parties to address, in response to Bench Request 1, the process by which the impacts of the TCJA would be incorporated into Avista's rates. For the reasons expressed in this response, the Joint Parties request the Commission incorporate the known impacts of the TCJA into the revenue requirement results used to establish base rates in this docket.

[1] Mr. Mullins appeared on behalf of the Joint Parties in this proceeding and presented testimony on Avista's revenue requirement for both the electric and gas utilities, among other issues.

II. TCJA Benefits Should Be Incorporated into Rates in This Docket

5. As a general matter, the Joint Parties believe that the base rate reduction associated with the TCJA should occur in a manner that is as expedient as possible for all utilities. There should be no disagreement that an expedient decision by the Commission to pass back to consumers one hundred percent of the tax benefits associated with the TCJA would serve the public interest.

6. Turning to the evidence presented in this docket, it is a known fact and a matter of record that the TCJA has significantly reduced the corporate taxes to be paid by Avista during the rate year and beyond, and for the period beginning January 1, 2018 and ending upon issuance of the Commission's final order in this docket. The Commission has also been informed that the monetary impact of Avista's reduced tax rates is significant and can be effectively measured. It is also a matter of record that the Company intends to pass the benefits associated with the reduced tax rates to its ratepayers.[2/]

7. The Joint Parties believe that the existing record, supplemented by this response and those submitted by the parties to this case, provides the Commission the evidence necessary to incorporate the TCJA's demonstrated tax benefits into the rates set in this docket.

8. Should the Commission determine that the record is insufficient to support all of the TCJA's many rate impacts, the Joint Parties recommend that the Commission include the TCJA's known tax benefits into rates, subject to refund. Under this scenario, the rates set and subject to refund could be trued up at the end of a specified period determined by the Commission as sufficient to ascertain all rate benefits resulting from the TCJA. To this end, the

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[2/] Avista Response to BR 1, dated January 12, 2018.

Commission could consolidate Avista's current deferred accounting docket related to the TCJA with this docket, using the deferred accounting dockets as the procedural vehicle for preserving the TCJA's benefits for later incorporation into rates.[3/] Accordingly, the Joint Parties do not recommend additional process at this time for the purpose of ascertaining the impacts of the TCJA, beyond that already in place.

9. Further, any delay in reducing Avista's base rates will result in the accrual of larger deferred accounts, which may cause rate instability over time. For example, rates might decline in the period that the deferral account is being amortized, only to increase again once the amortization has been completed. Said another way, as the deferrals grow larger, the risk of rate instability grows commensurately. For this reason, the Joint Parties recommend that the base rate reductions associated with the TCJA be implemented in this docket. Nothing should preclude the Commission from acting on the record evidence demonstrating that Avista's existing rates will grossly overcompensate the Company during the rate year, unless the Commission take corrective action.

10. In fact, the Joint Parties believe that it would be inconsistent with the normalization requirements in IRC § 168(i)(9) for the Commission to approve cost of service rates that do not take into consideration the changes resulting from the TCJA. The tax law has changed, and the Commission should guard against approving rates that are inconsistent with the requirements of the law.

11. The Joint Parties have also reviewed Avista's response to Bench Request 1 and strongly disagree that the TCJA's revenue impacts are too complicated to be implemented in

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[3/] See Dockets UE-171221 and UG-171222

rates at this time. In fact, the determination of taxable income did not materially change as a result of the TCJA, and for that reason it is relatively straightforward to consider the TCJA's impacts on revenue requirement. Further, incorporating the impacts through a rider, as Avista proposes, is unnecessary and will only make the implementation of the TCJA more complicated. While riders may be necessary for those utilities that are not currently in rate cases, it is more appropriate to incorporate the impacts into base rates in this matter, since those rates are currently open for Avista.

III. The Commission Should Account for the Reduction in Avista's Tax Rates from January 1, 2018 through April 30, 2018 and Pass the Benefits Through to Ratepayers

12. For the rates charged over the period January 1, 2018 through April 30, 2018, the Joint Parties recommend that the Commission's final order in this matter require the creation of a deferred account to house the excess Federal income taxes that Avista is collecting in current rates. The deferred account need not be incorporated into revenue requirement results in this matter. However, the deferral should remain on the Company's books—subject to carrying charges but no amortization—until the effective date of Avista's next rate proceeding. Under such an approach, Avista would be required to submit an amortization proposal for the deferral at the time of its next general rate case. Once again, no additional process is necessary to implement such a deferral.

IV. Responses to Questions in Bench Request 01

13. Accompanying this response are three attachments. Attachment Bench Request 01-1 provides revenue requirement calculations for electric services updated for the TCJA. Attachment Bench Request 01-2 provides revenue requirement calculations for gas services

updated for the TCJA. These attachments are based on the revenue requirement calculations admitted as Exhibits BGM-3 and BGM-4, respectively. Finally, in Attachment Bench Request 01-3, the Joint Parties have supplied the currently approved depreciation rates, which are relevant in calculating Excess Deferred Federal Income Tax ("EDFIT") amortization. The Joint Parties' witness Bradley Mullins will be available to answer any questions related to these attachments should the Commission require further process. Further information regarding these calculations items will also be discussed below in response to the specific questions identified in Bench Request 1.

A. Accumulated Deferred Federal Income Tax (ADFIT) balance as of December 31, 2017.

14. The Joint Parties are not in possession of the requested information. For purposes of calculating the revenue requirement impacts associated with excess deferred income taxes identified in Table 1, above, the Joint Parties relied on the ADFIT reserve balances, calculated on an average-of-monthly-averages basis over the 2016 test year. The ADFIT reserve balance for Avista is expected to be greater on December 31, 2017 than it was in the test period.[4/] Since a larger reserve would equate to greater amortization of EDFIT, use of the December 31, 2017 reserve balance would result in further reductions to revenue requirement, in comparison to the impacts detailed in Table 1, above.

15. The Company was in possession of this financial information at the time it responded to the Bench Request but did not provide the information in its response on January 12, 2018. That is concerning to the Joint Parties, since that information is necessary to support

[4/] See Exh. BGM-5r at 26.

further reductions of revenue requirement. Notwithstanding, the Joint Parties are not opposed to using the test period reserve balances, rather than the December 31, 2017 reserve balances, for the purpose of calculating EDFIT impacts. Because the amortization period for EDFIT is relatively long, the incremental revenue requirement impact of using the December 31, 2017 reserve balance, versus the test period reserve balance, is expected to be small.

B. The amount of excess deferred income tax reserve as described in IRC Sec 168(i)(9)(A)(ii) as of December 31, 2017, to comply with the TCJA.

16. For electric services, calculation of EDFIT reserve balances, and EDFIT amortization for the test period may be found in Attachment Bench Request 01-1, Page 17 (Tab 6a). For gas services, the calculation may be found in Attachment Bench Request 01-2, Page 14 (Tab 6a). The workpapers begin with the ADFIT reserve balances restated on an AMA basis over the test period. The source data behind the restated balances has also been provided on the following pages of the respective attachments (Tab 6b). The ADFIT amounts have been itemized by each “book-tax differences” included in ADFIT in Avista’s filing, with amounts related to depreciation detailed by functional plant. Based on this detail, it’s clear that Avista has a relatively narrow scope of book tax differences that it includes in ADFIT.

17. To calculate the EDFIT reserve balance associated with the tax rate change, one must divide the test period reserve balances by the old, 35% tax rate to arrive at the cumulative amount of book tax differences in the test period. The cumulative book-tax differences are then revalued at the new, 21% tax rate. The difference between ADFIT reserves valued at the 35% and ADFIT reserves valued at the 21% rate represents the EDFIT reserve balance.

18. Based on the calculations identified in the respective attachments, the Joint Parties have calculated EDFIT reserve balances of $142,051,361 for gas services and $30,713,275 for

electric services. In rate base, the Joint Parties have reclassified the EDFIT reserves from ADFIT, detailing the EDFIT reserve balance in a separate line item in the revenue requirement table.

19. In contrast to Avista, the Joint Parties do not consider the normalization provisions in the TCJA surrounding EDFIT as complications, but rather a way of simplifying the ratemaking treatment of the tax change for public utilities. EDFIT effectively represents a financial gain to the utility, and absent the TCJA provisions surrounding EDFIT, a utility might have claimed that it was entitled to retain those benefits. Or, perhaps ratepayers might have claimed that they should receive those gains through a single lump-sum payment. From that perspective, however, the TCJA actually simplifies the ratemaking treatment surrounding the tax changes by prescribing the specific methods that must be used by regulators to account for the EDFIT benefits, avoiding controversy over the way that those amounts get retuned to ratepayers.

20. Under Generally Accepted Accounting Principles, the general rule is that when a change in the tax rate is enacted into law, the effects of the change must be reported in the period that includes the "enactment date."[5/] The normalization requirements for EDFIT in IRC § 168(i)(9), however, provide an exception to that general rule for public utilities.

21. For business enterprises other than a public utility, the change in tax rate will result material balance sheet impacts. For a non-utility business enterprise, deferred tax liabilities—funds that the entity is effectively holding in reserve to pay for future taxes—are revalued at the new tax rate. If the tax rate falls, the liability balance declines resulting in the

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5/ See Financial Accounting Standards Board ("FASB"), Statement of Financial Accounting Standards No. ("SFAS") 109, Accounting for Income Taxes ¶ 27; See also FASB Accounting Standards Codification ("ACS") 740-25-47.

recognition of a gain, similar to the gain that occurs when the principal balance of a loan is forgiven. For non-utilities, this gain flows through the income statement in the current period, in one lump sum.

22. For public utilities, however, the treatment is different. Under normalization requirements IRC § 168(i)(9), the balance sheet gains associated with the change in tax rate, referred to as EDFIT, must remain on the public utility's balance sheet, and instead of amortizing the gains in one lump sum, the gains are amortized to the income statement over an extended period of time. A few methods are available to amortize the gains, but the amortization period is generally intended to correspond to the period over which the underlying book-tax differences are expected to reverse. Accordingly, the Joint Parties view it as being relatively straightforward to incorporate the impacts of EDFIT into rates in this matter.

C. The amount of excess deferred income tax expense the Company is currently collecting as of January 1, 2018, until the anticipated effective date of this general rate case.

23. The Joint Parties have calculated that the Company will over-collect income tax expense, including a provision for EDFIT, by $7,140,214 for electric services and $652,948 for gas services. Calculations underlying these amounts have been provided at Attachment Bench Request 01-1, Pages 19-20, for electric services and Attachment Bench Request 01-2, Pages 16-17, for gas services. As noted above, the Joint Parties request that these tax benefits remain on the Company's books as a deferral until the Company files its next general rate case, the rate effective date of which will commence amortization of the deferral.

D. A proposed amortization schedule for parts B and C of this bench request along with a supporting rationale for each schedule. Please identify and describe the amortization assumption, e.g., composite, average rate, or other alternative method.

24. Under IRC § 168(i)(9) two general methods are described to account for EDFIT: 1) the average rate assumption method and 2) the alternative method. The general rule is that a utility may not "reduce[] the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method," and thus the average rate assumption method generally must be used. As an exception to the general rule, however, a utility may use the alternative method, if it does not track ADFIT by asset vintage. Since, as a practical matter, most utilities do not calculate the ADFIT reserves by asset vintage, most will likely resort to using some form the alternative method.

25. Under the alternative method, EDFIT amortization may occur using composite depreciation rates, which is the method used by the Joint Parties in deriving the impacts detailed in Table 1, above. For electric services, see Attachment Bench Request 01-1, Page 17 (Tab 6a). For gas services, see Attachment Bench Request 01-2, Page 14 (Tab 6a). In addition, the composite depreciation rates relied upon in performing the calculation have also been attached as Attachment Bench Request 01-3.

26. As described in the attachments, the amortization associated with the EDFIT balances identified in response to Sub-request C of this response is $4,890,642 for electric services and $1,066,222 for gas services. That amortization is stated post-tax, and thus, the pre-tax revenue requirement impacts of that amortization must further grossed up for taxes, at the new 21% rate.

E. For the current proceeding, provide an updated revenue requirement based on the Company's rebuttal position that accounts for the anticipated impacts of the TCJA.

27. Please see Attachment Bench Request 01-1 for updated revenue requirements calculated for electric services and Attachment Bench Request 01-2 for updated revenue requirements calculated for gas services. These have been prepared based on the revenue requirements identified in the Response Testimony of Mr. Mullins.

28. The TCJA results in two principal adjustments of the revenue requirement model. First, the income tax expense included in results must be restated at the new tax rate. Second, the gains associated with EDFIT must be applied as a restating adjustment as discussed in response to sub-request D of this bench request. The Joint Parties refer to these restating adjustments as TCJA-1 and TCJA-2, respectively.

29. Two other adjustments, however, have also been identified in the referenced attachments. The attachments include Adjustment TCJA-3, which is a placeholder for the amounts deferred over the period January 1, 2018 through April 30, 2018, in case the Commission decides to incorporate those impacts into rates in this matter. The attachment also includes TCJA-4, which separately documents the impact of updating the revenue conversion factor. The impacts of the new revenue conversation factor, however, could also be applied separately to each restating and pro-forma adjustment included in results, rather than as a discrete adjustment.

TCJA-1: TCJA Restating Adjustment

30. The impact of restating income tax expense at the new 21% tax rate can be determined using one of at least two methods: the tax provision method or the gross-up method.

Both are relatively straightforward. Although performing the calculation using the utility's tax provision is, from the perspective of the Joint Parties, a more accurate methodology.

31. Under the tax provision approach the restating impact of the TCJA tax rate on income tax expense is determined by simply recalculating the tax provision (both current and deferred taxes) based on the new, 21% tax rate. Current tax expense is re-calculated by multiplying net taxable income for the test period by the 21% tax rate, rather than the 35% tax rate previously included in results. Deferred tax expense is also recalculated by multiplying the book-tax differences in the test period by the 21% tax rate, rather than the 35% tax rate that is currently being used to calculate deferred income tax expense in results.

32. This simple tax provision calculation has been detailed on Attachment Bench Request 01-1, Page 12 (Tab 5a), for electric services and Attachment Bench Request 1-2, Page 11, for gas services. For electric services, the tax provision method produces a reduction to income tax expense in the amount of $19,771,262, and a corresponding reduction to revenue requirement in the amount of $26,262,760. For gas services, the tax provision method produces a reduction to income tax expense in the amount of $3,178,212, and a corresponding reduction to revenue requirement in the amount of $4,213,330. These impacts also include the effects on all of the other restating and pro forma adjustments. This is the most accurate, and preferred, methodology for determining the impact of restating the tax rate on revenue requirement.

33. The gross-up method is a higher-level approach that is appropriate to be used if the tax provision data is unavailable. Under this approach the impact of the tax rate change may be estimated based on the utility's level of rate base and cost of capital. Under this method the

"pre-tax" return on equity is used to determine the portion of revenues dedicated to paying federal income taxes, as show in the following formula:

RB * ROE / (1-T) * E% = Revenues for Taxes

Where: RB = Rate Base; ROE = Return on Equity;
T = Marginal Tax Rate, and; E% = Equity %.

34. The above calculation is based on the old 35% tax rate, and then again based on the new 21% tax rate, to estimate the revenue requirement savings associated with the lower rate. This method is less precise that the provision method, since it does not account for the specific permanent and temporary book-tax differences in the test period.

35. A form of the gross-up calculation has been detailed in Attachment Bench Request 01-1, Page 19 (Tab 7a), for electric services and Attachment Bench Request 01-2, Page 16 (Tab 7a), for gas services. While the Joint Parties recommend against using the gross-up method for calculating base rates in this matter, the Joint Parties are supportive of using the gross-up method for the purposes of calculating the deferral associated with excess taxes collected in current rates over the period January 1, 2018 through April 30, 2018. Accordingly, the calculations referenced above were performed based on the current rate levels, as approved in Dockets UE-150204 and UG-1520205 (Consolidated). These calculations suggest that Avista's current rates are resulting in annual overcollection of income tax expenses by approximately $16,530,000 for electric services and $3,025,062 for gas services, on a pre-tax (i.e., revenue requirement) basis. Those amounts do not include the effects of EDFIT, which must be calculated separately.

TCJA-2: Excess Deferred Federal Income Taxes

36. The second restating adjustment to implement the TCJA is to incorporate EDFIT into the revenue requirement calculation. This restating adjustment is accomplished, first, by reclassifying the EDFIT balance out of ADFIT and assigning it a separate line in the revenue requirement table. The balance is then subjected to amortization through net operating income based on the amounts detailed in response to sub-request D, above. To account for the amortization, the EDFIT rate base balance is then further reduced by one-half of the amortization amount.

37. The revenue requirement impacts of this amortization are an increase to net operating income in the amount of $6,296,882 for electric services and $1,370,074 for gas services. Note that the amortization of EDFIT represents a post-tax gain, since the Company is not required to pay any income taxes on the EDFIT gain amortization. This means that the amortization amount must be grossed-up—by dividing by one minus the new 21% tax rate—in order to be stated on a pre-tax revenue requirement basis.

TCJA-3: TCJA Deferral (Jan 2018 - Apr 2018)

38. As noted above, this adjustment has been included as a placeholder, in case the Commission desires to incorporate the deferral impact into base rates in this matter. If the Commission desires to incorporate those impacts, calculations of deferred amounts, along with amortization proposals, have been detailed in the attachments to this Bench Request. Attachment Bench Request 1-1, Pages 19-20 (Tabs 7a, 7b), detail these calculations for electric services. Attachment Bench Request 1-1, Pages 16-17 (Tabs 7a, 7b), detail these calculations for gas services.

TCJA-4: Revenue Requirement Gross-up

39. As a final adjustment, the Joint Parties have separately detailed the impact of applying the new tax rate in the conversion factor used for the purpose of calculating revenue sufficiency or deficiency. Similar to the way cost of capital changes are often presented in revenue requirement results, the change to the conversion factor to account for the TCJA does not necessarily need to be stated as a separate restating adjustment, although the Joint Parties have detailed the relatively minor impact separately.

F. In the event that all impacts of the TCJA are not fully known to the Company by the due date set forth in this bench request, a projected date by which the Company intends to file an accounting petition to address the impacts.

40. The Joint Parties believe that all of the material impacts associated TCJA are known, and that it is appropriate to incorporate all known impacts into revenue requirement.

G. Supporting workpapers in electronic format with all formulas and links intact. See WAC 480-07-510(3)(e).

41. Please see Attachment Bench Request 01-1 for updated revenue requirement calculated for electric services and Attachment Bench Request 01-2 for updated revenue requirement calculated for gas services.

V. Conclusion

42. The Joint Parties again thank the Commission for the opportunity to respond to Bench Request 1. As the Commission can conclude, the Joint Parties' response provides its conclusions and calculations relative to the TCJA's impact on Avista's rates, along with the recommendation that the Commission incorporate the benefits of the TCJA into Avista's rates

when setting rates in this docket. The Joint Parties believe that its conclusions and supporting calculations provide evidence sufficient to support this recommendation.