

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

**CASCADE NATURAL GAS
CORPORATION,**

Respondent.

DOCKET UG-170929

**COMMISSION STAFF'S
RESPONSE TO BENCH
REQUEST NO. 1**

I. INTRODUCTION

On December 22, 2017, President Trump signed H.R.1 – An Act to provide for reconciliation pursuant to Titles II and V of the concurrent resolution on the budget for fiscal year 2018 (The Tax Cuts and Jobs Act, or “TCJA” or “new tax law”) into law. The TCJA amends the Internal Revenue Code to reduce tax rates and modify policies, credits, and deductions for individuals and businesses. The most notable impact for utilities regulated by the Commission is the reduction of the federal corporate tax rate from 35 percent to 21 percent.

On January 3, 2018, the Commission issued Bench Request No. 1, requiring Cascade Natural Gas Corporation (“Cascade” or the “Company”) to provide information related to the impacts of the new tax law on the Company’s current rates, revenue requirement, and the Company’s proposed ratemaking treatment(s) for these impacts.

On January 12, 2018, Cascade provided its initial response to Bench Request No. 1 indicating that it would need more time to provide estimates to the Commission. On January 25,

2018, Cascade filed its supplemental response to Bench Request 1. In neither its initial response nor its supplemental response did Cascade file an accounting petition or indicate when it intended to do so in response to Bench Request No. 1(F). Cascade also has not quantified the over-collection of excess income taxes being collected in current rates between January 1, 2018, and July 31, 2018 (the interim period), in response to Bench Request No. 1(C).

On March 15, 2018, Cascade filed a second supplemental response to Bench Request No. 1(E). The response further refined Cascade's analysis of the impacts of the new tax law on its revenue requirement using the 2016 test year for determining rates going forward. Specifically, Cascade proposed a test-year expense adjustment to capture the current reversal and amortization of "protected-plus EDIT."¹ Cascade does not propose adjusting rate base.

Commission Staff (Staff) has reviewed Cascade's response and supplemental responses to Bench Request No. 1 and has prepared this response, which specifically addresses Cascade's responses to Bench Requests No. 1(C) and 1(F). Staff recommends that the Company refund the benefits of the new tax law to customers without any sharing. These benefits represent monies that Cascade has collected from ratepayers for current and future tax liabilities that no longer exist because of the reduction to the federal corporate income tax rate.

II. BENCH REQUEST NO. 1(C)

The Commission asked the Company to provide "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."²

¹ Cascade uses the term "plant EDIT" due to the inability of its asset software to distinguish between protected and unprotected plant EDIT. Staff uses the term "protected-plus EDIT" to eliminate any confusion with what Staff has termed "protected EDIT" and "unprotected EDIT." For the purpose of ratemaking, the terms "protected EDIT" and "protected-plus EDIT" are the same in this context.

² The effective date for rates resulting from this general rate case is August 1, 2018.

A. Cascade's First Supplemental Response

In response to Bench Request No. 1(C), Cascade stated that “Customers receive the full benefit of the originally booked deferred federal income tax (“FIT”) based on 35 percent.” The Company interpreted the Commission’s bench request to require identification of Cascade’s reduction in estimated tax expense related to the reduction in the corporate tax rate from 35 to 21 percent, which it estimated for the relevant period as approximately \$1.4 million. Cascade’s response calculated the over-collection by using the 2016 adjusted test-year income tax expense in the Company’s proposed pro forma results of operations.

B. Staff's Response

Cascade’s response is inappropriate for two reasons. First, the 2016 adjusted income tax expense in the Company’s proposed pro forma results of operations has not been approved by the Commission. It is, therefore, inappropriate to use it to estimate the over-collection of taxes for the interim period. Second, the 2016 adjusted income taxes were not used to determine current rates. Rather, current rates were determined in Docket UG-152286 using a 12-month test year ending June 30, 2015. Staff recommends the Commission use revenues determined in Docket UG-152286 to calculate Cascade’s over-collection during the interim period (January 1 to July 31, 2018).

Using the inputs decided in Docket UG-152286,³ Staff estimates the annual over-collection of taxes embedded in current rates is approximately \$2.4 million.⁴ But the amount collected during the interim period is only a fraction of that annual amount. Staff uses a ratio of

³ Staff used Cascade’s initially filed revenue requirement model in Docket UG-152286, updated for the settlement which removed all but the Cost Recovery Mechanism adjustment and added a black box adjustment to net operating income to capture the \$4 million in additional annual revenue.

⁴ For Staff’s recommendation, please refer to attached file “170929-Staff-Response-WP-BR1-3-23-18.xlsx,” tab “Over-Collection Range,” cells C10 and C14.

January to July volumetric revenues over annual volumetric revenues to determine the pro rata amount of the over-collection related to the interim period. Staff estimates that the refund to ratepayers for over-collected taxes embedded in current rates for the interim period is approximately \$1.6 million.

Staff recommends that this amount – \$1.6 million – be refunded to ratepayers over seven months or one year by means of a separate tariff schedule. The amount refunded to each rate class should be based on each class’s contributions to the over-collection. Decoupling dollars per customer will need to be updated to in tandem with the reduction in annual revenue.

For comparison purposes, Staff updated and included NWIGU’s alternative over-collection calculation to use the same inputs decided in Docket UG-152286. This comparison is meant to show the Commission a range of estimates, from conservative to liberal, based on the approaches to quantify the over-collection in existing current rates.

III. BENCH REQUEST NO. 1(F)

The Commission asked the Company to provide “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.”

A. Cascade’s First Supplemental Response

The Company responded, among other things, that, “Customers will continue to see the full benefits of the deferred tax balances.” Cascade also stated that it “believes it is not necessary to file a deferral application.”

B. Staff's Response

Staff agrees with the Company that customers will receive the full benefits of the reduction in the tax rate from 35 to 21 percent. Staff also thinks that it is unnecessary for the Company to file a deferral application because the tax issues can all be addressed by the Commission in this pending proceeding. Further, the Commission may order an accounting deferral without Cascade's deferral application.

1. Customers Should Receive the Full Benefits

The above over-collection discussion and the following discussion sets a path that enables the Company to refund the full benefit to customers.

In order to determine the scope of the benefits that Cascade must refund to customers, Staff has divided the issue into three parts. The first part relates to the impacts of the new tax law on current rates for the interim period of January 1 to July 31, 2018. This impact is discussed above. The second part relates to the new tax law impacts going forward and how those known and measurable changes impact rates that will be effective August 1, 2018. The third part is the required deferral of the remaining protected EDIT and any other tax impact that have yet to be discovered.

In its responsive testimony, Staff's revenue requirement recommendation was based on a 2016 test year and did not include rate base adjustments for either protected or unprotected EDIT. After reviewing Cascade's supplemental responses to Bench Request No. 1, however, Staff found that adjustments were necessary to reflect the reduction in future tax liability related to refunding protected and unprotected EDIT.

a. Unprotected EDIT

For the second part, Staff recommends that the Commission order Cascade to refund the entire amount of unprotected EDIT back to customers over one year using a separate tariff schedule. Unprotected EDIT is estimated to be \$3.7 million.⁵ Staff proposes increasing rate base by approximately \$3.7 million to reflect the refund to customers. This adjustment is necessary to reflect the reduction in Cascade's future tax liability for those amounts being refunded. This refund passes the benefit back to ratepayers over a short enough time period that Staff thinks it eliminates any need to accrue interest on the balance to compensate ratepayers for Cascade's use of their money.

b. Protected EDIT

Staff also recommends that Cascade refund \$1.1 million of 2018 reversed, protected EDIT related to 2016 and earlier asset vintages over one year using a separate tariff schedule (consistent with unprotected EDIT). Staff proposes increasing rate base by approximately \$1.1 million to reflect the refund to customers. This adjustment is necessary to reflect the reduction in Cascade's future tax liability for those amounts being refunded. As a consequence, in future general rate cases the Company must identify the correct amounts of reversed, protected EDIT to refund to ratepayers. The need to provide this analysis will continue until the protected EDIT balance is zero and has been completely refunded to ratepayers.

This approach to protected EDIT differs somewhat from the approach Staff uses in the current Avista general rate case (Dockets UE-170485/UG-170486). Whereas in the Avista general rate case Staff was able to obtain an annualized ARAM amortization for the protected EDIT for the rate-effective period and, therefore, incorporated the annualized ARAM

⁵ This amount is subject to change. Staff will receive a final response to UTC Staff Data Request No. 150, which should confirm or modify the informal amount provided by Cascade, by March 28, 2018.

amortization into its base rates recommendation, Staff did not have that respective information for the rate-effective period for the Cascade general rate case. As a result, Staff herein presents an approach to returning protected EDIT to customers, whereby calendar year 2018 protected EDIT amortization is passed back to customers through a separate tariff schedule rather than being incorporated into base rates. In the event that the Commission prefers incorporating annualized EDIT amortization into base rates, Staff would support an alternative approach. But Staff would advise that such an approach will require Cascade to identify the ARAM amortization of EDIT for (a) August 1, 2018, through July 31, 2019, to be incorporated into base rates, and (b) January 1, 2018, through July 31, 2018, for refund to customers through a separate tariff schedule.

2. A Deferral Application Is Unnecessary

The protected EDIT balance using the 2016 test year is estimated to be \$30.3 million.⁶ Of the \$30.3 million protected EDIT, approximately \$29.2 million⁷ must be moved to a regulatory liability account.

For the third part, Staff recommends the Commission order the deferral of the \$29.2 million protected EDIT for rate base related to 2016 and earlier vintages to FERC account 254, Other Regulatory Liabilities. The amount deferred to this account should be refunded to customers in future general rate cases as these amounts become available based on the IRS's average rate assumption method (ARAM) normalization rules. This recommendation is particularly important because protected EDIT must **not** flow back to ratepayers more rapidly

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⁷ Total protected EDIT \$30.3 million less the 2018 reversal of the \$1.1 million refunded through a separate tariff schedule equals \$29.2 million.

than the rate at which the book and tax temporary difference reverses over the remaining life of the underlying plant or else Cascade will incur a significant tax penalty⁸ and will not have the opportunity to use accelerated depreciation for future tax years.⁹ To track the reversals of protected EDIT over future rate cases, Staff recommends that the Commission require Cascade to report annually the amounts of deferred protected EDIT that have reversed. Tracking these amounts will provide notice of the protected EDIT available for refund to ratepayers.

Staff agrees with Cascade that it is probably unnecessary for the Company to file a separate deferral application under these circumstances because all of the tax issues, including the return of over-collected amounts in the interim period (January 1 and July 31, 2018) can be addressed by the Commission in this general rate case. If the Company cannot identify and address all these tax issues in this general rate case, then Cascade should follow the Commission's direction to track tax savings to ensure these benefits will be refunded to customers and also indicate a projected date by which it intends to file an accounting petition. Any accounting deferral will facilitate the refund of tax savings to customers.

As discussed in Section III(B)(1)(b), above, as an alternative to deferring protected EDIT, Staff would support a method that captures an average amount of protected EDIT reversals in permanent rates on an annual basis. However, it is worth noting that the amounts that reverse on an annual basis can differ greatly from year to year which could harm the Company.¹⁰ The Company should take care to not embed in base rates EDIT amortization amounts that could exceed the amounts calculated using the ARAM method in years subsequent to the rate year..

⁸ The penalty is dollar-for-dollar on any amount returned to ratepayers faster than the rate at which the book and temporary tax difference reverses over the remaining life of the underlying asset. *See* Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 1561(d), 131 Stat. 2054, 2099 (2017).

⁹ Plant EDIT is not a protected difference, but the Company's asset accounting software cannot separate between protected and unprotected plant EDIT. Therefore, the Company's software applies the ARAM to all plant EDIT.

¹⁰ By "harm" Staff means any assessment of penalty by the IRS and the Company losing the opportunity to use accelerated depreciation for taxes.

IV. RECOMMENDATION

Ultimately, Staff recommends that the Commission:

- Refund \$1.6 million in over-collected taxes from interim period rates to customers over seven months or one year by means of a separate tariff schedule;
- Increase rate base by \$3.7 million, which corresponds to the unprotected amount of EDIT;
- Refund \$3.7 million of unprotected EDIT to customers over one year using a separate tariff schedule;
- Increase rate base by an additional \$1.1 million to account for the protected EDIT annual reversal calculated using ARAM identified by the Company;
- Refund \$1.1 million of reversed protected EDIT to customers over one year using a separate tariff schedule;
- Defer \$29.2 million of protected EDIT to FERC Account 254, Other Regulatory Liabilities; and
- Require Cascade to annually report the balances of reversals for protected EDIT in its Commission Basis Reports.