

Exhibit No.:
Issues: TCJA Tax Reform, AAO
Witness: Amanda C. McMellen
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: GR-2018-0230
Date Testimony Prepared: February 26, 2019

MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

AUDITING DEPARTMENT

DIRECT TESTIMONY

OF

AMANDA C. McMELLEN

SUMMIT NATURAL GAS OF MISSOURI, INC.

CASE NO. GR-2018-0230

Jefferson City, Missouri
February 2019

**** Denotes Confidential Information ****

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AMANDA C. McMELLEN

SUMMIT NATURAL GAS OF MISSOURI, INC.

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1 **DIRECT TESTIMONY**
2 **OF**
3 **AMANDA C. McMELLEN**
4 **SUMMIT NATURAL GAS OF MISSOURI, INC.**
5 **CASE NO. GR-2018-0230**

6 Q. Please state your name and business address.

7 A. Amanda C. McMellen, Governor Office Building, P.O. Box 360, Jefferson
8 City, Missouri 65102.

9 Q. By whom are you employed?

10 A. I am employed by the Missouri Public Service Commission (“Commission”)
11 as a Utility Regulatory Auditor.

12 Q. Please describe your educational background and work experience.

13 A. I attended DeVry Institute of Technology and received a Bachelor of Science
14 in Accounting. I have been employed by the Commission since June 1999 within the
15 Auditing Department.

16 Q. Have you previously filed testimony before this Commission?

17 A. Yes. Please refer to Schedule ACM-d1 attached to this direct testimony for a
18 complete listing of cases in which I have previously filed testimony or provided
19 recommendations to the Commission.

20 Q. What is the purpose of your direct testimony in this proceeding?

21 A. My direct testimony will provide Staff’s recommendation regarding the actions
22 that the Commission should take to appropriately address the decrease in federal corporate
23 income tax expense experienced by Summit Natural Gas of Missouri’s natural gas operations

1 (“SNGMO”) since January 1, 2018, due to the enactment of the Tax Cuts and Jobs Act
2 (“TCJA”) in December 2017.

3 Q. Please summarize your testimony in this proceeding.

4 A. In this testimony, I present Staff’s recommendation that the Commission
5 authorize an Accounting Authority Order (AAO) that requires SNGMO to quantify, track
6 and defer as a “regulatory liability” all amounts associated with the reduced level of
7 federal corporate income tax expense pertaining to its Missouri natural gas rates from
8 January 1, 2018, forward to the effective date of rates in SNGMO’s next general rate
9 proceeding. This action is appropriate because the passage of the TCJA should be considered
10 to be an “extraordinary event” and thus be eligible for deferral accounting. The appropriate
11 ratemaking treatment for this deferred regulatory liability balance would be addressed by the
12 parties in SNGMO’s next natural gas rate case.

13 **TAX REFORM**

14 Q. How has the TCJA impacted SNGMO’s gas operations?

15 A. The TCJA was signed into law in December 2017 and affected SNGMO in two
16 primary ways. First, the TCJA reduced the federal corporate income tax rate that SNGMO
17 was required to pay from 35% to 21%. Secondly, the new law resulted in a portion of
18 SNGMO’s previously recorded accumulated deferred income tax (ADIT) balances becoming
19 “excess” in nature, as these amounts were previously booked by SNGMO assuming the
20 higher 35% federal corporate income tax rate, but now will actually be paid to the Internal
21 Revenue Service (IRS) by SNGMO at a 21% federal corporate income tax rate. SNGMO’s
22 excess ADIT should be flowed back to its customers in rates over a time frame compliant
23 with the TCJA.

1 Q. What is “protected” and “unprotected” excess ADIT?

2 A. The protected excess ADIT amount is associated with accelerated depreciation
3 tax timing differences while the unprotected excess ADIT amount is associated with tax
4 timing differences other than from accelerated depreciation deductions. Under the TCJA, the
5 protected excess ADIT balance cannot be flowed back to customers in rates any quicker than
6 over the estimated average remaining life of the assets that created the excess ADIT under
7 current tax normalization requirements. The unprotected excess ADIT balance is not subject
8 to the normalization requirements and at the Commission’s discretion may be returned to
9 customers in rates over any period. SNGMO has calculated that its balance of protected
10 excess ADIT is a “regulatory liability” (i.e., should be flowed back to customers in rates over
11 time) and that its unprotected excess ADIT balance is a “regulatory asset” (i.e., additional
12 amounts should be collected in rates by the Company over time).

13 Q. Is Staff recommending that SNGMO defer the impact of the excess ADIT
14 flow-back as part of this AAO request?

15 A. Yes. Staff is currently working on an agreement with the parties to this
16 proceeding that concerns deferral treatment of the protected and unprotected ADIT.
17 Generally, the agreement under discussion would require the Company to amortize the same
18 amounts of the protected excess ADIT regulatory liability and the unprotected excess ADIT
19 regulatory asset from January 1, 2018 forward to the next general rate proceeding.
20 This approach will result in a “revenue neutral” earnings situation for the Company.
21 All ratemaking impacts of the TCJA, including rate treatment of remaining excess ADIT
22 balances will be addressed as part of SNGMO’s next rate case.

1 AAOs

2 Q. What is an AAO?

3 A. In general, an AAO is an authorization from the Commission allowing a utility
4 to account for a revenue, expense, asset or liability item in a different manner than the
5 accounting treatment normally required by the Uniform System of Accounts (USOA)
6 prescribed for the utility. In almost all AAO cases, Missouri utilities have sought authority to
7 defer to their balance sheets certain costs that would normally be charged to expense as
8 incurred. This results in the establishment of a “regulatory asset” on the utility’s books,
9 which represents an amount that the utility may then seek recovery of in a subsequent rate
10 case. The advantage to a utility of receiving this type of deferral treatment is to avoid an
11 immediate charge against income, which is what would have occurred if the cost in question
12 had been charged to expense. As well, receiving deferral authority increases the chance that
13 the utility will receive rate recovery for the cost in question even if it was not incurred within
14 the test year, update period or true-up period of a general rate proceeding. Conversely,
15 Commission approved deferral accounting can also result in the establishment of a
16 “regulatory liability,” which would represent amounts that the utility would treat as increases
17 to earnings under normal USOA accounting, but are instead preserved on the utility’s balance
18 sheet for potential return to ratepayers in a subsequent rate case.

19 Q. Does the Commission order ratemaking recovery as part of any party’s request
20 for an AAO?

21 A. No. The Commission only makes a determination of whether or not the item
22 warrants deferral accounting treatment in an AAO proceeding. The actual ratemaking

1 determination regarding the deferred balances are properly made by the Commission within
2 the context of the utility's next general rate proceeding.

3 Q. What type of items is an AAO used for?

4 A. The Commission's policy has been to only authorize AAOs in order to capture
5 the financial impact of extraordinary events¹. Extraordinary events often involve natural
6 disasters, or "acts of God," such as severe, widespread ice storms, wind storms or major flood
7 events. Under normal accounting practices, costs associated with these types of events are
8 normally recorded as expense during the period that the costs were incurred. By receiving
9 permission from the Commission to defer such extraordinary costs, the utility can avoid
10 immediately charging the costs to expense and decreasing its earnings. Deferral permits a
11 utility to record such extraordinary costs as a "regulatory asset" on the balance sheet and to
12 seek subsequent rate recovery for these costs even if the costs were incurred prior to the test
13 year, update and/or true-up cutoff period ordered by the Commission in the utility's next rate
14 proceeding. For example, recovery of reasonable and prudently incurred costs incurred to
15 complete repairs and to restore service in the aftermath of a natural disaster has been
16 permitted by the Commission through an amortization to expense for the regulatory asset over
17 a reasonable time period in a utility's subsequent general rate case. In other instances, the
18 Commission has permitted AAO treatment and subsequent rate recovery to utilities for items

¹ For example, refer to the Report and Order in Case No. EO-91-358, et al., Missouri Public Service Company, a division of UtiliCorp United Inc. regarding a request by that utility to defer certain costs associated with the life extension construction and coal conversion project at the Sibley Generating Station through use of an AAO. "Deferral of costs as discussed earlier, is only made for unusual or extraordinary events."

Also refer to the Report and Order in Case No. ER-2017-0370, et al., Kansas City Power & Light Company, regarding a request by that utility to defer certain transmission expenses through use of a tracker mechanism: "The evidence presented in this case showed that KCPL's transmission costs, while having increased in recent years, are normal, ordinary and recurring operation costs. These recurring costs are not abnormal or significantly different from the ordinary and typical activities of the company, so they are not extraordinary and, therefore, not subject to deferral under the USoA."

1 such as gas safety related service line replacement programs, significant capital improvement
2 projects, security related costs and even “Year 2000”² costs.

3 Q. How has the Commission defined the term “extraordinary event?”

4 A. The Commission has defined extraordinary events as being unusual, unique
5 and non-recurring in nature.

6 Q. Has the Commission applied any other criteria in the past to issuance
7 of AAOs?

8 A. Yes. Secondly, the Commission has considered whether or not the financial
9 impact of the event in question is material in nature. However, there is no requirement that
10 the amount must be material in order to be deferred³. A cost that exceeds the level of at least
11 5% of the utility’s net income is generally considered to be a material in nature for purposes
12 of AAO requests.

13 **APPROPRIATENESS OF AAO TO DEFER IMPACT OF REDUCTION IN**
14 **FEDERAL CORPORATE INCOME TAX RATE**

15 Q. Is the reduction in the federal corporate income tax rate associated with the
16 TCJA an extraordinary event under the Commission’s criteria?

17 A. Yes. As stated earlier, the TCJA reduced SNGMO’s corporate income tax rate
18 by approximately 40%, by reducing the rate from 35% to 21%. This event is certainly
19 unusual, unique and non-recurring in that such a dramatic and material change in the federal
20 corporate income tax rate and federal tax laws has not occurred since the passage of the

² Refer to the Report & Order in Case No. GO-99-258 Missouri Gas Energy, regarding a request to defer expenditures to upgrade or replace computer equipment for Y2K compliance through use of an AAO.

³ Refer to the Report & Order in Case No. GO-99-258 Missouri Gas Energy, “...the Commission stated materiality is an issue that may be considered when determining whether to allow deferral of expenses. However a finding of materiality is not necessary to allow deferral...”

1 Tax Reform Act of 1986.⁴ For this reason, the TCJA is unique, unusual and non-recurring in
2 nature. A federal tax rate change of this size has not occurred in over three decades.

3 Q. Is the financial impact of the federal corporate income tax rate reduction
4 material to SNGMO's natural gas operations net income?

5 A. Yes. Staff applied the "Summary of the Impact of the Federal Income Tax
6 Change" amount that was included in *SNGMO's Response to Commission's Questions*, filed
7 on January 31, 2018 in File No. AW-2018-0174, to the net income amount for the twelve
8 months ending December 31, 2017 that was included in *SNGMO's Response to Order*
9 *Scheduling a Conference Regarding Procedures for Consideration of an Accounting*
10 *Authority Order*, filed on October 24, 2018, in order to determine whether the financial
11 impact of the federal corporate income tax rate change should be considered to be material:

12

Financial Impact of TCJA	** _____ **
Net Income Before Taxes	** _____ **
	** _____ **

13

14 Q. Does this conclude your direct testimony?

15 A. Yes, it does.

⁴ At the time of the change in tax law the federal corporate income tax rate was reduced from 48% to 34%. In 1993, the federal corporate income tax rate was increased to the 35% level which was reduced by the TCJA that is the subject of this proceeding.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Propriety of the Rate)
Schedules for Natural Gas Service of) Case No. GR-2018-0230
Summit Natural Gas of Missouri, Inc.)

AFFIDAVIT OF AMANDA C. McMELLEN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

COMES NOW AMANDA C. McMELLEN and on her oath declares that she is of sound mind and lawful age; that she contributed to the foregoing *Direct Testimony*; and that the same is true and correct according to her best knowledge and belief.

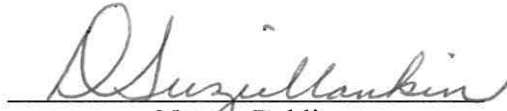
Further the Affiant sayeth not.


AMANDA C. McMELLEN

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 25th day of February 2019.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2020
Commission Number: 12412070


Notary Public

Amanda C. McMellen

SUMMARY OF RATE CASE TESTIMONY FILED

<u>COMPANY</u>	<u>CASE NO.</u>	<u>ISSUES</u>
Osage Water Company	SR-2000-556	Plant in Service Depreciation Reserve Depreciation Expense Operation & Maintenance Expense
Osage Water Company	WR-2000-557	Plant in Service Depreciation Reserve Depreciation Expense Operation & Maintenance Expense
Empire District Electric Company	ER-2001-299	Plant in Service Depreciation Reserve Depreciation Expense Cash Working Capital Other Working Capital Rate Case Expense PSC Assessment Advertising Dues, Donations & Contributions
UtiliCorp United, Inc./ d/b/a Missouri Public Service	ER-2001-672	Insurance Injuries and Damages Property Taxes Lobbying Outside Services Maintenance SJLP Related Expenses
BPS Telephone Company	TC-2002-1076	Accounting Schedules Separation Factors Plant in Service Depreciation Reserve Revenues Payroll Payroll Related Benefits Other Expenses

Amanda C. McMellen

SUMMARY OF RATE CASE TESTIMONY FILED

<u>COMPANY</u>	<u>CASE NO.</u>	<u>ISSUES</u>
Aquila, Inc. d/b/a Aquila Networks-MPS & Aquila Networks-L&P	ER-2004-0034	Revenue Annualizations Uncollectibles
Fidelity Telephone Company	IR-2004-0272	Revenue Revenue Related Expenses
Aquila, Inc. d/b/a Aquila Networks-MPS & Aquila Networks-L&P	ER-2005-0436	Revenue Annualizations Uncollectibles
Empire District Electric Company	ER-2006-0315	Payroll Payroll Taxes 401(k) Plan Health Care Costs Incentive Compensation Depreciation Expense Amortization Expense Customer Demand Program Deferred State Income Taxes Income Taxes
Aquila, Inc. d/b/a Aquila Networks-MPS & Aquila Networks-L&P	ER-2007-0004	Revenue Annualizations Uncollectibles Maintenance Expenses Turbine Overhaul Maintenance
Empire District Electric Company	ER-2008-0093	Revenues Bad Debts Employee Benefits Tree Trimming Storm Costs Customer Programs Amortizations Current Income Taxes Deferred Income taxes Jurisdictional Allocations Corporate Allocations

Amanda C. McMellen

SUMMARY OF RATE CASE TESTIMONY FILED

<u>COMPANY</u>	<u>CASE NO.</u>	<u>ISSUES</u>
Missouri Gas Energy, a Division of Southern Union Company	GR-2009-0355	Staff Report Cost of Service Revenues-Customer Growth Corporate Allocations Other Rate Base Items Amortization Expense Interest expense on customer Deposits Rents and Leases
Missouri-American Water Company	WR-2010-0131	Staff Report Cost of Service Corporate and District Allocations Lobbying Costs Net Negative Salvage Amortization of Regulatory Assets Belleville Lab Expenses Comprehensive Planning Study Payroll Payroll Taxes
Kansas City Power & Light Company	ER-2010-0355	Staff Report Cost of Service Revenues-Customer Growth In-Field Service Fees Gross Receipts Taxes Forfeited Discounts Other Revenues Credit Card Acceptance Program Bad Debts
KCP&L Greater Missouri Operations Company	ER-2010-0356	Staff Report Cost of Service Revenues-Customer Growth Other Revenues Credit Card Acceptance Program Bad Debts
Empire District Electric Company	ER-2011-0004	Staff Report Cost of Service Plant in Service Depreciation Reserve Depreciation Expense Pensions & OPEBs Customer Programs Amortizations Carrying Costs Revenue Annualizations

Amanda C. McMellen

SUMMARY OF RATE CASE TESTIMONY FILED

<u>COMPANY</u>	<u>CASE NO.</u>	<u>ISSUES</u>
Empire District Electric Company	ER-2012-0345	Staff Report Cost of Service Plant in Service Depreciation Reserve Depreciation Expense Prepayments Materials and Supplies Customer Demand Programs Amortization of Electric Plant Customer Deposits Customer Advances Carrying Costs Customer Programs Customer Deposit Interest Expense Franchise Taxes Amortizations Banking Fees Lease Expense Pay Station Fees Amortizations
Summit Natural Gas Company of Missouri, Inc.	ER-2014-0086	Corporate Allocations Capitalization Policy MGU Purchase Price SMNG Legacy Asset Valuation Energy Efficiency Programs
Empire District Electric Company	ER-2016-0023	Staff Report Cost of Service Test Year/Update/True-Up Accumulated Deferred Income Taxes SWPA Hydro Reimbursement SPP Revenues and Expenses SPP Transmission Expenses ASM Revenue and Expense Miscellaneous SPP Related Revenues and Expenses Off-System Sales Revenue and Expense Current Income Taxes Deferred Income Taxes Rate Case Expense-Sharing Advertising Dues and Donations SWPA Amortization Tornado AAO Amortization Corporate Expenses Capitalized Depreciation Proposed Acquisition
Laclede Gas Company	GR-2017-0215	Staff Report Cost of Service Revenues Uncollectibles

Amanda C. McMellen

SUMMARY OF RATE CASE TESTIMONY FILED

<u>COMPANY</u>	<u>CASE NO.</u>	<u>ISSUES</u>
Missouri Gas Energy	GR-2017-0215	Staff Report Cost of Service Revenues Uncollectibles