ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE INDIANA UTILITY REGULATORY COMMISSION'S INVESTIGATION IN TO THE IMPACTS OF THE TAX CUTS AND JOBS ACT OF 2017 AND POSSIBLE RATE IMPLICATIONS UNDER PHASE 2 FOR COMMUNITY NATURAL GAS CO., INC.	))))))	**CAUSE NO. 45032 S7** **APPROVED:** JAN 16 2019

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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 into the impact of the Tax Cuts and Jobs Act of 2017 ("Act") to review and consider the implications of the Tax Act on utility rates and to determine what additional action, if any, is warranted. The Act contains provisions that, among other things, reduce the corporate federal income tax rate from a maximum of 35% under a graduated rate structure to a flat 21% rate thereby affecting the current rates charged by utilities. The Commission also ordered all Respondents to apply regulatory accounting treatment, such as the use of regulatory assets and liabilities, for all estimated impacts resulting from the Tax Act.

As set forth in the Commission's February 16, 2018 Order in Cause No. 45032, the investigation into the Act was divided into two phases. The purpose of Phase 1 was "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[1] and "to foster an expedient process to reflect such impact in customer rates going forward." *Id.* at 2 (footnotes omitted). Respondents were required to complete a 30-day filing in Phase 1 revising their rates and charges to reflect the new tax rate. The purpose of Phase 2 was to address all remaining issues, including: (1) the amount and amortization of normalized and non-normalized excess accumulated deferred income taxes ("EADIT") and the regulatory accounting being used for estimated impacts resulting from the Act, and (2) the timing and method for how these benefits will be realized by customers, whether directly or indirectly.

On May 14, 2018, the Commission entered its Order establishing subdockets for all Respondents except those who had been dismissed or had motions to dismiss pending, for whom further filings had been stayed, or for whom the impact of the Act did not result in a direct rate benefit to customers. Respondent, Community Natural Gas Co., Inc. ("Community"), was assigned this subdocket.

[1] Indiana's jurisdictional rate-regulated, investor-owned utilities were made Respondents.

Community filed its case-in-chief on June 19, 2018. The Indiana Office of Utility Consumer Counselor ("OUCC") filed its case-in-chief on August 21, 2018. Community filed its rebuttal on September 21, 2018.

An evidentiary hearing in this Cause was held on November 7, 2018 at 9:30 p.m. in Room 222 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. Respondent and the OUCC appeared and offered their respective evidence, which was admitted into the record without objection.

Based on the applicable law and the evidence of record, the Commission now finds:

1. <u>Notice and Jurisdiction</u>. Due, legal, and timely notice was given and published as required by law. Respondent is a public utility as defined in Ind. Code § 8-1-2-1. The Commission has jurisdiction to approve changes in the schedule of rates, tolls, and charges of Indiana public utilities under Ind. Code § 8-1-2-42. The Commission also has authority to initiate an investigation into all matters relating to any public utility pursuant to Ind. Code § 8-1-2-58. 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. Therefore, the Commission has jurisdiction over Community and the subject matter of this Cause.

2. <u>Respondent's Characteristics</u>. Community is a public utility currently providing natural gas service to its customers in Dubois, Gibson, Greene, Monroe, Owen, Pike, Posey, Spencer, Sullivan, and Warrick Counties, Indiana pursuant to prior Orders of the Commission.

3. <u>Evidence of the Parties</u>.

A. <u>Respondent's Case-in-Chief</u>. Bonnie J. Mann, a Certified Public Accountant with LWG CPAs & Advisors ("LWG"), testified that she and her colleagues were assisting Respondent and several other small natural gas utilities in addressing the Phase 2 issues. She explained that calculating the amount of EADIT is not a simple math calculation and noted there are differences between year-end tax filers and fiscal year-end tax filers. She noted that Community is a fiscal year-end tax filer and therefore, an estimate was calculated for the EADIT liability and a regulatory liability account was created based on that estimate, which now may need to be adjusted.

Ms. Mann testified that the underlying deferred tax elements for the small gas utilities represented by LWG varies by utility and include: comprehensive income components for retirement benefits; unrealized gains and losses on investments; tax carryforwards, including capital loss carryforwards; charitable contribution carryforwards; rate case cost deducted for federal income tax purposes but amortized for regulatory purposes; unbilled revenue; and other miscellaneous differences. She noted, however, the one element they all have in common is the difference between book and tax depreciation.

She explained that Exhibit 1 attached to Respondent's Exhibit 1 contains the calculation of the amount of EADIT and includes both protected and unprotected portions of the EADIT liability. She also provided the amount of EADIT that should be returned to customers in Exhibit 3 and the amortization period that should be used in Exhibit 2. She indicated that the amortization period should be the same for both protected and unprotected deferred taxes. These exhibits reflect a refundable EADIT amount of $743,230 to be amortized over a period of 15.91 years.

Ms. Mann explained the methodology she used to calculate the amount of dollars to be refunded for the over-collection of tax dollars between January and April of 2018 and recommended a temporary tracker mechanism be used to refund the over-collection, with a reconciliation of any variances between the amount required to be refunded and the amount actually refunded being included in a gas cost adjustment ("GCA") filing after April 2019. She proposed the tracker begin in January 2019 to more closely match the natural gas usage of customers that occurred from January to April 2018. Exhibit 4 of Respondent's Exhibit 1 reflects a refund amount of $131,365.21.

Finally, Ms. Mann expressed concern related to the use of a blended tax rate for non-calendar year taxpayers and the costs of this proceeding. She stated that Respondent requests the Commission authorize the deferral of the cost of this proceeding as a regulatory asset for further review and recovery in the next base rate case.

B. <u>OUCC's Case-in-Chief</u>. Isabelle L. Gordon, a Utility Analyst I with the OUCC, provided background on the changes required by the Act and described Respondent's EADIT calculation. Ms. Gordon calculated a protected and unprotected EADIT amount of $885,312 and explained her calculation. She noted that her calculation differed from Respondent's calculation because she deducted the state deferred income tax applicable to the protected and unprotected EADIT separately to provide for a more accurate protected and unprotected EADIT balance.

She also disagreed with Respondent's proposal to refund the amount of EADIT calculated in Exhibit 3 of Respondent's Exhibit 1 for several reasons. First, she stated that not updating deferred tax calculations since the last rate case ignores ratepayer contributions to income taxes or contributions to depreciation expense for the years between the last rate case and the date of the most current deferred income tax balance before the Act went into effect. Second, she asserted that Exhibit 3 was not supported by any other schedules. Third, the short-term asset, allowance for doubtful accounts, should be included in the calculation. She testified that because items generating the deferred tax created a liability or asset at a higher tax rate, when the liability or asset reverses the following year, it will be at a lower tax rate, which leaves excess deferred tax. And finally, she stated the method summarized on Exhibit 1 of Respondent's Exhibit 1 is consistent with methods used by other utilities.

Ms. Gordon expressed agreement with Respondent's proposed amortization period of 15.91 years for both the protected and unprotected EADIT dollars. She testified that amortizing EADIT of $885,312 over 15.91 years or 191 months yields an annual amortization of $55,645. She recommended that Respondent's base rates be reduced by this annual amount using the same revenue requirement schedules applicable to the approved rate in Respondent's last rate case, reflecting the revised 21% income tax rate effective on May 1, 2018, in Cause No. 45032.

Regarding the refund of the over-collected tax dollars from January 1, 2018, Ms. Gordon agreed with Respondent's calculation of the over-collection and making the refund over the proposed four-month period in 2019. However, she disagreed with Respondent's proposal to use the GCA mechanism for the tax refunds because not all customer classes receiving refunds are included in the GCA mechanism. In addition, Respondent has one GCA rate for all customer classes, so the allocation of variances would deviate from the customer class allocation approved in the last rate case. Ms. Gordon recommended that any variances in the temporary tracker mechanism be reconciled and refunded in the same temporary tracker mechanism.

Finally, Ms. Gordon addressed Respondent's other concerns. She testified that the blended tax rate for non-calendar year taxpayers will not cause those utilities to refund more than they should because the blended rate will match the appropriate rate collected for the appropriate months. She also disagreed with Respondent's request to defer as a regulatory asset the costs of Community' participation in this Cause because the amount is unknown. She testified that because the Act changed Respondent's income tax rate, Respondent would have had to calculate its EADIT to adhere to the normalization requirements of the Internal Revenue Service. She also noted that legal and accounting fees are embedded in Respondent's current base rates. While Ms. Gordon also acknowledged that Respondent's cost of capital may increase, she stated that issue was outside of the scope of this proceeding.

C. Respondent's Rebuttal. Earl L. Ridlen, III, a Certified Public Accountant with LWG, explained his disagreement with the OUCC's recommendations. Mr. Ridlen disagreed that Respondent's proposed EADIT amount to be refunded should be rejected because it is not consistent with settlements reached in other cases. He stated that the reason Community and other small gas utilities sought individual subdockets is because they expected different facts would impact each utility differently in this Cause. Mr. Ridlen also disagreed with including short-term deferred tax items in the EADIT calculation. He stated that the short-term item in Ms. Mann's calculation was created when the tax rate was 34% and then paid in the next year when the tax rate was still 34%, so there was not excess deferred income tax on that item. He also disagreed that Respondent failed to provide sufficient support for its proposed EADIT refund calculation, noting that Exhibit 3 of Respondent's Exhibit 1 is the workpaper support from Respondent's last rate case.

Regarding the OUCC's position that the December 31, 2017 deferred income tax balance provides the most up to date balance paid by ratepayers before the new 21% income tax rate went into effect, Mr. Ridlen testified that the amount of rates allocated to deferred taxes has not changed since Respondent's last rate case. He stated that while it is true deferred income taxes are calculated and reflected on the balance sheet each year, Respondent's rates don't change to reflect that new deferred tax number and to use a more current number is to disregard what is actually included in rates. He also indicated that Respondent's proposed method of returning the amount of deferred taxes embedded in base rates is the same method the Commission required to be used in Phase 1. Therefore, Mr. Ridlen recommended that the amount of EADIT dollars to be returned is $743,230.

Mr. Ridlen also addressed the OUCC's disagreement with reconciling any variances in the temporary tracker mechanism through the GCA mechanism. He testified that contrary to the OUCC's statements, all of Respondent's customers are subject to the GCA, which make the GCA an excellent mechanism for the termination of the temporary refund mechanism.

Mr. Ridlen disagreed with the OUCC's position that non-calendar year-end utilities will not be over-refunding the tax refund. Mr. Ridlen noted that Community's tax year ends September 30. He said this means that Respondent will pay taxes for the 12 months from October 2017 through September 2018 at a blended rate of 24% on all taxable income during the tax year regardless of when it was earned. He stated the Internal Revenue Service does not allocate earnings by period. He said by agreeing to refund the difference between the 34% and 21% tax rates, Respondent will be refunding more than the difference between its old tax rate and the blended tax rate applicable to the months of January through April 2018.

Finally, regarding the OUCC's recommendation to deny Community's request for recovery of the costs associated with participating in this proceeding, Mr. Ridlen noted that the costs of this proceeding are not covered in Respondent's current base rates and that the costs of regulatory proceedings are typically recovered in future base rate cases. He also noted that Respondent is not proposing to recover these costs now, but instead is proposing to be permitted to defer such costs for discussion and recovery in a base rate case.

4. <u>Commission Discussion and Findings</u>. Respondent and the OUCC disagreed on the amount of EADIT dollars to be refunded to Respondent's customers. Respondent argued the amount owed to its customers should be based upon its deferred tax balance from its last base rate case, Cause No. 44062, resulting in a customer refund of $743,230. The OUCC maintained the refund should be based on Respondent's deferred tax balance as of December 31, 2017 (the day before the Act became effective) resulting in a refund of $885,312.

As we indicated above, the Commission began its investigation into the impacts of the Act and its possible rate implications to consider how any resulting benefits should be realized by customers. In Phase 2 of the investigation, the subject of this sub-docket, we look to address the treatment of EADIT and the timing and method for how benefits are to be realized by customers, whether directly or indirectly.

The Commission has issued various orders in a number of utility sub-dockets approving how the determined benefits are to be realized, some manifesting the customer benefit immediately and others providing for a delaying of the direct benefits. *See e.g., Duke Energy Ind., LLC,* Cause No. 45032 S2 (IURC August 22, 2018) and *N. Ind. Pub. Serv. Co.,* Cause No. 45032 S5 (IURC Docket Entry dated August 13, 2018). In this proceeding, Respondent has proposed that we apply a construct similar to that applied in Phase 1, namely that Respondent be required to adjust existing base rates to reflect the Act's impact on the rates established in its most recent base rate case. Specifically, Respondent proposes we should begin by looking at the income tax calculation from its last rate case. We do not find this to be an unreasonable place to begin. The rates determined in the base rate case are comprised of many components and are established by a snapshot of the conditions that existed in the test year. Accordingly, it is reasonable to conclude that the income tax and the accumulated deferred income tax ("ADIT") balance associated with the approved rate base at that snapshot in time created a condition in which customer rates paid for income taxes that Respondent was not required to pay the government in that same period. The restatement of the ADIT balance required by the Act means that some portion of the ratemaking created income tax mismatch feature of the existing base rates can now reasonably be used to determine the associated EADIT derived by that same base rate snapshot.

However, the operation of a public utility to serve its customers and those same customers' payment for that service has moved on in time beyond the rate setting condition of that base rate case. For example, it is reasonable to expect the addition of new customers and their usage and new utility plant to serve that usage has likely occurred since Respondent's last rate case. Simplistically, Respondent has utilized the rates set in that case to generate revenue so as to manage its public utility system for the benefit of its customers. Importantly, rates and revenues are not one and the same. New customers paying existing rates creates new revenues for the utility to manage new expenses, including new utility plant. Therefore, the proposition that only the Act driven EADIT on the prior rate case determined rate base was funded by customers and should flow to their benefit falls short.

Nonetheless, there is a measure of merit in Respondent's proposal to the extent we are directing them to change existing base rates. In effect, we are asking them to change the component of the income tax imbalance embedded in existing rates. With this condition, it is reasonable to suggest that it is appropriate to match the direct customer benefit from the base rate adjustment to the approved rate base at the same point in time, the most recent base rate case. However, it is also reasonable to recognize that utility plant existing at December 31, 2017, but not yet approved for inclusion in rate base, that is used for the provision of service to customers can also be matched to ADIT and because of the Act to EADIT. Should such utility plant be added to rate base in a future base rate case it is reasonable that its matching EADIT should follow it into the ratemaking considerations made at the time of that case.

Accordingly, we find it is a reasonable appropriation of direct and indirect benefits of the Act to make a current adjustment to existing base rates in a manner that matches the adjustment amount to the conditions used to set those same base rates, in effect the Phase 1 methodology, while deferring the inclusion of the remaining Act impact amount until it can be matched with its associated rate base in Respondent's next available base rate case. This latter customer benefit is in effect an indirect benefit at this time because it affords financial flexibility to Respondent to manage its public utility for the benefit of providing natural gas service to customers until such time that Respondent seeks to alter its base rates to reflect a new snapshot in time. At the time of Respondent's next base rate case, any Act adjustment that remains to be normalized which has not yet been reflected in rates will be considered for inclusion into the going forward rates as a direct benefit to customers.

The OUCC also argued that Respondent's short-term asset, allowance for doubtful accounts, should be included in the calculation of the amount of EADIT. We agree and find that Respondent's short-term assets and liabilities along with the allowance for doubtful accounts that create any deferred tax balances at the old rate should be included in the calculation of the amount of EADIT because items generating the deferred tax created a liability or asset at a higher tax rate, when the liability or asset reverses the following year, it will be at a lower tax rate, which leaves excess deferred tax.

Based on the evidence presented, we find that the EADIT dollars to be refunded to Respondent's customers shall be calculated in the manner set forth above. Respondent shall make a compliance filing under this Cause reflecting Respondent's calculation of the EADIT to be returned in a format the mirrors Attachment ILG-1 of Public's Exhibit 1. The parties also agreed that both the protected and unprotected EADIT should be amortized over 15.91 years. We find this amortization period for all EADIT to be reasonable and approve it. The annual amortization is to be reflected as a reduction to Respondent's existing rates using revenue requirement schedules from Respondent's last rate case, updated to the new tax rate as of May 1, 2018, using the same customer allocation and rate design as approved in Respondent's last rate case, and effected through the Commission's 30-day filing process under 170 IAC 1-6.

With regard to refunding the over-collection of tax funds from January 2018 through April 2018, Community proposed that such refund occur through a temporary tracking mechanism beginning in January 2019 to refund the over-collection as closely as possible to the customers by class who paid such over-collection during a similar heating period as when the taxes were collected. The OUCC agreed with both the amount and the use of a tracker mechanism. Therefore, based on the evidence of record, we find that the over-collection in the amount of $131,365.21 should be refunded to the customer classes as proposed by Community to begin in January 2019 and run through April 30, 2019. Such temporary tracker shall be implemented as a compliance filing under this Cause made at least three business days prior to intended implementation.

The parties disagreed on the approach that should be used to reconcile and return (or collect) any variances related to the refund of the over-collection of tax dollars. Community proposed to reflect the variances through the GCA process; whereas, the OUCC recommended using the temporary tracking mechanism. The evidence indicates that all customers receiving refunds are included in the GCA mechanism. However, Respondent has only one GCA rate for all customer classes, so the allocation of variances would deviate from the customer class allocation approved in Respondent's last rate case. Given that the refunds will occur in a temporary tracking mechanism that is effected as a compliance filing under this Cause, we find that reconciling any variance in a similar manner to be reasonable and appropriate. Therefore, we find that any variances in the temporary tracking mechanism should be reconciled and refunded (or collected) in a final refund tracker by making a compliance filing under this Cause in May 2019. The filing shall include workpapers sufficient to support the reconciliation amounts. Any further variance amounts, if not de minimus, should then be included in the GCA mechanism with any supporting workpapers.

Finally, Respondent requested approval to defer the cost of its participation in this Commission investigation proceeding as a regulatory asset. When we have previously considered such requests to create a regulatory asset, we have indicated that,

> …it is necessary to consider the balance struck between the utility and its ratepayers by approving such a request. For example, the gravity of the financial event involved and its impact upon the utility is appropriate to consider, as well as the impact such accounting and/or ratemaking treatment will have upon the utility's ratepayers. Further, it is necessary for the utility requesting such extraordinary treatment to be able to demonstrate with convincing evidence that the financial event is in fact occurring, and that such financial impact is fixed, known, and measureable. If all of these elements are established, a utility might receive approval for such an extraordinary request.

Ind. Mich. Power Co., Cause No. 40980 at 6-7 (IURC Nov. 12, 1998); *see also, Duke Energy Ind., Inc.*, Cause No. 43743 (IURC Oct. 19, 2011).

In this case, despite acknowledging that such approval has generally been given when costs are found to be reasonable, Respondent did not provide any evidence of the costs it has incurred in participating in this proceeding or the reasonableness of those costs. In addition, as noted by the OUCC, even without this investigation, Respondent would have been required by the Act to incur some costs to calculate and address its EADIT. Respondent also has legal and accounting fees embedded into its current rates. Therefore, we find that Respondent has failed to provide sufficient evidence that would allow us to approve the creation of a regulatory asset for the unknown costs it has incurred to participate in this proceeding. While we are not approving Respondent's request at this time, such decision does not preclude Respondent from seeking recovery of such costs in its next rate case.

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

1. Within five days of the date of this Order, Respondent shall make a compliance filing under this Cause demonstrating the calculation of the amount of EADIT to be returned as required by Finding Paragraph 4 above. The remainder of any EADIT shall be addressed in Respondent's next base rate case.

2. Such amortization of EADIT dollars shall occur over 15.91 years using the same customer allocation and rate design as approved in Respondent's last base rate case.

3. Respondent shall propose a new tariff annually through the Commission's 30-day filing process to change its existing tariff to reflect the refund of the EADIT amount.

4. Respondent shall refund $131,365.21 in the over-collection of taxes from January 2018 through April 2018 through a temporary tracker mechanism implemented as a compliance filing under this Cause to begin in January 2019 and continue through April 2019. The reconciliation and return (or collection) of any variance shall also occur through a final refund tracker by making a compliance filing under this Cause in May 2019 to true-up any remaining refund balances. Any further variance amounts, if not de minimus, shall be included in Respondent's GCA mechanism.

5. Prior to implementing the authorized rate adjustment, Respondent shall file the applicable rate schedules under this Cause for approval by the Commission's Energy Division. Such rates shall be effective on or after the date of this approval.

6. This order shall be effective on and after the date of its approval.

HUSTON, FREEMAN, KREVDA, OBER, AND ZIEGNER CONCUR:

APPROVED: JAN 16 2019

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