ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE INDIANA UTILITY REGULATORY COMMISSION'S INVESTIGATION INTO THE IMPACTS OF THE TAX CUTS AND JOBS ACT OF 2017 AND POSSIBLE RATE IMPLICATIONS UNDER PHASE 1 FOR SYCAMORE GAS COMPANY, INC.	))))))	**CAUSE NO. 45032 S3** **APPROVED:** OCT 09 2018

ORDER OF THE COMMISSION

Presiding Officers:
James F. Huston, Chairman
Loraine L. Seyfried, Chief Administrative Law Judge

On January 3, 2018, the Indiana Utility Regulatory Commission ("Commission") initiated an investigation under Cause No. 45032 to review and consider the implications of the Tax Cuts and Jobs Act of 2017 ("TCJA") on utility rates, which was enacted on December 22, 2017. Among other things, the TCJA reduced the federal corporate income tax rate from 35% to 21%. All jurisdictional utilities, including Sycamore Gas Company ("Sycamore"), were made Respondents to that investigation.

After holding an attorneys conference, the Commission issued an Order on February 16, 2018, creating two Phases to Cause No 45032. In Phase 1, all Respondents were required to make 30-day filings reflecting the new tax rate for all rates and charges pursuant to the Commission's 30-day filing rules.[1] However, if a respondent believed its rates should not be adjusted as reflected in the 30-day filing, it was permitted to withdraw its 30-day filings and request a subdocket to address the revision of its rates and charges to reflect the new tax rate.

Sycamore's request for a subdocket was granted on April 26, 2018. On May 7, 2018, Sycamore filed its direct testimony and exhibits. The Indiana Office of Utility Consumer Counselor ("OUCC") filed its responsive testimony and exhibits on June 14, 2018. Sycamore filed its rebuttal testimony on July 2, 2018. Sycamore also filed July 18, 2018, updated exhibits from its quarterly gas cost adjustment filing in Cause No. 37368 GCA 139. On July 20, 2018, Sycamore also responded to questions of the Presiding Officers set forth in a July 18, 2018 docket entry.

An evidentiary hearing in this subdocket was convened at 9:30 a.m. on July 20, 2018, in Room 222 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. Sycamore and

[1] Phase 2 is to address all remaining issues including: (1) the amount and amortization of normalized and non-normalized excess accumulated deferred income taxes and the regulatory accounting being used by Respondents as required by the Commission's January 3, 2018 Order for estimated impacts resulting from the Tax Act, and (2) the timing and method for how these benefits will be realized by customers, whether directly or indirectly. By docket entry issued on June 7, 2018, Sycamore was authorized to address Phase 2 issues in its pending rate case, Cause No. 45072.

the OUCC both appeared by counsel and participated in the hearing. The prefiled testimony and exhibits of both parties were admitted into the record without objection and Sycamore' responses to the Presiding Officers' docket entry questions were also admitted into the record without objection.

1. **Notice and Jurisdiction.** Notice of the hearing in this subdocket was given and published by the Commission as required by law. Sycamore is a public utility as defined by Ind. Code § 8-1-2-1(a). Under Ind. Code § 8-1-2-42, the Commission has jurisdiction over Sycamore's rates and charges for natural gas service. The Commission also has jurisdiction to initiate investigations into all matters relating to public utilities under Ind. Code §§ 8-1-2-58, 8-1-2-59, and 8-1-2-68. In addition, Ind. Code § 8-1-2-72 authorizes the Commission to alter or amend any order made by the Commission, upon notice and after opportunity to be heard. More generally, the Commission is vested with the implicit authority to "do that which is necessary to effectuate the regulatory scheme." *S.E. Ind. Nat. Gas v. Ingram*, 617 N.E.2d 943, 948 (Ind. Ct. App. 1993). Accordingly, the Commission has jurisdiction over Sycamore and the subject matter of this subdocket.

2. **Motion for Administrative Notice.** On August 10, 2018, after the close of the record in this subdocket, Sycamore filed a request for administrative notice of a single page of OUCC witness Mark Grosskopf's testimony in Cause No. 45072, Sycamore's pending rate case. On August 21, 2018, noting that the OUCC did not object to administrative notice so long as the entirety of Mr. Grosskopf's testimony was included, the OUCC filed its request to take administrative notice of all of Mr. Grosskopf's testimony in Cause No. 45072.

The Commission's procedural rule at 170 IAC 1-1.1-22 provides that, at any time after the record is closed, any party may petition to reopen the record for the purpose of taking additional evidence provided certain criteria are satisfied. Because Sycamore's request fails to satisfy those criteria, its request is denied.

3. **Summary of Evidence.**

A. **Sycamore's Case-in-Chief.** Cynthia Hughes, the Chief Financial Officer of Sycamore, testified concerning Sycamore's financial records. She sponsored Sycamore's income statement and balance sheet as of September 30, 2017, which was the end of the test year utilized in Sycamore's pending rate case, Cause No. 45072, as well as schedules showing rate base, amortization, and cost of capital calculations. She explained various adjustments made to Sycamore's test year operating expenses, including the reduction of test year federal income tax expense to reflect the lower rates adopted at the end of 2017 in the TCJA.

Ms. Hughes stated that the primary difference in her testimony in this subdocket from what she prefiled in Cause No. 45072 relates to Sycamore's deferred income tax liability. She stated that Sycamore's evidence in its pending rate case reflects changes to its deferred tax expense as a result of the TCJA, but because that issue is to be addressed in Phase 2, for purposes of this subdocket she backed out those impacts. She also noted that her calculations in this subdocket used the cost of capital approved for Sycamore in its last rate case of 10.40% rather than the 10.05% agreed to by Sycamore and the OUCC in Sycamore's pending rate case.

Ms. Hughes testified that neither Sycamore nor its parent company, Sycamore Corporation d/b/a Sycamore Energy, has any long-term debt as of March 31, 2018. Ms. Hughes concluded that evaluating Sycamore's lower federal income tax expense along with its other current costs and updating its revenue and rate base from the test year ending in 2006 to the test year ending in 2017, after pro forma adjustments, resulted in a need for an additional $984,840 in operating revenue.

John Browner, President of Sycamore, testified that it is unreasonable to evaluate in isolation the impact of a lower federal tax rate on Sycamore's current regulated utility rates. He stated that the Commission should address Sycamore's recovery of its post-2017 federal tax expense as part of a comprehensive evaluation of Sycamore's revenue and expenses in its pending rate case, Cause No. 45072.

He stated that Sycamore's current base rates were established by the Commission on June 20, 2007 in Cause No. 43090 and its costs have increased but its customer base has not grown enough to provide the additional revenue to meet those increased costs. In addition to facing higher employee wage and benefit costs and higher field construction and maintenance costs, Sycamore has also continued to invest in its utility system at an average rate which exceeds the amount of annual depreciation. Mr. Browner acknowledged that the utility's tax expense was reduced by the TCJA, but Sycamore's increased expenses since its last rate case more than offsets the reduction in its federal income tax expense.

Mr. Browner sponsored several pages from Sycamore's case-in-chief filing in its pending rate case. He stated that the new lower federal income tax rates are fully incorporated into the revenue requirement in Sycamore's pending rate case and that without those reduced tax rates, Sycamore would have been entitled to a larger increase in its base rates. He further noted that Sycamore's customers are currently enjoying, and have been enjoying since before the beginning of 2018, the benefit of utility rates which Sycamore's evidence in Cause No. 45072 has shown to be unreasonably low.

B. <u>OUCC's Case-in-Chief.</u> Mark Grosskopf, OUCC Senior Utility Analyst, recommended denial of Sycamore's proposal to increase its rates in this subdocket and recommended an immediate reduction in customer rates for the full amount of the excess income tax expense embedded in current rates and charges of $224,438, effective on the date a final order is issued in this subdocket.

Mr. Grosskopf testified that the main effects of the TCJA on regulated utilities are the reduction of the federal income tax rate to 21% and the elimination of bonus depreciation. He stated that Sycamore's evidence in this subdocket did not include any calculation of the excess income tax expense amount embedded in Sycamore's current rates and charges. He noted that instead of filing schedules showing the reduction to its current rates and charges for the new 21% income tax rate, Sycamore filed proposed revenue requirement schedules that incorporate the new tax rate along with alleged increased expenses and proposed rate base additions that are still subject to review in its pending rate case, Cause No. 45072. He stated that because the rate case is in progress, using the proposed revenue requirements from Sycamore's pending rate case is inappropriate.

Mr. Grosskopf stated that the Commission should not take Sycamore's allegation of increased expenses into consideration when deciding how TCJA benefits should be passed back to ratepayers, because Sycamore's expenses will be factored into new rates when Cause No. 45072 is decided. He further indicated that any increased expenses are deductions for tax purposes, which serve to lower Sycamore's income tax liability. From January 1, 2018 until the date of the rate case decision, rates should only reflect, as a flow-through expense, the 21% federal income tax rate in effect when service is rendered.

Mr. Grosskopf testified that Sycamore has provided no compelling justification for not immediately adjusting its current rates and charges to reflect a reduction in income tax expense. Citing to the Commission's June 1, 1987 Order (at p. 27) in Cause No. 38194 ("1987 Order"), he noted the Commission has previously addressed the reasonableness of adjusting a utility's rates and charges as a result of a change in only the federal income tax expense. Mr. Grosskopf calculated the amount of excess income tax expense embedded in Sycamore's current rates and charges as $224,438.

Mr. Grosskopf stated the OUCC recommends that Sycamore reduce its current rates and charges to reflect the 21% federal income tax rate and begin passing back the TCJA savings to its customers immediately, effective on the date a final order is issued in this subdocket. He stated that it is undisputed that Sycamore's federal income tax rate was reduced effective January 1, 2018 to 21%, and that the Commission has previously recognized that taxes are a flow-through expense. Therefore, ratepayers should begin receiving the benefits intended by federal tax reform immediately.

C. Sycamore's Rebuttal. Mr. Browner reiterated his assertion that Sycamore's current rates are unreasonably low and confiscatory. He noted that although Mr. Grosskopf correctly observes there has not yet been a determination on the merits of Sycamore's proposed revenue requirements in its pending rate case, he also did not offer any evidence disputing Sycamore's assertion about its current rates.

Mr. Browner disagreed with Mr. Grosskopf's testimony that Sycamore is advocating for any adjustment to its current rates in this subdocket. Rather, the point of Sycamore's case-in-chief was to show that if there is to be any rate change as a result of this subdocket, it can only be a rate increase. He also disagreed with Mr. Grosskopf's position that this subdocket could only result in a decrease in Sycamore's current rates. He stated that no two utilities are alike and that if the Commission intended to mandate all utilities lower their rates by filing new tariffs, there would be no need to provide this subdocket option.

Mr. Browner also disagreed with Mr. Grosskopf's characterization of the Commission's 1987 Order. He stated the impetus for the 1987 tax investigation was concern that the then recent federal tax cut might result in some utilities receiving excessive revenues if their utility rates weren't lowered to reflect the lower federal tax rates. He said for some utilities, the Commission's answer was clearly yes, but that conclusion hardly applied uniformly across all jurisdictional utilities. He noted that in the 1987 Order, the Commission did not approve a pass-through rate reduction for all utilities, but instead approved a reduction coupled with a generic allowance for

increased operating costs that may have been experienced since a utility's last rate case. And, for the smaller, more manageable number of utilities with pending rate cases, the impact of federal tax reductions were to be addressed as part of those rate cases.

4. Commission Discussion and Findings. As indicated in our January 3, 2018 Order in the underlying investigation to this subdocket, Cause No. 45032, the TCJA's enactment in 2017 reduced for many Respondents beginning on January 1, 2018 the corporate tax rate of 35% to 21%. Because the current rates being charged by most Respondents, such as Sycamore, were approved by the Commission and included recovery of costs incorporating the federal corporate tax rate of up to 35%, the Commission opened an investigation to review and consider the implications of the TCJA on utility rates and to take additional action where warranted.

The Commission recognized that the TCJA, by reducing the federal tax burden on Respondents, will create benefits for utility customers, and the realization of those benefits warranted consideration. The tax reduction became effective on January 1, 2018, and therefore, the benefits began accruing immediately and Respondents were ordered to begin using regulatory accounting for all calculated differences resulting from the TCJA and what would have been recorded if the TCJA had not be enacted.

Unlike the 1987 tax change, which became effective almost nine months after its enactment and allowed for sufficient time to conduct an expedited review on a preliminary basis of the entire benefit created by the tax change, the TCJA became effective less than two weeks after its enactment. Consequently, the Commission's February 16, 2018 Order created two Phases for addressing the benefits associated with the TCJA. We stated that the purpose of our investigation under Phase 1, which is involved here, is "to ascertain the real time existing customer rate impact directly related to the change in the federal income tax rate on the ongoing revenue requirement for each Respondent and to foster an expedient process to reflect such impact in customer rates going forward." *Commission Investigation into the Impacts of the Tax Cuts and Jobs Act of 2017*, Cause No. 45032 at 2 (IURC February 16, 2018) (footnotes omitted). The Commission clarified that what is effectively a mechanical revenue conversion factor was the focus of the initial customer benefit opportunity targeted in Phase 1. Rather than choosing to reduce its rates and charges on an ongoing basis to reflect the reduction in the federal tax rate under the TCJA through the expedited 30-day filing process, Sycamore requested this subdocket to present evidence addressing the revision of its rates and charges.

Sycamore argues that it would be unreasonable for the Commission to require Sycamore to reduce its current rates and charges to reflect the TCJA's reduction in the federal corporate tax rate from 35% to 21% because Sycamore's increased expenses since its last rate case more than offset the reduction in its federal income tax liability. Sycamore asserts that because its current rates are already insufficient to allow recovery of its authorized return, any reduction in rates to reflect the revised tax rate would only increase Sycamore's under-earnings.

We find Sycamore's arguments unpersuasive. It is generally accepted that taxes in utility rates are purely a pass-through expense; the utility receives in rates only what it is obligated to pay based on its books and not actual income tax obligation. Numerous cases have held that the Commission must use the actual, not hypothetical, tax rate. *See Ofc. of the Pub. Counselor v. Ind.*

& Mich. Elec. Co., 416 N.E.2d 161 (Ind. Ct. App 1981) (inclusion of tax expenses never actually incurred in overall revenue requirement was manifestly unreasonable); *Citizens Energy Coal. v. Ind. & Mich. Elec. Co.*, 396 N.E.2d 441 (Ind. Ct. App. 1979), *rhg. denied,* (use of statutory income tax rate, rather than actual income tax rate was contrary to law); *City of Muncie v. Pub. Serv. Comm'n*, 378 N.E.2d 896, *rhg. denied* (Ind. Ct. App. 1978) (Commission arbitrarily allowed inclusion of tax rate not actually used). Because taxes are a pass-through expense, a change in the federal income tax rate should have no substantive bearing on whether a utility is or is not earning its authorized return. We also note that the nature of the income tax component of the revenue requirement makes it different than many types of expenses because the rate of the burden is defined in statute rather than dependent on the management actions of the utility. Further, we have consistently held that utilities are not guaranteed to earn their authorized return but, rather are only entitled to a reasonable opportunity to earn such a return. *Ind. Mich. Power Co.*, Cause No. 44075 at 48 (IURC Feb. 13. 2013).

We are further unconvinced by Sycamore's assertions that it would be unjust, inequitable, or unlawful to reduce its rates on a going forward basis to reflect the TCJA's rate reduction. While Sycamore has a pending rate case and has offered evidence to demonstrate it is entitled to a rate increase, such evidence is not dispositive of whether Sycamore's rates should be adjusted on a going forward basis to reflect its *actual* federal income tax rate under the TCJA. The question of whether Sycamore's existing rates are unjust or unreasonable based on its revenue requirement to cover existing non-tax expenses is a separate question, which is pending in its rate case. Furthermore, while the GCA earnings test demonstrates that Sycamore has under-earned relative to its authorized level since September 2009, its net operating income has remained significantly positive.[2] Lastly, Sycamore's response to the Commission's July 18, 2018 docket entry stated that it had no plans that depend on the referenced amount. In short, the evidence indicates that Sycamore is responsible for a reduced federal tax burden and has no pending uses identified for the application of its TCJA created cash flow advantage. Therefore, we decline to accept Sycamore's argument that it should continue to collect on a going forward basis rates that are based on a level of pass-through expense it no longer has to bear and will not result in negative earnings.

Based on the evidence of record, we find that Sycamore shall adjust its rates and charges going forward to reflect the 21% tax rate. In accordance with the Commission's February 16, 2018 Order in Cause No. 45032 and the Presiding Officers' June 7, 2018 docket entry in this Cause, we will address in Sycamore's pending rate case, Cause No. 45072, the following: (1) the amount and amortization of normalized and non-normalized excess accumulated deferred income taxes and the regulatory accounting being used as required by our January 3, 2018 Order for estimated impacts resulting from the TCJA, including the difference between the 34% tax rate and 21% tax rate incurred to date; and (2) the timing and method for how these benefits will be realized by customers, whether directly or indirectly.

[2] We note that Sycamore could have filed a rate case at any time over the past eight years that it has been under-earning, but it did not choose to do so.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. Sycamore shall adjust its rates and charges to reflect a 21% tax rate.

2. Sycamore shall file with the Energy Division revised tariffs and applicable rate schedules under this Cause reflecting its adjusted tax rate.

3. This Order shall be effective on and after the date of its approval.

HUSTON, FREEMAN, KREVDA, OBER AND ZIEGNER CONCUR:

APPROVED: OCT 09 2018

I hereby certify that the above is a true and correct copy of the order as approved.

Mary M Becerra

Mary M. Becerra
Secretary of the Commission