

**Exh. MCC-9T
Docket UG-170929
Witness: Melissa Cheesman**

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

**CASCADE NATURAL GAS
CORPORATION,**

Respondent.

DOCKET UG-170929

CROSS ANSWERING TESTIMONY OF

Melissa Cheesman

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

*Cross Answering Testimony
NWIGU's Proposed Adjustment - TCJA-3*

March 23, 2018

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1 **I. INTRODUCTION**

2

3 **Q. Are you the same Melissa Cheesman who filed direct testimony in this case?**

4 A. Yes.

5

6 **Q. What is the purpose of your cross-answering testimony?**

7 A. I respond to NWIGU witness Mr. Bradley G. Mullins’s testimony about his proposed
8 adjustment for the amortization of excess deferred income tax (“EDIT”)¹
9 necessitated by the passage of the new tax law (“Tax Cuts and Jobs Act” or
10 “TCJA”). Mr. Mullins proposed amortizing EDIT and refunding it to ratepayers
11 based on the alternative method mentioned by the Internal Revenue Service (“IRS”)
12 because, he contended, Cascade lacked the necessary vintage information for using
13 the Average Rate Assumption Method (“ARAM”).²

14 I also respond to Mr. Mullins’s adjustment TCJA-3. This adjustment would
15 reduce base rates by calculating the over-collection for federal income taxes paid by
16 customers between January 1, 2018, and July 31, 2018, (“interim period”) based the
17 2016 test year financial data plus an amortized portion of EDIT. Mr. Mullins
18 proposes accruing interest on the over-collected funds and amortized EDIT.
19 Mr. Mullins also proposes a two year amortization period.

20

¹ Mr. Mullins and other parties use the acronym EDFIT (excess deferred federal income tax).

² Mullins, Exh. BGM-1T at 22:9-12.

1 **II. EXCESS DEFERRED INCOME TAX**

2

3 **Q. In his testimony, does Mr. Mullins differentiate between protected and**
4 **unprotected EDIT?**

5 A. No. Mr. Mullins testimony does not differentiate between protected EDIT and
6 unprotected EDIT, although his adjustment does separate plant and non-plant EDIT.
7 Within the scope of the normalization rules, protected EDIT (which the IRS refers to
8 as excess tax reserve) refers to the method of depreciation and also the asset-life
9 differences between how depreciation is calculated for book versus tax. All other
10 temporary differences between Cascade’s financial books and tax reporting are
11 considered unprotected EDIT.

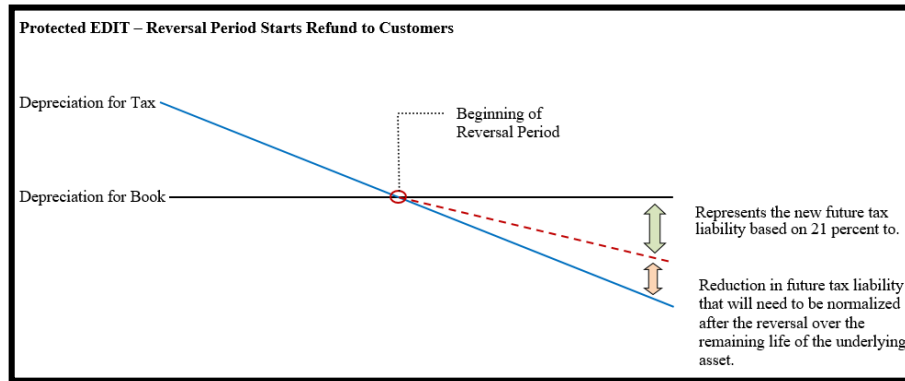
12 The Commission has discretion over the amortization of unprotected EDIT,
13 but the amortization of protected EDIT is governed by provisions in the new tax law.
14 Those provisions require that utilities normalize protected EDIT and, therefore,
15 refund to customers at the same rate at which the book and tax temporary differences
16 reverse over the remaining life of the plant giving rise to the EDIT or else face a tax
17 penalty.³ Hence the term “protected EDIT.”⁴

³ Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 1561(d), 131 Stat. 2054, 2099 (2017).

⁴ 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.

1

Figure 1. Protected EDIT – Reversal Period Starts Refund to Customers



2

Figure 1, above, provides a graphical depiction of the relationship between

3

protected EDIT, the reversal period, and refunds to customers for a specific vintage.

4

It is this relationship that complicates the timing for refunding protected EDIT to

5

customers.

6

7 **Q.**

What does the IRS require in order to amortize protected EDIT on an ARAM basis?

8

9 **A.**

The utility must have sufficient asset vintage records.

10

11 **Q.**

Does Cascade have sufficient asset vintage records?

12 **A.**

Yes. Please see the Company's supplemental response to Bench Request 1(C) and Exh. MCC-10: Cascade's Response to UTC Staff Data Request No. 133.

13

14 **Q.**

Is Cascade required to use ARAM for normalizing protected EDIT?

15 **A.**

Yes. According to the new tax law, because Cascade has sufficient asset vintage records to apply the average rate assumption method, using ARAM to normalize

16

1 protected EDIT is the only normalization method the Company may use for its
2 protected EDIT, or else it would face a significant tax penalty.⁵ Requiring the
3 Company to use the alternative method would, therefore, harm the Company.
4

5 III. NWIGU PROPOSED ADJUSTMENT – TCJA-3 6

7 **Q. What is the over-collection of taxes in existing current rates?**

8 A. Cascade’s current rates were calculated using a test year, ending June 30, 2015, with
9 an embedded federal income tax rate of 35 percent.⁶ The new tax law reduces the tax
10 rate to 21 percent effective January 1, 2018. Cascade has, therefore, been collecting
11 an amount in current rates since January 1, 2018, corresponding with the federal
12 income tax rate of 35 percent. However, since that same date, the effective tax rate
13 has been 21 percent. Cascade has, therefore, been over-collecting for tax expense
14 since the start of the year and will continue to over-collect in its current rates until
15 those rates are changed as a product of this general rate case (Docket UG-170929),
16 the rates resulting from which will go into effect on August 1, 2018.
17

18 **Q. What components of current rates must be considered in order to determine the**
19 **impact of the tax rate decrease and the proper over-collection amount that**
20 **should be refunded to customers?**

⁵ Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 1561(d), 131 Stat. 2054, 2099 (2017).

⁶ *Wash. Utils. & Transp. Comm’n v. Cascade Natural Gas Corp.*, Docket UG-152286, Order 04 (July 7, 2016).

1 A. The two main components embedded in current rates that must be considered are:
2 (1) net operating income (“NOI”) impacts; and (2) rate base impacts.

3 To calculate the NOI impacts of the new tax law, the test year federal income
4 tax (“FIT”) expense, the FIT expense for restating and pro forma adjustments, and
5 the pre-gross-up value of the \$4 million revenue increase allowed in the settlement
6 must be adjusted by substituting the new 21 percent tax rate for the then-effective 35
7 percent rate.

8 To calculate the rate base impacts, the return on the rate base deemed to be
9 the basis in the settlement and the accumulated deferred FIT at that time must be
10 compared with those same components as if the tax change affected them. The
11 difference between the results is the excess deferred income tax. EDIT should then
12 be further divided between “protected EDIT,” which I discuss above, and
13 “unprotected EDIT,” or all other temporary timing differences.

14 For purposes of over-collection, Staff recommends refunding customers only
15 the NOI impacts. Staff does not consider rate base impacts for over-collection in the
16 interim period. Staff will be addressing protected and unprotected EDIT using the
17 2016 test year going forward. Since rate base represents balance sheet accounts, the
18 2016 test year rate base will capture all prior years’ accumulated deferred taxes.
19 Using the 2016 test year provides a point in time to calculate EDIT and inform the
20 2016 test period for the reduction in future tax liability.

21

1 **Q. How does Mr. Mullins propose calculating the over-collection in current rates?**

2 A. Mr. Mullins proposes to determine the over-collection in current rates by calculating
3 an EDIT “gain” on rate base using the current general rate case (UG-170929), i.e.,
4 the results of operations test year rate base balance as of December 31, 2016. Mr.
5 Mullins’s calculation also includes an interest accrual and an amortized portion of
6 EDIT using an accumulated deferred income tax balance from Cascade’s current
7 filing, which, as just mentioned, involves a test year ending December 31, 2016.

8

9 **Q. Should the Commission accept Mr. Mullins’s proposed methodology?**

10 A. No, the Commission should reject Mr. Mullins’s proposal for multiple reasons. First,
11 Cascade’s current rates were set using a test year ending June 30, 2015.⁷ The 2016
12 test year rate base, used by Mr. Mullins, differs significantly from the one used in
13 Docket UG-152286 to set the current rates. For example, the June 30, 2015, results
14 of operation test year rate base balance was \$267.3 million, which is \$12.7 million
15 less than the results of operation test year rate base balance as of December 31,
16 2016.⁸ Knowing approximately the test year and amount of taxes embedded in
17 current rates is important because estimates must be informed and conservative in
18 order for results to be reasonable and fair.

19 Mr. Mullins’s decision to use the 2016 rate base corrupts his results because
20 the 2016 rate base is not relevant to rates currently in effect. The over-collection of
21 taxes embedded in current rates is correctly calculated by using the same information

⁷ *Wash. Utils. & Transp. Comm’n v. Cascade Natural Gas Corp.*, Docket UG-152286, Order 04 (July 7, 2016).

⁸ The results of operation test year rate base balance as of December 31, 2016 was approximately \$280 million.

1 from Docket UG-152286 that was used to set current rates. The Commission’s
2 Order 04 in Docket UG-152286 approved the parties’ Joint Settlement Agreement.
3 That joint settlement included a revenue increase of \$4 million (or 1.6 percent), and
4 an overall rate of return of 7.35 percent.⁹ While a majority of the joint settlement was
5 “black boxed” and this complicates separating out the over-collection of taxes, it
6 remains possible to use this information to provide a reasonable estimation of the
7 over-collection of taxes.

8 Second, Mr. Mullins proposes amortizing the over-collection of taxes over
9 two years. This does not reasonably reflect how the amounts were collected. Instead,
10 the amortization should reflect the approximate period of time in which the
11 Company over-collected, seven months or, at most, one year. Further, to track the
12 refund of the over-collection of taxes embedded in current rates, a separate tariff
13 schedule should be established that will credit to ratepayers any over-collection, and
14 then it should expire once the refund is complete.

15 Finally, Mr. Mullins proposes to accrue interest at Cascade’s pre-tax cost of
16 capital but does not identify who pays this interest: ratepayers or shareholders? The
17 new tax law was completely out of the Company’s control and is more analogous to
18 an “act of God.” Unlike Mr. Mullins, Staff does not support attributing blame or
19 credit to the Company for the passage of the new tax law such that the Company

⁹ The additional annual revenue and cost of capital was a black box settlement, meaning that the only things agreed upon in the revenue requirement determination was to increase revenues by \$4 million without regard to adjustments that inform the test year and to set the rate of return at 7.35 percent. However, the compliance filing at the conclusion of Docket UG-152286 included a tariff revision for the Cost Recovery Mechanism (CRM), Schedule No. 597, where all rates were set to zero. This indicates that the CRM adjustment was implicitly included as an adjustment in the black box settlement.

1 should be harmed or benefitted. There would be little need to accrue interest if the
2 Commission requires the Company to refund the over-collection of taxes to
3 customers over seven months (the period of over-collection) or, at most, one year.
4

5 **Q. Does Staff see benefits for using a separate tariff schedule to refund the over-**
6 **collection of taxes?**

7 A. Yes. Customers will benefit by seeing an explicit credit on their bills to assure them
8 that the utility is not unduly enriched by over-recovery of taxes that it did not and is
9 under no obligation to pay. The Company benefits from having a credit that expires
10 at a specific amount and is not harmed by the accrual of interest on excess revenue
11 related to tax changes it had no control over.
12

13 **Q. What, ultimately, is your recommendation to the Commission?**

14 A. The Commission should reject Mr. Mullins's proposal for refunding customers and
15 accept Staff's proposed method for refunding the over-collection of taxes for the
16 interim period. Staff proposes that:

- 17 • The refund of over-collected taxes during the interim period, January 1 to
18 July 31, 2018, be based on the financial data in Docket UG-152286;
- 19 • No interest be accrued on the over-collected taxes; and
- 20 • The amount of over-collected taxes be refunded back to customers over
21 seven months to a year using a separate tariff schedule that expires.
22

1 Q. Does this conclude your testimony?

2 A. Yes.