

State of Florida



## Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

**-M-E-M-O-R-A-N-D-U-M-**

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**DATE:** January 24, 2019

**TO:** Office of Commission Clerk (Teitzman)

**FROM:** Division of Accounting and Finance (Cicchetti, D. Buys, Hightower) *MC DBB*  
Division of Economics (Coston, Guffey) *ALM*  
Division of Engineering (Ellis) *WBL SKG JMH*  
Office of the General Counsel (DuVal, Dziecheiarz) *FE TB RD TD*

**RE:** Docket No. 20180053-GU – Consideration of the tax impacts associated with Tax Cuts and Jobs Act of 2017 for Florida Public Utilities Company - Fort Meade Division.

**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. 20180053-GU on February 23, 2018, to consider the tax impacts affecting Florida Public Utilities Company (FPUC) – Fort Meade Division (Fort Meade or Company), resulting from the passage of the Tax Cuts and Jobs Act of 2017 (TCJA). FPUC – Fort Meade is a subsidiary of Chesapeake Utilities Corporation (CUC). CUC is also the parent of the Florida division of CUC (Chesapeake) and FPUC. FPUC – Indiantown and FPUC – Fort Meade are separate divisions of FPUC. Docket Nos. 20180051-GU, 20180052-GU and 20180054-GU were opened to address the tax impacts affecting FPUC, Indiantown and Chesapeake

On April 25, 2018, an Order Establishing Procedure for the instant 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, November 9, 2018, OPC filed an Agreed Motion to Consolidate for Purposes of Hearing in Docket Nos. 20180051-GU, 20180052-GU, 20180053-GU and 20180054-GU. On November 16, 2018, the Prehearing Order was issued and reflected proposed stipulations between Fort Meade and OPC on most of the issues. Order No. PSC-2018-0555-PCO-GU, issued on November 20, 2018, consolidated the four dockets for purposes 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. 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:** Fort Meade should be allowed to retain the amortized amount of the protected excess deferred tax balance of \$1,787. (Hightower, D.Buys, Cicchetti)

### **Position of the Parties**

**FORT MEADE:** Fort Meade should be allowed to retain the estimated amortized deferred balance, thereby fulfilling the purpose of the TCJA by allowing Fort Meade to continue making capital improvements and potentially delaying a rate proceeding.

**OPC:** Fort Meade should not be allowed to retain the benefit of the protected excess 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 Fort Meade does not have the information to compute the ARAM.

### **Staff Analysis:**

## PARTIES' ARGUMENTS

### **FORT MEADE**

Fort Meade argued that given its earnings posture, the Company should be allowed to retain the estimated annual amount of \$1,787 as a result of the tax benefit created by the excess deferred tax balance. (Fort Meade BR 8-9; TR 129-130, 132-133) Fort Meade argued that the ability to retain this amount will provide the Company with further opportunity to earn a reasonable return, 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. (Fort Meade BR 10, TR 130) Fort Meade contended that if the Company is allowed to retain the tax benefits as it has proposed, the Company's return on equity (ROE) for 2019 is projected to be negative 19.40 percent. (Fort Meade BR 12; EXH 10, BSP 00047)

Fort Meade argued that while retention of the benefits as proposed will not enable the Company to earn within its authorized range of ROE, it will certainly allow it to earn closer to its range. (Fort Meade BR 12; EXH 10, BSP 00047)

### **OPC**

OPC argued that Fort Meade should return the net tax benefit amount of \$6,375 to the customers via a base rate reduction. (OPC BR 1) OPC contended that Fort Meade's earning surveillance reports for 2014-2018 demonstrate the Company has been in an under-earnings posture for several years; thus, it had the ability to file at any time for a base rate increase, which it unilaterally chose not to do. (OPC BR 7; EXH 19) OPC argued the TCJA effect on the excess accumulated deferred income tax (ADIT) resulted in ratepayers making overpayments to Fort Meade. (OPC BR 8) OPC argued that the protected excess deferred taxes should be refunded as

rapidly as possible under the IRS regulations to ensure only fair, just, and reasonable rates are paid by ratepayers. (OPC BR 8)

### ANALYSIS

Fort Meade and OPC agree on the amount of the annual amortization of the protected excess accumulated deferred income tax (ADIT) benefit of \$1,787. (Fort Meade BR 9; TR 270) Nor is there any debate regarding Fort Meade's earnings posture. (Fort Meade BR 8; TR 273, 305-306) Witness Cassel testified that retention of the protected deferred income tax benefit will potentially provide the Company with an opportunity to earn a reasonable return, to continue making capital investments, and enable Fort Meade to charge current rates for a longer period of time thus, delaying a rate case proceeding. (Fort Meade BR 10; TR 130)

Fort Meade witness Cassel explained that if the Company is allowed to retain the protected excess accumulated deferred income tax (ADIT) benefit of \$1,787 annually, this would allow the Company to delay a rate case enabling continuation of its interim consolidation efforts pending its next rate case while also placing downward pressure on any rate increase sought in its next rate case. (Fort Meade BR 11; TR 130-132) Fort Meade wishes to avoid customer confusion that could be associated with implementation of a rate decrease resulting from flowing through the tax benefit as a rate reduction, followed, in short order, by a rate increase arising from a full rate case proceeding. (Fort Meade BR 11; TR 132-133)

OPC witness Smith relied on the 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 274; EXH 17) OPC argued, by definition, the excess tax monies in Fort Meade’s possession are a windfall to the Company that should be flowed back to the customers who paid the taxes in rates. (OPC BR 6-7; TR 274) OPC pointed out during cross-examination of Fort Meade 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 benefits were retained by the Company. (OPC BR 9, TR 208) However, in response to a staff interrogatory, Fort Meade indicated that its forecasted return on equity (ROE) for 2018 would be negative 19.40 percent if it were to retain all the tax benefits resulting from the TCJA. (EXH 10, BSP 00047)

Fort Meade argued in its brief that OPC witness Smith also acknowledged that Reedy Creek 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 Reedy Creek would be required to refund. (Fort Meade BR 13-14; TR 310-311) The Commission had already determined that Reedy Creek would have to make a refund, because it was over-earning. (Fort Meade BR 13-14, TR 308, 314-315) Fort Meade argued in its brief that witness Smith's refusal to consider Fort Meade's earnings posture in rendering his opinion on Fort Meade’s proposals to retain some of the TCJA benefits 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. (Fort Meade BR 14) As such, Fort Meade contended and staff agrees, OPC’s arguments on this point should be rejected. (Fort Meade BR 14) 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)

OPC maintained that Fort Meade witness Cassel's interpretation of the Reedy Creek decision mistakenly links the over-earnings posture of the utility in that case with the Court's use of the term "windfall." (OPC BR 6) While OPC conceded that it is a given that the decision in Reedy Creek was driven by the over-earning posture of the utility; OPC argued the foundation of the analysis was based on the cause of the increase in earnings, not on the extent of the utility's earnings. (OPC BR 6) 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 a 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 [public utilities] do not earn in excess of a fair and reasonable return on their investment."<sup>1</sup>

In its brief, Fort Meade contended that the Company's approach is not inconsistent with Reedy Creek or prior Commission practice as mentioned by OPC witness Smith. (Fort Meade BR 14; TR 314-315) There is agreement between the parties with regard to the calculation of the annual protected excess deferred tax amount of \$1,787. Witness Cassel testified that approval of its proposed treatment reflects the more reasonable approach to addressing the disposition of the tax benefits and provides the greatest overall benefit for the Company and its customers. (TR 130-133) Staff agrees with Fort Meade that a key factor in the Reedy Creek case pertained to the utility's earnings posture whereby the utility was required to make a refund because it was over-earning.

Staff agrees that the record is clear that Fort Meade is currently earning a negative return well below its authorized ROE range, and that retention of the protected tax benefit will improve the Company's earnings posture and will not cause it to exceed its authorized range. (TR 129-130, 133; EXH 19)

Staff agrees with Fort Meade's argument that OPC's reliance upon the Reedy Creek case is misplaced. (Fort Meade BR 13-14) 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 benefits arising under the 1978 Tax Reform. (Fort Meade BR 13-14; TR 311-315)

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<sup>1</sup> 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.

## **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 base rates as recommended by OPC would result in a cash flow reduction to the Company, put further downward pressure on Fort Meade's earnings, and accelerate the need for a full rate case sooner due to Fort Meade earning well below its authorized range of ROE. Therefore, staff recommends that Fort Meade be allowed to retain the amortized protected excess deferred tax balance attributed to the TCJA of \$1,787.

**Issue 5B:** What is the appropriate disposition of the unprotected excess deferred taxes?

**Recommendation:** Fort Meade should be allowed to retain the unprotected excess deferred tax amortized over 10 years of \$4,588. (Hightower, D.Buys, Cicchetti)

**Position of the Parties**

**FORT MEADE:** Ft. Meade should be allowed to retain the unprotected deferred tax liability amortized over 10 years.

**OPC:** Fort Meade should not be allowed to retain the benefit of the unprotected excess ADIT. The unprotected excess ADIT net liability of \$45,881 should be amortized over 10 years at \$4,588 per year.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

**FORT MEADE**

Fort Meade asserted that given its earnings posture, the Company should be allowed to retain the unprotected excess deferred tax benefits. (Fort Meade BR 8) Fort Meade contended that it has an unprotected excess deferred tax liability recorded on its books with an estimated balance of \$45,881. (Fort Meade BR 9; TR 129) The Company requests this deferred tax liability be amortized over 10 years at \$4,588 per year. (Fort Meade BR 9; TR 129) The Company requested that this annual amortization benefit be retained by the Company. (Fort Meade BR 9; TR 129-130; EXH 2) Fort Meade argued that this amount will provide the Company with further opportunity to earn a reasonable return, to provide service at present rates for a longer period, to continue making necessary capital investments, and to delay a costly rate proceeding. (Fort Meade BR 10) Fort Meade also argued that the ability to retain the excess ADIT of \$4,588 related to the unprotected excess deferred tax liability would enable the Company to delay a rate case, enable the Company to continue its interim consolidation efforts pending its next rate case, and would place downward pressure on the rate increase that the Company would be seeking in its next rate case. (Fort Meade BR 11; TR 132-133) Fort Meade contended that allowing the Company to retain some of the tax benefits will provide immediate financial support to the utility, thereby enabling it to continue to provide safe and reliable service to its customers. (Fort Meade BR 13; TR 133)

**OPC**

OPC argued that Fort Meade should return the total tax benefit amount of \$6,375, to the customers via a base rate reduction. (OPC BR 1) OPC contended that Fort Meade's earning surveillance reports for 2014-2018 demonstrate the Company has been in an under-earnings posture for several years; thus, it had the ability to file at any time for a base rate increase, which it unilaterally chose not to do. (OPC BR 7; EXH 19) OPC argued the TCJA effect on the ADIT resulted in ratepayers making overpayments to Fort Meade. (OPC BR 10) OPC argued that the unprotected excess deferred taxes should be refunded as rapidly as possible under the IRS regulations to ensure ratepayers pay only fair, just, and reasonable rates. (OPC BR 10) In its



brief, OPC argued that, as an alternative to the Company's proposal to retain the full benefit amount of the excess ADIT amortization, this amount should be returned to the customers via a base rate reduction. (OPC BR 9) OPC repeated its argument in Issue 4B citing the Florida Supreme Court Reedy Creek case. (OPC BR 9) OPC maintained that the TCJA's effect on the Company results in the customers making overpayments which create excess accumulated deferred income taxes. (OPC BR 10) Like any overpayment, the unprotected excess deferred taxes should be refunded as rapidly as possible to avoid intergenerational inequity and to ensure only fair, just, and reasonable rates are paid by Fort Meade's ratepayers. (OPC BR 10)

## ANALYSIS

Staff agrees the record shows there is no debate between the Parties regarding the amount of unprotected excess deferred tax, nor is there any debate regarding Fort Meade's earnings posture. (TR 129-130, 271, 273) Staff agrees with Fort Meade's position as discussed in Issue 4B, that the Company's under-earnings posture necessitates its retention of the unprotected excess ADIT amount arising from the TCJA. (Fort Meade BR 10, TR 130) The Company contended retention of the unprotected excess ADIT amount will potentially provide the Company with an opportunity to earn a reasonable return, to continue making capital investments and to enable Fort Meade to charge current rates for a longer period of time, thus delaying a rate case proceeding. (Fort Meade BR 10; TR 130)

OPC reiterated its argument as articulated in Issue 4B, based on the Reedy Creek Florida Supreme Court case, that, "[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 9) OPC further argued that the TCJA's effect on Fort Meade results in the customers making overpayments, and like any overpayment, the unprotected excess deferred taxes should be refunded to avoid intergenerational inequity and to ensure only fair, just, and reasonable rates are paid by the Company's customers. (OPC BR 10) Staff disagrees with OPC's arguments regarding the unprotected excess ADIT.

As discussed in Issue 4B, the record evidence demonstrates that Fort Meade is earning a negative return well below its authorized range of ROE. (EXH 10, BSP 00044-00046; EXH 12 00059-00061) Staff agrees that Fort Meade made a compelling argument that regulatory efficiency supports allowing the Company to retain the annual tax benefit of \$4,588 associated with the unprotected excess deferred accumulated taxes.

Fort Meade is currently earning well below its authorized ROE range, and retention of the unprotected excess ADIT amount will improve the Company's earning posture, but will not cause it to exceed its authorized range of ROE. (TR 170)

In response to a staff interrogatory, Fort Meade provided a calculation of its projected ROE of negative 22.35 percent "with tax savings recognized." (EXH 12, BSP 00059) Staff further agrees that this approach is not inconsistent with Reedy Creek or prior Commission practice as acknowledged by OPC witness Smith. (Fort Meade BR 14; TR 314-315)

## **CONCLUSION**

Staff recommends that it is fair, just, and reasonable for the Commission to consider the earnings position of the Company in its decision. Therefore, for the reasons discussed in Issue 4B and the aforementioned analysis, staff recommends Fort Meade be allowed to retain the unprotected excess deferred tax amount and that this balance be amortized over 10 years for an annual amount of \$4,588.

**Issue 18:** Should Fort Meade be allowed to recover any detrimental impact associated with the corporate income tax rate change implemented by the TCJA? If so, what amount, and should Fort Meade be allowed to recover such amount through the Energy Conservation Cost Recovery (ECCR) clause?

**Recommendation:** No, Fort Meade should not be allowed to recover any supposed detrimental impact associated with the corporate income tax rate change as a result of the TCJA through the ECCR clause. (Hightower, D.Buys, Cicchetti, Coston)

**Position of the Parties**

**FORT MEADE:** Yes, Ft. Meade should be allowed to recover any detrimental impact associated with the corporate income tax rate change implemented by the TCJA. The amount Fort Meade should be allowed to recover through the ECCR clause is \$17,929.

**OPC:** No, Ft. Meade should not be allowed to recover any detrimental impact associated with the corporate income tax rate change implemented by the TCJA.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

**FORT MEADE**

Fort Meade argued that the change in the corporate income tax rate from 35 percent to 21 percent results in a tax detriment of \$17,929. (Fort Meade BR 8; TR 128) Fort Meade proposes to recover the annual tax detriment associated with the tax rate reduction for purposes of addressing infrastructure investment. (Fort Meade BR 8; TR 128) Fort Meade argued that the Company is projected to be earning below the bottom of the earnings range utilized for Fort Meade's surveillance reporting purposes. (Fort Meade BR 8; TR 196; EXH 12, BSP 00059-00061) Fort Meade argued that approval to recover the tax detriment will provide the Company with an opportunity to preserve or improve its current earnings posture, thereby potentially deferring a future rate case. (Fort Meade BR 9) Such regulatory efficiency will extend rate stability and be more consistent with the stated purpose outlined by the tax bill's sponsor, Congressman Brady, to provide tax relief for workers, families, and job creators. (Fort Meade BR 9) Fort Meade acknowledged that approval of the Company's proposal to recover the tax detriment is at the discretion of the Commission. (Fort Meade BR 9)

**OPC**

OPC argued that a punitive tax detriment is not suffered directly by Fort Meade but is suffered, if at all, by Fort Meade's parent company Chesapeake Utility Corporation through its consolidated tax return. (OPC BR 10; TR 213-215) Upon cross-examination, witness Cassel admitted the taxes at issue here are already part of current base rates. (OPC BR 10; TR 196) The excess ADIT in dispute in Issues 4B and 5B is already calculated into the detriment amount of \$17,929. (OPC BR 10; TR 196)

Further, OPC argued that the fallacy of Fort Meade's proposed treatment of the putative tax detriment is demonstrated by inverting the effects of the TCJA. (OPC BR 10) If, instead of a

detriment to the parent company's consolidated tax return, as purported here, the TCJA resulted in a benefit on the parent company's consolidated tax return, Fort Meade would not be requesting to include the benefit in its rate base. (OPC BR 10)

### **ANALYSIS**

As pointed out by OPC in its post-hearing brief, Fort Meade projects to have negative operating income for 2018 and has identified an annual net tax detriment of \$17,929, based on its pro forma surveillance report. (OPC BR 2) Fort Meade contends that the change in the corporate income tax rate from 35 percent to 21 percent results in a tax detriment of approximately \$17,929 for the Company. (Fort Meade BR 8; 128) Witness Cassel testified that while this amount will not be sufficient to increase the Company's earned return into its allowed range of ROE, it will help the Company to make additional investments in infrastructure. (TR 128)

In response to discovery requests, the Company explained the tax detriment is due to an operating loss recognized by Fort Meade. (EXH 10, BSP 00048-00049) When a company incurs a net operating loss (NOL), the lower tax rate creates a smaller amount of tax deduction for the tax payer. (TR 205-206, TR 272; EXH 10) Fort Meade does not file its own Federal tax return, but instead files a consolidated Federal tax return with its parent company, CUC. (TR 214) CUC is the tax payer, and the NOL is recognized as a tax detriment on CUC's books. (TR 214) Consequently, the "write off" on CUC's books from Fort Meade's NOL is worth less to the parent company due to the lower tax rate. (TR 214) Fort Meade is requesting to recover the loss of that tax deduction for its parent company through an increase of \$17,929 in its ECCR Clause factors. (TR 128) However, witness Cassel confirmed regulated public utility rates are set on a stand-alone basis, that is, as if the regulated utility is required to pay income taxes. (TR 214) The utility rates charged to customers already include an allowance for income taxes. (TR 90)

The record demonstrates that Fort Meade is requesting to use a purported tax detriment to recover incremental costs in lieu of initiating a rate increase. As argued by OPC, the tax detriment is not suffered directly by Fort Meade, but is suffered, if at all, by CUC through its consolidated tax return. (OPC BR 10; TR 213-215) Further, sufficient record evidence is lacking to support that the tax detriment as proposed by Fort Meade is a result of the TCJA on a stand-alone basis. Recovery of a tax detriment or benefit by a regulated utility on behalf of its parent company is inconsistent with current regulatory practice to align income tax expense on a stand-alone basis.

As to whether the Company should be allowed to collect any detrimental impact through the ECCR clause, staff notes that the clause is governed by Rule 25-17.015, F.A.C., which states that a utility "may seek to recover its costs for energy conservation programs." OPC witness Smith stated that "[t]he estimated amount of 2018 income tax detriment does not have anything to do with the ECCR and, therefore, should not be charged to ratepayers through the ECCR." (TR 273) Witness Cassel agreed during cross-examination that the taxes in question are part of base rates, and that the ECCR has nothing to do with base rates tax impacts. (TR 196)

Additionally the Company stated in its response to staff's 2<sup>nd</sup> Set of Interrogatories, No. 4(c), that it:

recommends that the annual tax detriment be collected through the ECCR clause on an entirely consolidated basis, rather than a per-division basis. The company believes that this computation is more favorable to the Ft. Meade customers as compared to assigning the detrimental impacts specific to only the appropriate division customers. (EXH 13)

Per Commission Order No. PSC-14-0655-FOF-GU, the Commission allowed FPUC to consolidate the conservation programs' expenses of the various divisions for purposes of ECCR cost recovery.<sup>2</sup> The Order is specific to conservation expenses and does not consider non-conservation expenses or costs. As FPUC proposes, customers from all FPUC's divisions would contribute to Fort Meade's base rates tax impact through the ECCR factors. The Company further stated in its response to staff's 2<sup>nd</sup> Set of Interrogatories, No. 4(F) that it "anticipates collecting these funds through the clause until its next rate proceeding." (EXH 13) Witness Cassel stated during cross-examination that 2020 or 2021 is the current anticipated timeframe for potential rate filings. (TR 218) As such, there would not be a clearly defined endpoint at which the non-division customers would cease supporting Fort Meade's base rate tax detriment through ECCR factors.

Based on the aforementioned, staff agrees with OPC and recommends that Fort Meade should not be allowed to recover any alleged detrimental impact associated with the corporate tax rate change implemented by the TCJA, and that the ECCR clause is not the appropriate mechanism to collect the tax detriment because the taxes are part of base rates and not associated with conservation expenses.

## **CONCLUSION**

Staff recommends Fort Meade not be allowed to recover any presumed detrimental impact associated with the corporate income tax rate change implemented by the TCJA through the ECCR clause.

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<sup>2</sup>Order No. PSC-14-0655-FOF-GU, issued November 6, 2014, in Docket No. 20140004-GU, In re: Natural gas conservation cost recovery.

**Issue 19:** Should Fort Meade be allowed to retain and amortize, over 26 years, the total annual benefit associated with the Protected Deferred Tax liability?

**Recommendation:** Yes, Fort Meade should be allowed to retain and amortize, over 26 years, the total annual benefit associated with the Protected Deferred Tax liability. (Hightower, D.Buys, Cicchetti)

**Position of the Parties**

**FORT MEADE:** Yes, Fort Meade should be allowed to retain and amortize, over 26 years, the total annual benefit associated with the Protected Deferred Tax liabilities.

**OPC:** No, Fort Meade should not be allowed to retain any portion of the protected deferred income taxes; however, OPC agrees with the 26 years amortization which is consistent with ARAM.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

**FORT MEADE**

Fort Meade argued that for protected excess deferred taxes, the grossed-up balance for Fort Meade was approximately \$46,451, which was recorded as a Deferred Regulatory Tax Liability. (Fort Meade BR 9; TR 129-130) This estimated deferred balance will be amortized over 26 years using the Average Rate Assumption Method (ARAM) as prescribed by the Internal Revenue Service (IRS), which is approximately \$1,787 annually. (Fort Meade BR 9; TR 130; EXH 2)

**OPC**

As discussed in Issue 4B, OPC argued Fort Meade should not be allowed to retain the annual benefit associated with the protected excess deferred tax liabilities. (OPC BR 11) However, if the Commission decides to allow Fort Meade to retain the protected excess deferred tax benefit, then OPC agreed the amount should be amortized over 26 years consistent with the ARAM. (OPC BR 11)

**ANALYSIS**

In Issue 4B, OPC maintained that the protected excess deferred tax amount should be returned to customers while Fort Meade argued the amount should be retained. However, both Parties agree Fort Meade should amortize the total annual benefit associated with the protected excess deferred tax liabilities, over 26 years consistent with the ARAM. (Fort Meade BR 9; OPC BR 11, TR 130) Staff agrees that it is appropriate for the Company to follow the IRS ARAM and that the protected excess ADIT should be amortized over a period of 26 years.

## **CONCLUSION**

Because Fort Meade is earning a negative return well below its authorized range of ROE and is expected to continue to earn below this range even with retention of the tax savings, staff recommends that Fort Meade be allowed to retain the total annual amount associated with the protected excess deferred tax liabilities and to amortize this balance over 26 years consistent with the ARAM.

**Issue 20:** Should Fort Meade be allowed to retain and amortize, over 10 years, the total annual benefit associated with the Unprotected Deferred Tax liability?

**Recommendation:** Yes, Fort Meade should be allowed to retain and amortize, over 10 years, the total annual benefit associated with the Unprotected Deferred Tax liability. (Hightower, D.Buys, Cicchetti)

**Position of the Parties**

**FORT MEADE:** Yes, Fort Meade should be allowed to retain and amortize, over 10 years, the total annual benefit associated with the Unprotected Deferred Tax liabilities.

**OPC:** No, Fort Meade should not be allowed to retain any portion of the unprotected deferred income taxes; however, OPC agrees with the 10 years amortization period.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

**FORT MEADE**

Fort Meade argued that the Company has an unprotected excess deferred tax liability recorded on its books with an estimated balance of \$45,881. (Fort Meade BR 9; TR 129) The Company requested this excess deferred tax liability be amortized over 10 years at \$4,588 per year. (TR 129; Fort Meade BR 9) Fort Meade argued that in light of its earnings posture, this annual amortization benefit be retained by the Company as it will provide the Company with further opportunity to earn a reasonable return. (Fort Meade BR 10)

**OPC**

As discussed in Issue 5B, OPC argued Fort Meade should not be allowed to retain the annual benefit associated with the Unprotected Deferred Tax liabilities. (OPC BR 11) However, if the Commission decides to allow Fort Meade to retain the unprotected deferred tax benefit, OPC agreed the benefit should be amortized over 10 years. (OPC BR 11)

**ANALYSIS**

In Issue 5B, OPC maintained that the unprotected excess deferred tax amount should be returned to customers while Fort Meade argued the amount should be retained by the Company. (OPC BR 11; Fort Meade BR 10) However, both Parties agreed Fort Meade should amortize the total annual benefit associated with the unprotected excess deferred tax amount over 10 years. (OPC BR 11; Fort Meade BR 9, TR 129-130) Staff agrees that it is appropriate for the Company to amortize the unprotected excess ADIT amount over a period of 10 years.

**CONCLUSION**

Because Fort Meade is earning a negative return well below its authorized range of ROE and is expected to continue to earn below this range even with retention of the tax savings, staff



recommends that Fort Meade be allowed to retain the total annual amount associated with the unprotected excess deferred taxes and to amortize this balance over 10 years.

**Issue 21:** Should Fort Meade be allowed to retain the 2018 tax benefits arising from the TCJA excluding the 2018 GRIP savings?

**Recommendation:** Yes, Fort Meade should be allowed to retain the 2018 tax benefits arising from the TCJA, excluding the 2018 gas reliability infrastructure program (GRIP) savings. (Hightower, D.Buys, Cicchetti)

**Position of the Parties**

**FORT MEADE:** Yes, Fort Meade should be allowed to retain the 2018 tax benefits arising from the TCJA excluding the 2018 GRIP savings.

**OPC:** No, Fort Meade should not be allowed to retain the 2018 tax benefits arising from the TCJA.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

**FORT MEADE**

Fort Meade argued there are two components of the tax savings on the gas reliability infrastructure program (GRIP) surcharge. (Fort Meade BR 10; EXH 3, 4) The first component consists of the tax savings on the GRIP surcharge from the Jurisdictional Date through the end of the calendar year. (Fort Meade BR 10) The second component is the impact to the GRIP surcharge for 2019 forward. (Fort Meade BR 10) The tax savings in 2018 will be \$2,376. (Fort Meade BR 10) The Company contended that for 2019 and beyond, the savings will be approximately \$2,000. (Fort Meade BR 10; TR 131) The Company proposed to retain the 2018 savings. (Fort Meade BR 10) Fort Meade argued that in 2019, the new tax rate would be incorporated in the calculation of the GRIP surcharge passing the estimated \$2,000 tax benefit on to Fort Meade's customers. (Fort Meade BR 10) Fort Meade argued, if the Commission accepts Fort Meade's proposal to retain a portion of the benefits of the Tax Act, Fort Meade's customers would experience continued rate stability and would see a reduction to the GRIP surcharge. (Fort Meade BR 10; TR 132) Fort Meade contended the Company would likewise benefit from an improved earnings posture and a healthier fiscal outlook, which ultimately inures to the benefit of Fort Meade's customers. (Fort Meade BR 10; TR 132-133)

**OPC**

OPC contended that Fort Meade's proposal to retain the 2018 tax savings associated with GRIP is for the Company's sole benefit. (OPC BR 12; TR 274-275) OPC argued that Fort Meade should return the 2018 GRIP-related TCJA savings directly to its customers for the same reasons presented in the preceding issues. (OPC BR 12; TR 274-275)

OPC agreed with Fort Meade's proposal to apply the new 21 percent federal income tax rate to its 2019 GRIP surcharge projections and future projections, reducing the annual GRIP revenue amount by the resulting annual tax savings of approximately \$2,000. (OPC BR 12; TR 274-275)

OPC agreed with the return of the GRIP-related TCJA savings directly to its customers. (OPC BR 12; TR 274-275)

## ANALYSIS

As a point of clarification, Fort Meade's position on this issue is inconsistent with its argument and testimony. In its position statement, Fort Meade stated that it should be allowed to retain the 2018 tax benefits arising from the TCJA *excluding* the 2018 GRIP Savings. (Fort Meade BR 6) (emphasis added) However, in Fort Meade's argument and witness Cassel's testimony, it is clear that the Company proposes to retain the 2018 GRIP tax savings. (TR 131)

Fort Meade proposed to retain the estimated annual amount of \$1,787 from the tax benefit associated with the protected deferred tax amortization and the annual amount of \$4,588 associated with the unprotected deferred tax amortization for a total amount of \$6,375. (Fort Meade BR 10, TR 130) In addition, Fort Meade proposed to retain the tax savings of \$2,376 from the 2018 GRIP surcharge. (Fort Meade BR 10; TR 131; EXH 3) Fort Meade proposed to incorporate the new tax rate of 21 percent into the calculation of the 2019 GRIP surcharge passing on an estimated \$2,000 tax benefit to the Company's customers on a prospective basis. (Ft. Meade BR 10; TR 131) As discussed in Issues 4B, 5B, 19, and 20, staff believes the record supports allowing Fort Meade to retain the tax benefit resulting from the protected and unprotected excess deferred taxes. However, as discussed in Issue 18, staff does not believe allowing the Company to monetize a tax detriment due to a net operating loss into clause revenue is supported by record evidence, nor is it sound regulatory policy.

In Docket Nos. 20180051-GU and 20180054-GU, FPUC and Chesapeake, respectively, the Company and OPC agreed to a Type 1 Stipulation to flow the 2018 GRIP tax savings back to the customers as an over-recovery in 2019.<sup>3,4</sup> Fort Meade's argument for retaining the 2018 GRIP tax benefit in the instant docket was that the Company would benefit from an improved earnings posture and a healthier financial fiscal outlook, which ultimately inures to the benefit of its customers. (Fort Meade BR 10; TR 132-133) However, the GRIP surcharge is separate from base rates and the surcharge is based on the costs incurred by the Company to make reliability improvements to its system and is trued-up annually. (EXH 3) All expenses, including income tax expense, recovered through the GRIP surcharge are trued-up at the end of the year as an over or under recovery and applied to the ensuing year's GRIP factor. Income tax expense is not an exception to the true-up methodology. (EXH 8, 00033) As such, flowing the 2018 GRIP tax benefit back to the customers as an over-recovery in the 2019 GRIP surcharge is the appropriate regulatory treatment in this case. In consideration of consistent regulatory treatment across all CUC owned utilities, staff agrees with OPC that Fort Meade should return the 2018 GRIP-related TCJA savings to its customers as an over-recovery applied in the 2019 GRIP surcharge.

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<sup>3</sup> Order No. PSC-2018-0535-PHO-GU, issued November 16, 2018, in Docket No. 20180051-GU, In re: Consideration of the tax impacts associated with Tax Cuts and Jobs Act of 2017 Florida Public Utilities Company – Gas, Issues 9 and 22.

<sup>4</sup> Order No. PSC-2018-0538-PHO-GU, issued November 16, 2018, in Docket No. 20180054-GU, In re: Consideration of the tax impacts associated with Tax Cuts and Jobs Act of 2017 Florida Division of Chesapeake Utilities Corporation.

## **CONCLUSION**

Staff recommends Fort Meade be allowed to retain the 2018 tax benefits arising from the TCJA, excluding the 2018 GRIP over-recovery.

**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**

**FORT MEADE:** Yes.

**OPC:** No.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

**FORT MEADE**

None Provided.

**OPC**

Once the Commission makes the findings contained herein it will be unnecessary to keep this docket open. However, until that time, the docket should not be closed.

**ANALYSIS**

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