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| State of Florida  pscSEAL | | Public Service Commission  Capital Circle Office Center ● 2540 Shumard Oak Boulevard Tallahassee, Florida 32399-0850  -M-E-M-O-R-A-N-D-U-M- | |
| DATE: | January 24, 2019 | | |
| TO: | Office of Commission Clerk (Teitzman) | | |
| FROM: | Division of Accounting and Finance (Cicchetti, D. Buys, Hightower)  Division of Economics (Guffey)  Division of Engineering (Ellis)  Office of the General Counsel (Dziechciarz, DuVal) | | |
| RE: | Docket No. 20180051-GU – Consideration of the tax impacts associated with Tax Cuts and Jobs Act of 2017 Florida Public Utilities Company - Gas. | | |
| AGENDA: | 02/05/19 – Regular Agenda – Post-Hearing Decision – Participation is Limited to Commissioners and Staff | | |
| COMMISSIONERS ASSIGNED: | | | Brown, Clark, Fay |
| PREHEARING OFFICER: | | | Brown |
| CRITICAL DATES: | | | None |
| SPECIAL INSTRUCTIONS: | | | None |

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Case Background

The Florida Public Service Commission opened Docket No. 20180051-GU on February 23, 2018, to consider the tax impacts affecting Florida Public Utilities Company – Gas, (FPUC or Company) resulting from the passage of the Tax Cuts and Jobs Act of 2017 (TCJA). FPUC is a wholly owned subsidiary of Chesapeake Utilities Corporation (CUC). CUC is also the parent of CUC – Florida (Chesapeake). FPUC – Indiantown and FPUC – Fort Meade are separate divisions of FPUC. Docket Nos. 20180052-GU, 20180053-GU and 20180054-GU were opened to address the tax impacts affecting Indiantown, Fort Meade and Chesapeake.

On April 25, 2018, an Order Establishing Procedure for the docket was issued, in which controlling dates were set for filing testimony, exhibits, and discovery. On May 31, 2018, the discovery procedures and controlling dates were modified. Order No. PSC-2018-0412-PCO-GU, issued on August 20, 2018, was the second order revising the order establishing procedure that allowed the Company to file revised and supplemental testimony, and extended testimony filing dates for Commission staff and the Office of Public Counsel (OPC). OPC is the only intervenor in this docket.

The prehearing conference was held on November 5, 2018. On Monday, November 9, 2018, OPC filed an Agreed Motion to Consolidate for Purposes of Hearing Docket Nos. 20180051-GU, 20180052-GU, 20180053-GU and 20180054-GU. On November 16, 2018, Prehearing Order No. PSC-2018-0535-PHO-GU was issued and reflected proposed stipulations between FPUC and OPC on most of the issues. Order No. PSC-2018-0555-PCO-GU, issued on November 20, 2018, consolidated the four dockets for the purpose of the hearing. The hearing was held on November 27, 2018. At that time, the Commission voted to accept and approve the parties’ proposed stipulations. This recommendation addresses the remaining contested issues. The Commission has jurisdiction pursuant to Sections 366.04, 366.041, 366.06, and 366.07, Florida Statutes.

Discussion of Issues

Issue 4B:

 What is the appropriate disposition of the protected excess deferred taxes?

Recommendation:

 FPUC should be allowed to retain the annual amortized amount of the protected excess deferred tax balance less the unprotected excess deferred tax amortization, for an annual net amount of $537,174. (Hightower, D. Buys, Cicchetti)

Position of the Parties

FPUC:

 FPUC should be allowed to retain the estimated amortized deferred balance less the unprotected deferred tax amortization, thereby fulfilling the purpose of the TCJA by allowing FPUC to continue making capital improvements and potentially delaying a rate proceeding.

OPC:

 The Company should not be allowed to retain the amount of the protected excess accumulated deferred income tax (ADIT). The protected excess ADIT should be reversed using an Average Rate Assumption Method (“ARAM”) if the utility has the available information to calculate the ARAM, or via another appropriate method that complies with normalization requirements, if the Company does not have the information to compute the ARAM.

Staff Analysis:

PARTIES’ ARGUMENTS

FPUC

FPUC argued that the Company is projected to be earning at the bottom of its allowable range of return on equity.[[1]](#footnote-1) (FPUC BR 9; TR 98) In light of the Company’s earning posture, FPUC argued that it should be allowed to retain the estimated annual amortized amount of the protected excess accumulated deferred income tax (ADIT) balance of approximately $844,461, less the unprotected deferred tax amortization annual amount of $307,287, for an annual net amount of $537,174. (FPUC BR 10; TR 100) FPUC argued that the ability to retain the net tax amount will provide the Company with further opportunity to earn within its authorized range of return on equity (ROE), while also enabling the Company to provide service at present rates for a longer period, to continue making necessary capital investments, and to delay a costly rate proceeding. (FPUC BR 10; TR 100) FPUC argued that if it is allowed to retain all of the tax amounts as proposed, the Company’s return on equity for 2019 is projected to be 8.67 percent, which is below FPUC’s allowed range of return on equity of 9.85 to 11.85 percent.[[2]](#footnote-2) (FPUC BR 12; EXH 10, BSP 00043; EXH 12, BSP 00067) FPUC also argued that if it is required to reduce its base rates by $537,174 for the net excess deferred tax amount, its projected ROE would be even lower, at 8.29 percent. (FPUC BR 12, EXH 12, BSP 00064)

OPC

OPC argued that the Commission should reject FPUC’s proposal to retain the tax amount associated with the protected deferred taxes as being unjust, unfair and unreasonable, and should apply the estimated annual tax savings of $537,174 for the benefit of customers in the form of a rate reduction. (OPC BR 1; TR 232, 241) OPC also argued that the tax savings represents money that was previously paid by FPUC’s customers, and that the money therefore belongs to those customers and should be returned to them. (OPC BR 5) Finally, OPC argued that the TCJA did not contain any language, express or otherwise, that suggests an intended goal of the TCJA was to allow a utility to keep tax savings so as to continue making capital investments, while potentially delaying the need for a rate proceeding. (OPC BR 5; TR 184)

ANALYSIS

FPUC and OPC agree on the amount of the protected excess deferred tax of $21,955,992, amortized over 26 years, resulting in an annual tax amount of $844,461. (TR 100, 232) Where the parties differ is how the disposition of the tax savings should be resolved. OPC argued that the tax savings should be returned to FPUC’s customers regardless of the Company’s earnings posture to satisfy the intent of the TCJA. (OPC BR 10) FPUC proposed to retain the tax savings which, it argued, will benefit its customers by enabling the Company to delay a rate case and place downward pressure on the requested rate increase in its next rate case. (FPUC BR 11)

OPC witness Smith relied on a 1982 Florida Supreme Court decision in Reedy Creek Utils. Co. v. Fla. Public Serv. Comm., 418 So. 2d 249, 254 (Fla. 1982), which stated, “[a] change in a tax law should no [sic] result in a ‘windfall’ to a utility, but in a refund to the customer who paid the revenue that translated into the tax saving.” (OPC BR 6; TR 235; EXH 17) OPC argued that, by definition, the excess tax monies in FPUC’s possession are a windfall to the Company that should be flowed back to the customers who paid the taxes in rates. (OPC BR 7, 10) OPC pointed out during cross-examination of FPUC witness Cassel that he admitted he did not provide in his testimony any calculations or evidence to demonstrate what the Company’s projected earnings would be if the tax savings were retained by the Company. (OPC BR 8-9; TR 182) However, in response to a staff interrogatory, FPUC indicated that its forecasted ROE for 2018 and 2019 would be 9.10 and 8.67 percent, respectively, if it were to retain all the tax savings resulting from the TCJA. (EXH 12, BSP 00062, 00067)

FPUC noted that OPC witness Smith acknowledged that Reedy Creek utility was in an over-earnings position at the time of the 1978 Tax Reform; thus, the issue that ultimately came before the Florida Supreme Court in the Reedy Creek case was a question of how much the utility would be required to refund. (FPUC BR 14) The Commission had already determined that Reedy Creek would have to provide a refund because it was over-earning. (FPUC BR 14, TR 308)

In the Reedy Creek decision, the Florida Supreme Court acknowledged the Commission’s decision wherein the Commission stated its position regarding a company’s over-earnings position:

Viewing the documents together with the testimony in the record, it is clear that a utility would be required to refund revenues if and only if it were earning in excess of the range of its authorized rate of return. (EXH 17)

FPUC argued that OPC witness Smith's refusal to consider FPUC's earnings posture in rendering his opinion of FPUC’s proposals to retain some of the TCJA tax savings is contrary to prior Commission policy as reflected in Order Nos. 8624 and 8624A, and overstates the applicability of the Court's conclusions in the Reedy Creek case. (FPUC BR 14) As such, FPCU contends OPC’s arguments on this point should be rejected and staff agrees with the Company’s interpretation. (FPUC BR 14)

OPC maintained that FPUC witness Cassel’s interpretation of the Reedy Creek decision mistakenly links the over-earnings posture of the company in that case with the Court’s use of the term “windfall.” (OPC BR 9) Staff disagrees with OPC’s argument. It is staff’s opinion that in the Reedy Creek case, the utility was ordered to make a refund to its customers because regulated utilities are not allowed to earn above the Commission authorized range of ROE regardless of the cause, and therefore, any over-earnings should be refunded to the customers. In Order No. 8624 the Commission asserted, “It is the Commission’s responsibility to ensure they do not earn in excess of a fair and reasonable return upon their investment.”[[3]](#footnote-3)

The record evidence demonstrates that FPUC is earning below its allowed range of ROE. (FPUC BR 12; TR 102; EXH 15, BSP 000518) The record also indicates that even with FPUC retaining all of the tax savings it has requested, the Company will not earn above its authorized range of ROE. (EXH 12, BSP 00062, 00067) Staff agrees with FPUC that a key factor in the Reedy Creek case pertained to the utility’s earning posture whereby the utility was required to make a refund because it was over-earning.

Staff agrees with FPUC’s argument that OPC's reliance upon the Reedy Creek case is misplaced, and staff agrees with the Company’s analysis. (FPUC BR 14) On cross-examination, OPC witness Smith conceded that the Commission's orders underlying the Reedy Creek case, Order Nos. 8624 and 8624A, reflect that, in addressing the 1978 Tax Reform, the Commission considered the circumstances of the utilities on a case-by-case basis, and only required those utilities that were earning above the ceiling of their Commission-authorized ROE range to refund the tax savings arising under the 1978 Tax Reform. (FPUC BR 14; TR 311-315)

CONCLUSION

Staff recommends that it is fair, just, and reasonable for the Commission to consider the earnings position of the Company in its decision. Reducing the base rates as recommended by OPC would result in a cash flow reduction to the Company, put downward pressure on FPUC’s earnings, and would accelerate the need for a full rate case sooner than it would otherwise due to FPUC earning below its authorized range of ROE. Therefore, staff recommends that FPUC be allowed to retain the estimated amortized protected deferred tax balance, less the unprotected deferred tax amortization attributed to the TCJA, for an annual savings of $537,174, because FPUC will not exceed its authorized range of ROE.

Issue 5B:

 What is the appropriate disposition of the unprotected excess deferred taxes?

Recommendation:

 FPUC should be allowed to retain the excess deferred tax amount associated with the net acquisition adjustment of $6,518,569 amortized over the life of the acquisition adjustment. Further, the unprotected deferred tax amount of $3,072,874 should be amortized over 10 years and netted against the protected excess deferred taxes of $21,955,922. (Hightower, D. Buys, Cicchetti)

Position of the Parties

FPUC:

  FPUC should be allowed to retain the deferred tax liability associated with the net acquisition adjustment amortized over the life of the acquisition adjustment and unprotected deferred tax asset amortized over 10 years, netted against the protected excess deferred taxes.

OPC:

  The Company should not be allowed to retain the tax savings from the unprotected excess ADIT. The Unprotected excess ADIT net asset of $3,072,874 should be amortized over 10 years at $307,287 per year.

Staff Analysis:

PARTIES’ ARGUMENTS

FPUC

FPUC argued that the Company is projected to be earning at the bottom of its authorized range of return on equity.[[4]](#footnote-4) (FPUC BR 9, TR 98) In light of the Company’s earning posture, FPUC argued that it should be allowed to retain the estimated annual amortized amount of the protected excess accumulated deferred tax balance of approximately $844,461, less the unprotected deferred tax amortization annual amount of $307,287, for an annual net amount of $537,174. (FPUC BR 10; TR 100) FPUC also argued that the annual unprotected excess deferred tax of $298,560 associated with the acquisition adjustment should be applied to reduce the remaining grossed up balance of the unamortized acquisition adjustment of $6,518,569. (FPUC BR 11; TR 99) FPUC contended that this accounting treatment will facilitate a more expeditious reduction of the acquisition adjustment balance. (FPUC BR 11; TR 99) FPUC argued that the ability to retain the net tax savings will provide the Company with further opportunity to earn within its authorized range of ROE, while also enabling the Company to charge current rates for a longer period, continue making necessary capital investments, and delay a costly rate proceeding. (FPUC BR 10; TR 100) FPUC argued that if it is allowed to retain all of the tax savings as proposed, the Company’s return on equity for 2019 is projected to be 8.67 percent. (FPUC BR 12; EXH 12, BSP 00067) FPUC also argued that if it is required to reduce its base rates by $537,174 for the net excess deferred tax amount, its projected ROE would be 8.29 percent. (FPUC BR 12; EXH 12, BSP 00064) FPUC’s authorized range of ROE is 9.85 to 11.85 percent.[[5]](#footnote-5) (FPUC BR 12; EXH 10, BSP 00043)

OPC

OPC agreed with FPUC that the estimated annual protected excess ADIT amount amortization of $844,461, less the estimated annual unprotected excess ADIT amortization of $307,287, produces an estimated annual net amount of $537,174. (OPC BR 6; TR 234) However, OPC argued this net amount of $537,174 should be returned to customers via a base rate reduction, and not retained by the Company. (OPC BR 6; TR 234) OPC argued that in the recent cases before the Commission that address the tax savings due to the TCJA, the electric and gas utilities have agreed to refund the monies to their customers, or to apply them in a manner that directly benefits their customers (e.g., pay off storm costs in lieu of utilizing a storm surcharge). (OPC BR 7; TR 318) OPC further contended that FPUC is currently earning a positive return, and that FPUC will continue to earn within its authorized range without the tax savings being retained by the Company. (OPC BR 7; TR 98) OPC argued that although FPUC claims that retaining the tax savings would not put the Company in an over-earning position, FPUC witness Cassel could not point to any calculations or evidence that was offered by FPUC to demonstrate where FPUC’s projected earnings level would be if the tax savings were retained. (OPC BR 7, TR 103, 182) OPC contended that the net amount of the protected and unprotected excess ADIT that is not related to the acquisition adjustment of $537,174 should be applied for the benefit of the customers as a rate reduction. (OPC BR 7, TR 241) OPC argued that to do otherwise would be unjust, unfair, and unreasonable to FPUC’s customers. (OPC BR 7)

ANALYSIS

FPUC witness Cassel testified that there are two distinct components of the unprotected excess deferred tax balance. (TR 99) The first component is a deferred tax amount associated with the acquisition adjustment. (TR 99) This grossed up balance is $6,518,569, which the Company requested be included with the net acquisition adjustment and amortized at $298,560 per year, based on the remaining months of amortization of the acquisition adjustment. (TR 99) The second component is a net unprotected excess deferred tax amount of $3,072,874. (TR 99) The Company requested this excess deferred tax amount be amortized over 10 years at $307,287 per year. (TR 99) The Company requested that the amortization detriment be netted against the annual protected tax amount and retained by the Company. (TR 99)

Staff recommends that this treatment is appropriate because the Company is not earning above its authorized range of ROE. OPC witness Smith agreed that the net annual amortization of the protected and unprotected excess ADIT that is not associated with the acquisition adjustment estimated by the Company is approximately $537,174 annually. (TR 241) Witness Smith further testified that the TCJA savings should be applied for the benefit of customers as a permanent base rate reduction, rather than being retained by FPUC. (TR 241) Staff disagrees with OPC witness Smith because the record demonstrates that the Company is not projected to be in an over-earnings position even if it is allowed to retain all the tax savings. (EXH 12, BSP 00067) Staff additionally finds the Company’s proposal appropriate because the record shows that OPC did not take issue with FPUC’s proposed disposition of the unprotected deferred tax amount associated with the acquisition adjustment. (TR 233-234)

CONCLUSION

Staff recommends that it is fair, just, and reasonable for the Commission to consider the earnings position of the Company in its decision. Therefore, for the reasons discussed in Issue 4B and the aforementioned analysis, staff recommends FPUC be allowed to retain the excess deferred tax amount associated with the net acquisition adjustment of $6,518,569 amortized over the life of the acquisition adjustment. Further, the unprotected deferred tax amount of $3,072,874 should be amortized over 10 years and netted against the protected excess deferred taxes of $21,955,922.

Issue 21:

 Should FPUC be allowed to retain the tax benefits arising from the TCJA rate reduction, excluding the 2018 GRIP savings, as well as the estimated Deferred Tax portion of the Protected and estimated Unprotected Deferred Tax regulatory asset that are not associated with the acquisition adjustment?

Recommendation:

  Yes, FPUC should be allowed to retain the tax savings arising from the TCJA rate reduction, excluding the 2018 GRIP savings, as well as the estimated net deferred tax savings of the protected and unprotected deferred tax regulatory amount not associated with the acquisition adjustment (Hightower, D. Buys, Cicchetti)

Position of the Parties

FPUC:

  Yes, FPUC should be allowed to retain the tax benefits arising from the TCJA rate reduction, excluding the 2018 GRIP savings, as well as the estimated Deferred Tax portion of the Protected and estimated Unprotected Deferred Tax regulatory asset including those that are associated with the acquisition adjustment.

OPC:

  No, FPUC should not be allowed to retain the tax savings arising from the TCJA rate reduction.

Staff Analysis:

PARTIES’ ARGUMENTS

FPUC

FPUC argued that even if the Company is allowed to retain the tax savings as it has requested, FPUC's ROE for 2019 is projected to be only 8.67 percent, which is below its authorized range of 9.85 percent to 11.85 percent. (FPUC BR 12; EXH 12, BSP 00067) The Company also contended that if it is required to reduce its base rates in 2019 by $537,174 for the net excess deferred tax amount, its projected ROE will be only 8.29 percent. (FPUC BR 12; EXH 12, BSP 00064) FPUC also argued that if it is required to refund the $1,141,134 in annual tax savings, along with the gas reliability infrastructure program (GRIP) tax savings it has already proposed to refund, its ROE is projected to be even lower at only 7.85 percent. (FPUC BR 12; EXH 12, BSP 00065) Also, if FPUC is not allowed to retain any of the tax savings, FPUC projected that its 2019 ROE would be 7.74 percent. (FPUC BR 12; EXH 12, BSP 00064).

FPUC contended that the Company is currently under-earning. (TR 102; EXH 15, BSP 000518) FPUC argued that earning below its authorized range would drives the Company into a rate case or force it to deal with severe financial duress. (FPUC BR 12) The Company opined that such a result would be contrary to the stated intent of those that sponsored the TCJA. (FPUC BR 13) Although retention of the savings as proposed by the Company will not enable the Company to earn above its authorized range, it will allow it to earn much closer to its ROE. (TR 102) This will ensure that the Company remains well-positioned financially pending its next rate case so that it can continue to provide safe and reliable service to its customers. (FPUC BR 13)

OPC

OPC argued that FPUC is not currently under-earning, and is projected to earn within its authorized range - albeit at the lower end of the range for the foreseeable future. (OPC BR 8; TR 98) OPC further argued that FPUC did not offer any evidence or provide any calculations indicating where FPUC would be earning relative to its authorized earnings range if the Commission were to allow the Company to keep the tax savings. (OPC BR 8; TR 182) OPC contended that even though the Company asserts that it could avoid a potential rate case if the tax savings was retained, a close examination of witness Cassel’s testimony demonstrates no rate case will be avoided. (OPC BR 9) Witness Cassel acknowledged that FPUC was already earning within its authorized earnings range. (TR 98) Furthermore, OPC argued that none of the testimony or exhibits submitted by FPUC included any evidence indicating a rate case by the Company was pending. (OPC BR 9) Finally, OPC argued that the tax savings resulting from the TCJA is money that belongs to the Company’s customers and should be returned to them as a permanent base rate reduction. (OPC BR 10; TR 241)

ANALYSIS

FPUC witness Cassel testified that the estimated impact of the federal income tax rate change from 35 percent to 21 percent for FPUC is approximately $2,181,275. (TR 98, 180) Excluding $1,040,141 of tax savings related to FPUC’s GRIP, the incremental amount of tax savings is $1,141,134. (TR 98; EXH 10, BSP 00047) In Issues 9 and 22, FPUC and OPC stipulated to return the tax savings related to GRIP back to the customers. (FPUC BR 3, 6) Further, FPUC proposed to retain the net savings annual amount of $537,174 related to the protected and unprotected excess deferred tax saving ($844,461 for the protected excess ADIT less $307,287 for the unprotected excess ADIT). (TR 100) A second component of the unprotected deferred tax amount is associated with the acquisition adjustment. (TR 99) FPUC proposed to reduce the amortization amount for the remaining life of the acquisition adjustment to $298,560 per year. (FPUC BR 9; TR 99) OPC witness Smith did not object to FPUC’s proposal for disposition of the tax savings associated with the acquisition adjustment. (OPC BR 6; TR 233) It is staff’s opinion that the record evidence demonstrates that FPUC is earning below the bottom of its authorized ROE. (TR 98; EXH 15, BSP 000518) The record also indicates that even with FPUC retaining all of the tax savings it has requested, the Company will not earn above its authorized range of ROE. (EXH 12, BSP 00062) Therefore, it is staff’s opinion that FPUC should be allowed to retain the tax savings.

CONCLUSION

Staff agrees with FPUC that the Company should be allowed to retain the tax savings arising from the TCJA rate reduction, excluding the 2018 GRIP savings, as well as the estimated net deferred tax saving of the protected and unprotected deferred tax amount not associated with the acquisition adjustment.

Issue 24:

 Should this docket be closed?

Recommendation:

 Yes, this docket should be closed after the time for filing an appeal has run. (Dziechciarz, DuVal)

Position of the Parties

FPUC:

  Yes.

OPC:

  No.

Staff Analysis:

PARTIES’ ARGUMENTS

FPUC

None provided.

OPC

None Provided.

ANALYSIS

Upon issuance of an order determining the tax impacts associated with the Tax Cuts and Jobs Act of 2017 for Florida Public Utilities Company, this docket should be closed after the time for filing an appeal has run.

1. Although FPUC witness Cassel’s testimony stated that the Company expects to be earning *at* the bottom of its allowable range of return on equity, the record indicates that its projected return on equity is 8.38 percent, which is *below* its allowable range. (ESH 10, BSP 00043; EXH 15, BSP 000518) [↑](#footnote-ref-1)
2. FPUC incorrectly referenced a range of 9.50 percent to 11.85 percent in its post-hearing brief. [↑](#footnote-ref-2)
3. Order No. 8624, issued December 29, 1978, in Docket No. 780921-PU (CI), *In Re: Disposition of Federal Tax Savings Realized under the Revenue Act of 1978, p. 4.* [↑](#footnote-ref-3)
4. Although FPUC witness Cassel’s testimony stated that the Company expects to be earning at the bottom of its allowable range of return on equity, the record indicates that its projected return on equity is 8.38 percent, which is below its allowable range. (ESH 10, BSP 00043; EXH 15, BSP 000518) [↑](#footnote-ref-4)
5. FPUC incorrectly referenced a range of 9.50 percent to 11.85 percent in its post-hearing brief. [↑](#footnote-ref-5)