BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Proceeding Under Section 393.137 (SB 564) to Adjust the Electric Rates of The Empire District Electric Company	))))	Case No. ER-2018-0366

INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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OPC's brief generally is organized by its list of issues and the Chairman's requests that the parties brief, as if § 393.137, RSMo., does not apply, the propriety of Commission Accounting Authority Orders ("AAOs") to address the impacts of the federal Tax Cuts and Jobs Act of 2017 ("TCJA") on (a) The Empire District Electric Company's excess Accumulated Deferred Income Tax (excess "ADIT") and (b) the difference in the federal corporate income tax rate used to set rates in effect from January 1, 2018, and the federal corporate income tax rate thereafter, until new rates are in effect that reflect that change in the federal corporate income tax rate.

Issue 1. **Did Empire have a "general rate proceeding pending before the Commission as of . . . June 1, 2018"?**

OPC response**:** No.

In its motion to dismiss or for summary determination and in its position statements Empire argues that Case No. ER-23018-0228 was a general rate proceeding pending before the Commission on June 1, 2018. Case No. ER-23018-0228 was not a general rate proceeding and was not pending before the Commission on June 1, 2018.

General Rate Proceeding

Subsection 393.137.1, RSMo., limits the applicability of § 393,137, RSMo., as follows: "This section applies to electrical corporations that do not have a ***general rate proceeding*** pending before the commission as of the later of February 1, 2018, or June 1, 2018." Emphasis added. OPC has argued in this case that "general rate proceeding" is a term of art, but it has become so based on plain language and statutory definition. Section 1.0190, RSMo, instructs: "Words and phrases shall be taken in their plain or ordinary and usual sense, but technical words and phrases having a peculiar and appropriate meaning in law shall be understood according to their technical

import." Following are dictionary definitions[1] of "general" and "proceeding" and "case," and the applicable Missouri statutory definition of "rate":

General

adjective

1. of or relating to all persons or things belonging to a group or category: a general meeting of the employees.
2. of, relating to, or true of such persons or things in the main, with possible exceptions; common to most; prevalent; usual: the general mood of the people.
3. not limited to one class, field, product, service, etc.; miscellaneous: the general public; general science.
4. considering or dealing with overall characteristics, universal aspects, or important elements, especially without considering all details or specific aspects: general instructions; a general description; a general resemblance one to another.
5. not specific or definite: I could give them only a general idea of what was going on.
6. (of anesthesia or an anesthetic) causing loss of consciousness and abolishing sensitivity to pain throughout the body.
7. having extended command or superior or chief rank: the secretary general of the United Nations; the attorney general.[2]

Rate

As used in this chapter, the following words and phrases mean:

* * * *

(46) ""Rate", every individual or joint rate, fare, toll, charge, reconsigning charge, switching charge, rental or other compensation of any corporation, person or public utility, or any two or more such individual or joint rates, fares, tolls, charges, reconsigning charges, switching charges, rentals or other compensations of any corporation, person or public utility or any schedule or tariff thereof[.]"[3]

[1] Dictionary.com Unabridged Based on the Random House Unabridged Dictionary, © Random House, Inc. 2018.
[2] http://www.dictionary.com/browse/general?s=t, accessed 9:17 a.m. 7/26/2018.
[3] § 386.020(46), RSMo.

Proceeding

noun

1. a particular action or course or manner of action.
2. proceedings, a series of activities or events; happenings.
3. the act of a person or thing that proceeds: Our proceeding down the mountain was hindered by mud slides.
4. proceedings, a record of the doings or transactions of a fraternal, academic, etc., society.
5. proceedings, Law.
    a. the instituting or carrying on of an action at law.
    b. a legal step or measure: to institute proceedings against a person[4]

Case

noun

1. an instance of the occurrence, existence, etc., of something: Sailing in such a storm was a case of poor judgment.
2. the actual state of things: That is not the case.
3. a question or problem of moral conduct; matter: a case of conscience.
4. situation; circumstance; plight: Mine is a sad case.
5. a person or thing whose plight or situation calls for attention: This family is a hardship case.
6. a specific occurrence or matter requiring discussion, decision, or investigation, as by officials or law-enforcement authorities: The police studied the case of the missing jewels.
7. a stated argument used to support a viewpoint: He presented a strong case against the proposed law.

[4] http://www.dictionary.com/browse/proceeding?s=t, accessed 9:26 a.m. 7/26/2018.

8. an instance of disease, injury, etc., requiring medical or surgical attention or treatment; individual affliction: She had a severe case of chicken pox.

9. a medical or surgical patient.

10. Law.

    a. a suit or action at law; cause.

    b. a set of facts giving rise to a legal claim, or to a defense to a legal claim.

11. Grammar.

    a. a category in the inflection of nouns, pronouns, and adjectives, noting the syntactic relation of these words to other words in the sentence, indicated by the form or the position of the words.

    b. a set of such categories in a particular language.

    c. the meaning of or the meaning typical of such a category.

    d. such categories or their meanings collectively.

12. Informal. a peculiar or unusual person: He's a case.[5]

In the context of utility regulation, from the above definitions, a general rate proceeding is: "a legal step or measure" or "carrying on of an action at law" that is "of or relating to all persons or things belonging to a group or category" where the group or category is "every individual or joint rate, fare, toll, charge, reconsigning charge, switching charge, rental or other compensation of any corporation, person or public utility, or any two or more such individual or joint rates, fares, tolls, charges, reconsigning charges, switching charges, rentals or other compensations of any corporation, person or public utility or any schedule or tariff thereof." In other words, a general rate proceeding is a case in which the Commission considers all of the rates of a utility; therefore, "general rate proceeding" and "general rate case" are synonymous. Both "general rate proceeding" and "general rate case" are used to distinguish cases where the Commission considers all relevant factors when setting rates based on a utility's costs to serve its retail customers and cases where

[5] https://www.dictionary.com/browse/case?s=t, accessed 11:21 a.m. 7/28/2018.

the Commission is setting rates based on something less than all relevant factors—cases such as fuel adjustment clause cases, infrastructure system replacement surcharge cases, purchased gas adjustment and actual cost adjustment cases, environmental cost recovery mechanism cases, and renewable energy standard rate adjustment mechanism cases.

In Missouri, for electrical corporations such as Empire, a general rate case is initiated by the Commission, a complaint, or a tariff filing.[6] In general rate cases the Commission must consider "all relevant factors[,] including all operating expenses and the utility's rate of return."[7] Missouri courts consistently have understood this to be the definition of general rate case since at least as early as the 1950's.[8] Similarly, the legislature has done so in sections 386.266 (authorizing

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[6] See *State ex rel. Jackson Cty. v. Pub. Serv. Com.*, 532 S.W.2d 20 (Mo. 1975); §§386.390, 393.140, 393.150, 393.260 and 393.270, RSMo.

[7] See, e.g., *State ex rel. Util. Consumers Council, Inc. v. Pub. Serv. Com.*, 585 S.W.2d 41, 49 (Mo. 1979).

[8] *State ex rel. Util. Consumers Council, Inc. v. Pub. Serv. Com., 585 S.W.2d 41, 49 (Mo. 1979)* citing to *State ex rel. Mo. Water Co. v. Pub. Serv. Com.*, 308 S.W.2d 704, 718-19, 720 (Mo. 1957); *Laclede Gas Co. v. Office of Pub. Counsel*, 417 S.W.3d 815, 821-22 ("Collectively, the ISRS statutes permit the gas company to make single-issue rate increases between general rate cases in order to timely recover its costs for certain government-mandated infrastructure projects without the time and expense required to prepare and file a ***general rate case***,[9] while, at the same time, limiting the collection of the ISRS surcharge to three years to prevent its unlimited use outside of a ***general rate case***.[10] *See §§ 393.1009*, *393.1012*, and *393.1015*." (Footnotes omitted.)); *Mo. Pub. Serv. Comm'n v. Office of the Pub. Counsel (In re Mo.-Am. Water Co.)*, 516 S.W.3d 823 (Mo. 2017) (Water ISRS); *State ex rel. Laclede Gas Co. v. Pub. Serv. Comm'n'n*, 328 S.W.3d 316 (Mo. App. 2010) (Bad debt expense is recovered through rates set in a general rate case, not through a purchased gas adjustment mechanism); *State ex rel. Midwest Gas Users' Ass'n v. Psc*, 976 S.W.2d 470 (Mo. App. 1998) (General rate cases are not the exclusive means of adjusting rates, and purchased gas adjustment, actual cost adjustment mechanisms for adjusting rates between general rate cases are lawful.); *State ex rel. Mo. Energy Dev. Ass'n v. Pub. Serv. Comm'n'n*, 386 S.W.3d 165 (Mo. App. 2012) (certain renewable energy standard compliance costs may be recovered through RESRAM between general rate cases or in general rate cases); *State ex rel. Noranda Aluminum, Inc. v. PSC*, 356 S.W.3d 293 (Mo. App. 2011) (Section 386.266, RSMo, authorizes, outside of general rate cases, single issue ratemaking mechanisms.where only certain costs and revenues are considered); *State ex rel. Office of Pub. Counsel v. Mo. PSC*, 331 S.W.3d 677, 685, 690 (Mo. App. 2011) (Environmental cost recovery mechanism rules are lawful because "[t]he plain language of section 386.266[, RSMo,] permits periodic rate adjustments outside of a general rate case in order to reflect increases and decreases in prudently incurred environmental compliance costs and expenses." "Section 386.266.2 explicitly authorizes "periodic rate adjustments *outside of general rate proceedings* to reflect increases and decreases in its prudently incurred costs, whether capital or expense, to comply with any federal, state, or local environmental law, regulation, or rule." (Emphasis added.) Section 386.266 is consistent with the Supreme Court's directive that "[i]f the legislature wishes to approve automatic adjustment clauses, it can of course do so by amendment of the statutes." *Util. Consumers Council of Mo.*, 585 S.W.2d at 57. Stated another way, section 386.266 permissibly authorizes a *single issue* ratemaking mechanism that allows periodic (automatic) adjustments outside a general rate case where other costs and revenues are *not* considered. In enacting S.B. 179 (*section 386.266*), the General Assembly understood the different roles between *single issue* ratemaking mechanisms and *full rate case* proceedings. The General Assembly understood that the role of full rate case proceedings is to set base rates upon a

fuel and environmental rate adjustments between general rate cases, using general rate case synonymously with general rate proceeding), 386.520 (appeals of Commission orders; rate case), 92.280 (telecommunication company requests for depreciation rates changes, general rate case synonymous with general rate case proceeding), 393.146 (public utility acquisition of small water or sewer utility; general rate proceeding), 393.355 (special electric rates for smelters, production or fabrication of steel, new or existing customer demand increase of 50MW or more; general rate proceeding), 393.1000-1006 (water utility infrastructure system replacement surcharges; general rate case and general rate proceeding), and 393.1009-1015, RSMo (natural gas utility infrastructure system replacement surcharges; general rate case and general rate proceeding). And, likewise, the Commission has done so in at least rules 4 CSR 240-3.161(1),[9] (3), (4), (9)-(14); 4 CSR 240-3.162(1),[10] (3), (4), (6), (9)-(14); 4 CSR 240-3.260(2); 4 CSR 240-3.265(2), (5), (6), (15), (18), and (21); 4 CSR 240-3.650(2), (5), (6), (14), (17), (19), (20); 4 CSR 240-20.070 (4); 4 CSR 240-

consideration of all relevant factors. The General Assembly understood that by enacting *section 386.266*, an ECRM mechanism could only first be established in a full rate case proceeding, at which time base rates would be established upon a thorough review and consideration of "all relevant factors." *§§ 386.266.2-4*. The legislature "is presumed to know the state of the law and to pass only those statutes which have some effect or purpose," *State v. Rousseau, 34 S.W.3d 254, 262 (Mo. App. W.D. 2000)*, and the legislature is presumed to have intended a change in existing law by enacting new statutes. *Kilbane v. Dir. of Dep't of Revenue, 544 S.W.2d 9, 11 (Mo. banc 1976)*. Succinctly stated, *section 386.266* authorizes a change in the law — that periodic *single issue* ratemaking mechanisms are authorized after first being established in a *full rate case* proceeding.").

[9] General rate proceeding is defined in subsection (C) as follows: "General rate proceeding means a general rate increase proceeding or complaint proceeding before the commission in which all relevant factors that may affect the costs, or rates and charges of the electric utility are considered by the commission," but general rate case is not defined in the rule.

[10] General rate proceeding is defined in subsection (G) as follows: "General rate proceeding means a general rate increase proceeding or complaint proceeding before the commission in which all relevant factors that may affect the costs, or rates and charges, of the electric utility are considered by the commission," but general rate case is not defined in the rule.

20.090(1),[11] (2)-(7), (9) and (11); 4 CSR 240-20.091(1)[12]-(7); 4 CSR 240-20.092(1)[13]; 4 CSR 240-20.093(2)-(5), (7), and (16); 4 CSR 240-20.100(1),[14] (5), and (6).

Case No. ER-2018-0228

Empire argues in its motion to dismiss or for summary determination and in its position statements that Commission Case No. ER-2018-0228 was a general rate proceeding. While the Commission's Staff moved the Commission to open Case No. ER-2018-0228, the Commission's Staff has no authority to file a complaint "as to the reasonableness of any rates or charges of any public utility,"[15] one of the three ways by which a general rate case may be initiated—the Commission, a complaint, or a tariff filing. Empire did not make a tariff filing in Case No. ER-2018-228, so it was not initiated as a rate case for that reason. Thus, the only way Case No. ER-2018-0228 could be a general rate case is if the Commission initiated to examine all relevant factors bearing on Empire's rates. It did not. In its ***Order Opening Rate Case, Directing Notice,***

[11] General rate proceeding is defined in subsection (D) as follows: "General rate proceeding means a general rate increase proceeding or complaint proceeding before the commission in which all relevant factors that may affect the costs, or rates and charges, of the electric utility are considered by the commission," but general rate case is not defined in the rule.

[12] General rate proceeding is defined in subsection (E) as follows: "General rate proceeding means a general rate increase proceeding or complaint proceeding before the commission in which all relevant factors that may affect the costs, or rates and charges, of the electric utility are considered by the commission," but general rate case is not defined in the rule.

[13] General rate proceeding is defined in subsection (AA) as follows: "General rate proceeding means a general rate increase proceeding or complaint proceeding before the commission in which all relevant factors that may affect the costs or rates and charges of the electric utility are considered by the commission," but general rate case is not defined in the rule.

[14] General rate proceeding is defined in subsection (G) as follows: "General rate proceeding means a general rate proceeding before the commission where the commission considers all relevant factors that may affect the costs or rates and charges of the electric utility when setting rates," but general rate case is not defined in the rule.

[15] "No complaint shall be entertained by the commission, except upon its own motion, as to the reasonableness of any rates or charges of any public utility unless the complaint is signed by the public counsel, the mayor or the president or chairman of the board of aldermen or a majority of the council or other legislative body of any town, village, county, or other political subdivision, within which the alleged violation occurred, or not fewer than twenty-five (25) consumers or purchasers or prospective consumers or purchasers of public utility gas, electricity, water, sewer, or telephone service as provided by law. Any public utility has the right to file a formal complaint on any of the grounds upon which complaints are allowed to be filed by other persons and the same procedure shall be followed as in other cases." 4 CSR 240-2.070(5).

Establishing Time to Intervene, and Requiring Company to Show Cause Why Its Rates Should Not Be Adjusted, as Staff requested, the Commission ordered:

1. No later than March 19, 2018, Empire shall show cause, if any, why the Commission should not order it to promptly file tariffs reducing its rates for every class and category of electric service to reflect the percentage reduction in its federal-state effective income tax rate.

2. Empire shall quantify and track all impacts of the Tax Cuts and Jobs Act of 2017 potentially affecting electric service rates from January 1, 2018, going forward.

3. Empire shall quantify and track its excess protected and unprotected ADIT for possible future flow back to ratepayers, and shall advise the Commission how best such flow-back may be accomplished.

4. Empire shall, as part of its response to this order to show cause, advise the Commission as to its position on whether the impact of the Tax Cuts and Jobs Act of 2017 is like the gross receipts tax analyzed in Hotel Continental and the natural gas commodity costs considered in Midwest Gas Users' Association, such that the Commission may order a reduction in utility rates without considering all relevant factors in an extended general rate case.

5. Empire shall, as part of its response to this order to show cause, identify and quantify all other impacts of the Tax Cuts and Jobs Act of 2017 on its electric rates not otherwise addressed in this order.

6. The Commission's Data Center shall send a copy of this notice and order to each party to Empire's most recent general rate case – ER-2016-0023 - and to the county commission of each county within Empire's service area. The Commission's Public Policy and Outreach Department shall make notice of this order available to the members of the General Assembly representing Empire's service area and the news media serving Empire's service area.

7. Any party wishing to apply to intervene shall file an appropriate motion no later than March 5, 2018, by transmitting it to:

Morris L. Woodruff, Secretary
Missouri Public Service Commission
Post Office Box 360
Jefferson City, Missouri 65102-0360

or by using the Commission's Electronic Filing and Information System.

8. This order shall be effective when issued.

Nothing in the Commission's order provides any notice of an intent to look at the all relevant factors required in a general rate proceeding. Instead, the scope of the inquiry is limited to the potential impacts of the Tax Cuts and Jobs Act of 2017, the same subject that § 393.137, RSMo, addresses. Further, while the Commission has the authority to initiate a general rate case, this case opened in response to a Staff motion. That Staff, not the Commission, initiated Case No. ER-2018-0228 is confirmed by the Commission's May 17, 2018, *Notice Acknowledging Dismissal and Closing File*, where the Commission stated:

> On February 16, 2018, the Commission's Staff filed a motion asking the Commission to open this rate case to consider the propriety of the rates charged for electric service by The Empire District Electric Company. On May 17, Staff filed a pleading indicating it has voluntarily dismissed this action.
>
> The dismissal of an action before the Commission is controlled by Commission rule 4 CSR 240-2.116(1), which states:
>
> > An applicant or complainant may voluntarily dismiss an application or complaint without an order of the commission at any time before prepared testimony has been filed or oral evidence has been offered by filing a notice of dismissal with the commission.
>
> No prepared testimony was filed in this case and no oral evidence has been offered.
>
> The Commission acknowledges the dismissal of this action and will close this file.

Because the Commission acknowledged the dismissal of the action and closed Case No. ER-2018-0228 on May 17, 2018, nothing was pending in Case No. ER-2018-0228 on June 1, 2018, when § 393.137, RSMo, became law.

Moreover, the Legislature's grant to the Commission this year of one-time authority "to adjust such electrical corporation's rates prospectively so that the income tax component of the revenue requirement used to set such an electrical corporation's rates is based upon the provisions

of such federal act without considering any other factor as otherwise required by section 393.270"[16] is meaningless if the Commission already had that authority. The courts avoid rendering language in legislative acts meaningless.[17]

The conclusion is inescapable that Case No. ER-2018-0228 never was a "general rate proceeding" within the meaning of that phrase in § 393.137, RSMo.

Meaning of § 393.137, RSMo

Having shown § 393.137, RSMo, applies to Empire, what does § 393.137, RSMo, require of the Commission and Empire? Missouri courts have often expressed the following guidelines when interpreting legislatively enacted statutes:

> The primary rule of statutory construction is to ascertain the intent of the legislature from the language used, to give effect to the intent if possible, and to consider the words in their plain and ordinary meaning." Wolff Shoe Co. v. Director of Revenue, 762 S.W.2d 29, 31 (Mo. banc 1988). Construction of statutes should avoid unreasonable or absurd results. Taylor v McNeal, 523 S.W.2d 148, 152 (Mo. App. 1975). Furthermore, the legislature is not presumed to have intended a meaningless act. City of Willow Springs v. Missouri State Librarian, 596 S.W.2d 441, 444 (Mo. banc 1980).[18]

The text of § 393.137, RSMo, follows:

> **393.137. Electrical corporation rate adjustment, one time — definitions — when, how calculated — alternative deferral, when, how calculated. —**
> 1. This section applies to electrical corporations that do not have a general rate proceeding pending before the commission as of the later of February 1, 2018, or June 1, 2018.
>
> 2. For purposes of this section, the following terms shall mean:

[16] § 393.137, RSMo.
[17] See *Murray v. Mo. Highway & Transp. Comm'n*, 37 S.W.3d 228, 233 (Mo. Banc 2001) "[T]he legislature is not presumed to have intended a meaningless act. *City of Willow Springs v. Missouri State Librarian*, 596 S.W.2d 441, 444 (Mo. banc 1980)."
[18] *Id.*

(1) **"Commission"**, the public service commission;

(2) **"Electrical corporation"**, the same as defined in section 386.020, but shall not include an electrical corporation as described in subsection 2 of section 393.110.

3. If the rates of any electrical corporation to which this section applies have not already been adjusted to reflect the effects of the federal 2017 Tax Cut and Jobs Act, Pub. L. No. 115-97, 94 Stat. 2390, the commission shall have one time authority that shall be exercised within ninety days of June 1, 2018, to adjust such electrical corporation's rates prospectively so that the income tax component of the revenue requirement used to set such an electrical corporation's rates is based upon the provisions of such federal act without considering any other factor as otherwise required by section 393.270. The commission shall also require electrical corporations to which this section applies, as provided for under subsection 1 of this section, to defer to a regulatory asset the financial impact of such federal act on the electrical corporation for the period of January 1, 2018, through the date the electrical corporation's rates are adjusted on a one-time basis as provided for in the immediately preceding sentence. The amounts deferred under this subsection shall be included in the revenue requirement used to set the electrical corporation's rates in its subsequent general rate proceeding through an amortization over a period determined by the commission.

4. Upon good cause shown by the electrical corporation, the commission may, as an alternative to requiring a one-time rate change and deferral under subsection 3* of this section, allow a deferral, in whole or in part, of such federal act's financial impacts to a regulatory asset starting January 1, 2018, through the effective date of new rates in such electrical corporation's next general rate proceeding. The deferred amounts shall be included in the revenue requirement used to set the electrical corporation's rates in its subsequent general rate proceeding through an amortization over a period determined by the commission.

What do subsections three and four mean? A plain reading of subsection three is that the Commission has one-time authority to reduce Empire's rates prospectively based only on the impacts of Tax Cuts and Jobs Act of 2017 on the income tax component of the revenue requirement used to set Empire's current rates, and to order Empire to book into a deferral account the same impacts on Empire for the period beginning January 1, 2018, through the implementation of the new rates. There is no real dispute among the parties as to what this section means—revising

current rates to reflect Empire's income tax expense based on a 21% rate rather than a 35% and to reflect Empire's excess accumulated deferred income tax balance.[19]

A plain reading of subsection four is that, only if Empire "shows good cause," then the Commission may, instead of taking the actions laid out in subsection three, allow Empire to defer, all or part, the financial impacts Empire would have experienced from revising its current rates on January 1, 2018, to reflect Empire's income tax expense based on a 21% rate rather than a 35% and to reflect Empire's excess accumulated deferred income tax balance.

Good Cause

OPC did not include good cause on its list of issues because Empire's direct testimony is limited to legal argument by its non-attorney witnesses Christopher D. Krygier as to the meaning of § 393.137, RSMo, and discussion by him and Empire witness Charlotte T. North of a settlement agreement filed in Case Nos. EO-2018-0092 and ER-2018-0228, which OPC opposed, and the terms of which the Commission did not order. Commission rule 4 CSR 240-2.130 (7)(A) provides:

> (7) For the purpose of filing prepared testimony, direct, rebuttal, and surrebuttal testimony are defined as follows:
>
> (A) Direct testimony shall include all testimony and exhibits asserting and explaining that party's entire case-in-chief; . . . .

Section 393.137.4, RSMo, puts the burden on Empire to show "good cause" and 4 CSR 240-2.130 (7)(A) requires Empire to do so in its direct testimony.[20] While Empire's agreement to redesign its rates to collect $17,837,022 less prospectively on an annual basis and track excess accumulated deferred income taxes from January 1, 2018, starting October 1, 2018, is an admission

[19] OPC witness Stephen C. Williams, Tr. 2:200-02.
[20] Case-in-chief means: "The evidence presented at trial by the party with the burden of proof." Black's Law Dictionary, Seventh Edition, West Group, St. Paul, MN, 1999.

that it can do so, it cannot be the "good cause" required by subsection four. This is because subsection three requires that Empire's current rates be revised by August 30, 2018, to reflect Empire's income tax expense based on a 21% rate rather than a 35% and to reflect Empire's excess accumulated deferred income tax balance. Further, Empire witness Christopher D. Krygier testified that, if the Commission orders Empire to change rates based on OPC's and MECG's positions, Empire has sufficient cash flow to do so.[21] Moreover, Empire witness Christopher D. Krygier, who is Liberty Utility Services Corp.'s Director of Rates and Regulatory Affairs for Liberty Utilities Central Region which includes The Empire District Electric Company, testified in the hearing that it is his understanding Empire could file new rate schedules designed to reduce its revenues by $17,837,022 annually at any time, but, it has not done so, and, when questioned if there was a particular reason why it had not, Mr. Krygier provided none.[22]

Empire witnesses Charlotte T. North's and Stephen C. Williams' post-direct live testimony regarding Empire's belief that it has records sufficient to use the Average Rate Assumption Method ("ARAM") required by federal law,[23] but does not have the software now required to do

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[21] Tr. 2:100.
[22] Tr 2:101-02.
[23] Section 13001(d)(1) of the Tax Cuts and Jobs Act of 2017, which provides:
(d) NORMALIZATION REQUIREMENTS.—
(1) IN GENERAL.—A normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of section 167 or 168 of the Internal Revenue Code of 1986 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method.

The average rate assumption method is defined in Section 13001(d)(3)(B) of the Tax Cuts and Jobs Act of 2017 as follows:

(B) AVERAGE RATE ASSUMPTION METHOD.—The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying—
(i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by

so,[24] in response to OPC's calculations of protected and unprotected excess accumulated deferred income tax cannot be used by Empire to show "good cause," because Empire was required by § 393.137.4, RSMo, and Commission rule 4 CSR 240-2.130 (7) to show good cause to defer amounts in its case-in-chief, *i.e.*, in its direct case. It did not do so.

Empire's claim in its position statements that "the potential disparity of treatment of the various Missouri utilities" constitutes "good cause," is without any merit. The statute on its face treats differently situated utilities differently. The statute applies only to electrical corporations,[25] it treats electric utilities in pending general rate proceedings as of June 1, 2018, differently than others,[26] and it permits different treatment for an electric utility that establishes "good cause."[27]

Having demonstrated that Empire has not shown good cause as required by subsection four of § 393.137, RSMo, resolution of this case turns on subsection three. OPC designed its issues two through seven for subsection three.

Findings required for § 393.137.4, RSMo

If it is not sufficient that the Commission is familiar with which utilities it rate regulates, Empire's admission that the Commission has jurisdiction over its electric rates is sufficient for the Commission to find that Empire is an electrical corporation as defined by § 386.020(15), RSMo.

Issue 2. **What is the revenue requirement upon which Empire's current rates are set?**

(ii) the amount of the timing differences which reverse during such period.
[24] Charlotte T. North, Tr. 2:130-32, 165-66, 170-71, 174, 177-181; Stephen C. Williams, Tr. 2:184-185, 188-192, 203-210, 217-222.
[25] § 393.137.1,2(2), RSMo; e.g., Union Electric Company d/b/a Ameren Missouri, Case No. ER-2018-0362.
[26] § 393.137.1, RSMo; e.g. Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company, Case Nos. ER-2018-0145 & 0146, respectively.
[27] § 393.137.3,4, RSMo.

OPC response: $489,566,812.

Using this as the basis for determining the revenue requirement impacts on Empire and, thus, its rates due to the Tax Cuts and Jobs Act of 2017 is uncontested.

This is the number OPC used. Ex. 5, OPC witness John S. Riley corrected direct testimony, Sch. JSR-D-2. And while they did not necessarily agree that $489,566,812 is the revenue requirement upon which Empire's current rates are set, Empire's witnesses Christopher D. Krygier and Charlotte T. North (Tr. 2:113-14 and 169-70, respectively) agree that $489,566,812 is an acceptable number to use as the starting point for implementing any rate changes from this case, and Staff witness Oligschlaeger did not disagree (TR 2:244-45). It is also the number used as the basis for the Tax Cuts and Jobs Act of 2017-related terms of the settlement agreement to which Empire was a party in Case Nos. ER-2018-0228 and EO-2018-0092. Ex. 2, Empire witness Charlotte T. North direct testimony pp. 4-5, Sch. 1, the same terms of the *Non-Unanimous Stipulation and Agreement* Empire joined in and filed on July 17, 2018, to which OPC objected that same day.

Issue 3. **By what amount should the revenue requirement upon which Empire's current rates are set be reduced to reflect the change in the federal corporate income tax rate from 35% to 21% effective January 1, 2018, "to adjust [Empire's] rates prospectively so that the income tax component of the revenue requirement used to set such an electrical corporation's rates is based upon the provisions of [the 2017 Tax Cut and Jobs Act, Pub. L. No. 115-97, 94 Stat. 2390,] without considering any other factor as otherwise required by section 393.270"?**

OPC response**:** $17,469,270.

Empire and Staff's response is $17,837,022, due to Empire using a lower composite tax rate than OPC—25.12% vs. 25.45%. Empire concedes the difference in composite tax rates is immaterial and, therefore, the difference in results must be immaterial as well.

OPC calculated this $17,469,270 amount.[28] Empire and Staff's number is $17,837,022.[29] According to Empire witness Charlotte T. North, both numbers are estimates.[30] The difference between OPC, and Empire and Staff is due to OPC using a different composite tax rate than Empire and Staff.[31] OPC used a composite tax rate of 25.45%, where Empire and Staff used a composite tax rate of 25.12%. Empire agrees that the difference in the composite tax rate is immaterial[32]; therefore, the difference in the revenue requirement amounts is as well. Empire witness Stephen C. Williams testified as much.[33] The Commission should note that Empire used a composite tax rate of 25.12% when calculating the prospective impact on its rates from reducing the federal corporate income tax rate from 35% to 21%, but it used a composite tax rate of 25.64% when estimating the impact of excess accumulated deferred income taxes.[34] OPC witness John S. Riley used a composite tax rate of 25.45% for both.[35]

Issue 4. **What is the total amount of Empire's protected excess Accumulated Deferred Income Taxes due to the 2017 Tax Cut and Jobs Act, Pub. L. No. 115-97, 94 Stat. 2390?**

OPC response: $130,161,870.[36]

Although Empire prefiled direct testimony in this case on June 25, 2018, which it amended on July 6, 2018, it did not include any balances for its protected excess accumulated deferred income taxes or unprotected excess accumulated deferred income taxes, or even a balance for its

[28] Ex. 5, OPC witness John S. Riley corrected direct testimony, p.2, l. 15, p.4, 1l. 20-22.
[29] Ex. 2, Empire witness Charlotte T. North direct testimony pp. 4-5, Sch. 1, Tr. 2:121-22; Ex. 3, Staff witness Mark L. Oligschlaeger rebuttal testimony, pp. 4-5.
[30] Tr. 2:129.
[31] See Ex. 5, OPC witness John S. Riley corrected direct testimony, Sch. JSR-D-2 and Ex. 2, Empire witness Charlotte T. North direct testimony, Sch. 1.
[32] Empire witness Charlotte T. North, Tr. 2:158.
[33] Tr. 2:203.
[34] Ex. 2, Empire witness Charlotte T. North direct testimony, Sch. 1; Empire witness Charlotte T. North, Ex. 6, p. 4 and Tr. 158-59.
[35] OPC witness John S. Riley corrected direct testimony, Schs. JSR-D-2 and JSR-D-4, Ex. 8 and Ex. 9.
[36] OPC witness John S. Riley corrected direct testimony, p. 2, l. 22; p. 6, l. 15; Sch. JSR-D-4, p. 2, l. 16, cols. k & m; Ex. 8.

excess accumulated deferred income taxes.[37] OPC is the first party who introduced into evidence any amount for Empire's protected excess accumulated deferred income tax due to the Tax Cuts and Jobs Act of 2017. It did so through the direct testimony of its witness John S. Riley who, based on Empire's July 5, 2018, responses to OPC's data requests nos. 1301[38] and 1302[39] issued on June 15, 2018, prefiled that testimony on July 11, 2017, and then corrected it for errors on July 17, 2018, and again on July 23, 2018, during the evidentiary hearing.[40] With the exception of changing certain composite tax rates on his schedules to 25.45%, Mr. Riley's corrections to his testimony were made to conform that testimony to his schedules, which show how, starting with information Empire provided on July 5, 2018, he calculated protected and unprotected accumulated deferred income tax balances for Empire's electric operations.[41]

For the first time, during the evidentiary hearing, Empire's witnesses Charlotte T. North and Stephen C. Williams provided some explanation of what Empire did to create the files upon which OPC witness John S. Riley relied for estimating Empire's excess accumulated deferred income tax, protected excess accumulated deferred income tax, and unprotected excess accumulated deferred income tax balances. Ms. North testified that she pulled general ledger balances into the file based on criteria Steven C. Williams provided to her.[42] To the extent Steven C. Williams provided explanations, his explanations appear with his criticisms of OPC's quantification of those balances that follow:

[37] Ex. 1, Empire witness Christopher D. Krygier direct testimony; Ex. 2, Empire witness Charlotte T. North direct testimony.
[38] Ex. 7.
[39] Ex. 6.
[40] Ex. 6, Ex. 7, Ex. 5, OPC witness John S. Riley direct testimony, Sch. JSR-D-4, Ex. 8, Ex. 9, Empire witness Stephen C. Williams, Tr. 2:194-95; OPC witness John S. Riley, Tr. 3:295.
[41] Ex. 5, OPC witness John S. Riley direct testimony, Ex. 8, Ex., 9, OPC witness John S. Riley, Tr. 3:278-79.
[42] Tr. 2:162-63, referring to Ex. 6, Tr. 2:158.

1. “Mr. Riley's estimates of excess ADIT include both the Missouri wholesale allocations, which are subject to FERC jurisdiction and retail allocations”;

2. “Mr. Riley listed Account 190112, which is a deferred tax asset, relating Ozark Beach lost generation on both his unprotected and protected schedules and he double counted the balance”;

3. “Mr. Riley's protected worksheet assumes that all the account balances appearing to relate to depreciation differences would be protected.· In fact, these accounts are used to record accumulated deferred income taxes from all differences between book and tax depreciation and -- and the treatment of fixed assets”;

4. “[O]n Account 190230, which is a net operating loss carry forward, our position was that it should be netted against Account 282100, which is the primary fixed asset, deferred liability account since the net operating loss came about as a result of bonus depreciation on the heavy capital investment required by utility companies. Since it was depreciation related and a tax -- a deferred tax asset provides no cash benefit at this point in time, could possibly never, then it -- we thought it would be more appropriate to net it against the depreciation that brought it about. Mr. Riley's worksheet he agreed with our reclassification which eliminated the NOL, but he did not net it against Account 282100 and that overstates his assumed estimated excess deferred income tax by 5.4 million dollars”;

5. “[I]n comparing the amounts for the pre-TCJA composite tax rate, post-tax reform tax rate and the gross-up conversion factor from schedules prepared by Empire, he was -- he used different rates, but we did not receive any details of his computations where we could ascertain, you know, why there were any changes”;

6. “Mr. Riley's unprotected worksheet doesn't include nine of our general ledger accumulated deferred tax asset income tax accounts.· And those accounts total 31.4 million dollars of deferred tax assets.· And the omission increases his computation of the unprotected excess ADIT”;

7. “Account Number 283123, the hedge transaction losses, was partially excluded from rate-base in prior cases.· And our computations remove that excluded portion from excess ADIT.· Mr. Riley's schedule includes our taking it out, but he makes another adjustment that puts it back in, the excluded portion, and restored the entire account balance to the amount included in rate-base and computed excess ADIT upon it.· That adjustment was in excess of a million dollars”; and

8. “Account 283915, the deferred tax liability FAS 109 is an account that contains deferred tax -- the deferred tax side of tax gross-up -- prior tax gross-up adjustments.· On Empire's schedules we eliminated this account as a non-cash item because it's

offset by a corresponding regulatory asset account. Mr. Riley's schedules do not eliminate the account and it has a 1 -- or 13.3 million dollar credit balance."[43]

OPC does not dispute that, if the balances in column (k) of Exhibits 6, 8 and 9, and 5 Schedule JSR-D-4 to the direct testimony of OPC witness John S. Riley are FERC jurisdictional then they should be excluded from the calculations of the estimates of Empire's excess accumulated deferred income tax, protected excess accumulated deferred income tax, and unprotected excess accumulated deferred income tax balances.

As to Mr. Williams' fifth criticism, it is based on differences in the composite tax rate, which Empire has conceded is not material.[44]

Further, to the extent, if any, to which the Commission finds Empire's eight criticisms have merit, then it should adjust, but not reject, OPC's quantifications of Empire's excess accumulated deferred income tax, protected excess accumulated deferred income tax, and unprotected excess accumulated deferred income tax balances shown on Exhibits 8 and 9.

a. **By what amount should the revenue requirement upon which Empire's current rates are set be reduced to reflect Empire's protected excess Accumulated Deferred Income Taxes due to the 2017 Tax Cut and Jobs Act, Pub. L. No. 115-97, 94 Stat. 2390?**

OPC response: $8,729,631 ($130,161,870*1.34135/20).[45]

The amount here is the result of three inputs: Empire's protected excess accumulated deferred income tax balance, an amortization period, and the composite tax rate. Empire has used composite tax rates of 25.12 and 25.64% in this case, and OPC has used a composite tax rate of 25.45%. As stated above for the composite tax rate, Empire concedes that the differences are

[43] OPC witness Stephen C. Williams Tr.2:195-98.
[44] Empire witness Charlotte T. North, Tr. 2:158; Empire witness Stephen C. Williams, Tr. 2:203.
[45] OPC witness Riley corrected direct testimony, p. 2, ll. 19-21; p. 4, l. 17, p. 6, ll. 15-16.

immaterial. With a reasonable estimate of Empire's protected excess accumulated deferred income tax balance, the remaining issue is a reasonable amortization period. Empire provided none, while, based on what the Commission did in Spire's last general rate, case OPC recommends an amortization period of 20 years with a tracker, to avoid the potential income tax consequences of a normalization violation.[46]

Empire first raised the specter of a normalization violation and potential adverse tax consequences that may follow in live testimony in response to OPC's recommendation.[47] A normalization violation occurs when protected excess accumulated deferred income tax balances are flowed back to retail customers through rates faster than the remaining life of the assets that create the accumulated deferred income tax balances.[48] OPC witness John S. Riley testified, "And if the 20 years was going to not cover the ARAM method or it was going to, you know, return it too fast, that with a tracker you would be able to make that adjustment to keep from them from being in violation with the IRS."[49] Further, Staff witness Mark L. Oligschlaeger testified, "I mean what exactly would constitute a normalization violation I think somewhat depends on the facts and circumstances of how the benefits are flowed back and whether there's a true-up mechanism and other factors."[50] A pertinent question is "What does the IRS think?"

The IRS has indicated what it thinks in its revenue procedure 2017-47 *Safe Harbor for Inadvertent Normalization Violations*[51] it issued and the clarification memorandum[52] it issued

[46] Ex. 5, OPC witness John S. Riley direct testimony, pp. 3, 6; OPC witness John S. Riley, Tr. 3:316-19.
[47] Empire witness Charlotte T. North, Tr. 2:192-93; Stephen C. Williams, Tr. 2:213, 216-17.
[48] Empire witness Charlotte T. North, Tr. 2:192-93; Stephen C. Williams, Tr. 2:213, 216-17, Mark L. Oligschlaeger, Tr. 2:227.
[49] Tr. 3:317.
[50] Staff witness Mark L. Oligschlaeger, Tr. 2:227.
[51] https://www.irs.gov/pub/irs-drop/rp-17-47.pdf .
[52] https://www.irs.gov/pub/lanoa/am-2018-001.pdf

February 6, 2018. OPC requests that the Commission take notice of both, and copies of each are attached. Both indicate that, so long as this Commission attempts to comply with the normalization requirements and Empire has the opportunity and does "cure" any violation as soon as possible, the IRS will not disallow Empire's accelerated depreciation or investment tax credits based on a normalization violation. See Internal Revenue Service Private Letter Ruling Number: 201709008, released March 3, 2017,[53] a copy of which is also attached.

OPC's twenty-year amortization period is a 5% rate—100%/20. OPC witness John S. Riley testified that an alternative to the average rate assumption method when it cannot be used is the reverse South Georgia method. He testified that preliminary calculations using that method yield an amortization rate for Empire of 2.96%.[54] Despite his refusal to quantify the risk that a 40-year amortization period—a 2.5% (100%/40) rate—would cause a normalization violation for Empire, Empire's own witness Stephen C. Williams testified that the Riverton 12 assets he identified as a concern for violating the average rate assumption method went into service in 2016 with a 40-50 year life.[55] A fifty-year amortization period results in a 2% rate.

OPC advocates that the Commission reduce the revenue requirement upon which Empire's current rates are set by $8,729,631 to reflect Empire's protected excess Accumulated Deferred Income Taxes. It is OPC's position that the Commission cannot reasonably reduce

It is OPC's position that, based on this record, the Commission could not reasonably reduce the revenue requirement upon which Empire's current rates are set the revenue requirement upon which Empire's current rates are set by less than $3,266,769. Empire's own evidence is that it

[53] https://www.irs.gov/pub/irs-wd/201709008.pdf .
[54] Ex. 5, OPC witness John S. Riley direct testimony, p. 6.
[55] Empire witness Stephen C. Williams, Tr. 2:215-17.

estimates its protected excess accumulated deferred income tax balance to be $121,457,659 (line 16, column (m) on page 6 of Exhibit 6) and applied a composite tax rate of 25.64% (Exhibit 6), and its witness Stephen C. Williams' testifies and refers in e-mails to asset lives no longer than 50 years.[56] A fifty-year amortization period yields a rate of 2%.

Regardless of its quantification of by what amount to design Empire's rates to reduce what it collects on an annual basis to reflect return to its retail customers of its protected excess accumulated deferred income tax balance, the Commission should explicitly state that it is not the Commission's intent to violate the tax normalization requirements, order Empire to seek a private letter from the IRS as to whether the Commission's order creates a normalization violation, and state that if its order creates a normalization violation the Commission intends to cure any such violation at the earliest opportunity.

Since Empire has four years from when it last continued is fuel adjustment clause to have a new tariff that continues that clause, it is highly likely Empire will file a general electric rate case before mid-October 2019—since when the Commission approved Empire's fuel adjustment clause compliance tariff sheets in Case No. ER-2016-0023 it made them effective September 14, 2016, any mismatch should be remedied soon.

Issue 5. **What is the total amount of Empire's unprotected excess Accumulated Deferred Income Taxes due to the 2017 Tax Cut and Jobs Act, Pub. L. No. 115-97, 94 Stat. 2390?**

OPC response: $22,825,532.[57]

[56] Tr. 2:216, 221-222; Ex. 5, OPC witness John S. Riley direct testimony, Sch. JSR-D-3, p. 7.
[57] OPC witness Riley corrected direct testimony, p. 2, ll. 7-10; Sch. JSR-D-4, p. 3, l. 36, cols. k & m as corrected by Ex. 9 and Tr. 3:279.

Rather than repeating the same information and argument it presents in its response to Issue 4 regarding quantification of the total amount of Empire's protected excess accumulated deferred income taxes due the Tax Cuts and Jobs Act 0f 2017 here, OPC refers the Commission to what it said there *supra*.

a. **By what amount should the revenue requirement upon which Empire's current rates are set be reduced to reflect Empire's unprotected excess Accumulated Deferred Income Taxes due to the 2017 Tax Cut and Jobs Act, Pub. L. No. 115-97, 94 Stat. 2390?**

OPC response: $2,282,553 ($22,825,532*1.34135/10).[58]

As it did for Empire's protected excess accumulated deferred income tax balance, OPC recommends the Commission use a composite tax factor of 25.45%. As OPC addressed under Issues 3 and 4.a., OPC used different composite tax rate than Empire and Staff.[59] OPC used a composite tax rate of 25.45%, where Empire and Staff used a composite tax rate of 25.12%. Empire agrees that the difference in the composite tax rate is immaterial.[60] As OPC suggested in discussing issues 3 and 4.a., the Commission should note that Empire used a composite tax rate of 25.12% when calculating the prospective impact on its rates from reducing the federal corporate income tax rate from 35% to 21%, but it used a composite tax rate of 25.64% when estimating the impact of excess accumulated deferred income taxes.[61] OPC witness John S. Riley used a composite tax rate of 25.45% for both.[62]

[58] OPC witness Riley corrected direct testimony, p. 3, ll. 6-7; p. 4, l. 17; p. 7, ll. 3-8, as corrected by Tr. 3:279.
[59] See Ex. 5, OPC witness John S. Riley corrected direct testimony, Sch. JSR-D-2 and Ex. 2, Empire witness Charlotte T. North direct testimony, Sch. 1.
[60] Empire witness Charlotte T. North, Tr. 2:158.
[61] Ex. 2, Empire witness Charlotte T. North direct testimony, Sch. 1; Empire witness Charlotte T. North, Ex. 6, p. 4 and Tr. 158-59.
[62] Ex. 5, OPC witness John S. Riley corrected direct testimony, Schs. JSR-D-2 and JSR-D-4, Ex. 8 and Ex. 9.

OPC recommends the Commission use an amortization period of 10 years based on Union Electric Company agreeing to the same period and the Commission using a 10-year period for Spire in its most recent general gas case.[63]

Issue 6. **What is the amount the Commission should order Empire to defer for Empire's recovery from its Missouri electric customers of its federal income tax from January 1, 2018, until new rates take effect in this case that is based on a federal corporate income tax rate of 35% when the actual rate is 21%, that is to be included as a reduction the revenue requirement used to set Empire's rates in its next general rate proceeding through an amortization over a period determined by the commission?**

OPC response: Assuming new rates take effect August 30, 2018, $11,582,365 (242/365*$17,469,270).[64]

No party disputes this calculation.[65]

a. **Over what period should the Commission amortize this deferred amount?**

OPC response: Four years, which makes the annual revenue requirement reduction $2,895,591.[66]

Issue 7. **How should Empire's rates be designed to implement the rate reductions?**

OPC response: Empire's customer charges should be reduced now on an equal percentage basis designed to reduce Empire's annual revenues by $28,487,356 based on the $28,487,356 reduction in Empire's annual revenue requirement.

In its next general electric rate case the Commission should use the annual amount from amortizing the deferred amount for Empire's recovery from its Missouri electric customers of its federal income tax from January 1, 2018, to when new rates take effect in this case to reduce

[63] Ex. 5, OPC witness John S. Riley corrected direct testimony, pp. 3, 7; OPC witness John S. Riley Tr. 3:316-19, 322.
[64] Ex. 5, OPC witness Riley corrected direct testimony, p. 3, ll. 11-15; p. 7, ll. 12-16.
[65] Empire witness Charlotte T. North, Tr. 2:133-35.
[66] Ex. 5, OPC witness Riley corrected direct testimony, p. 8, ll. 1-2.

Empire's then existing customer charges on an equal percentage basis designed to reduce Empire's annual revenues by $2,895,591, before making any other changes to Empire's customer charges in that case.[67]

OPC's rationale for reducing the customer charges to reflect the rate reductions is that doing so best ensures that Empire's customers will realize the benefits of the Tax Cuts and Jobs Act of 2017 as the Missouri Legislature contemplated in § 393.137, RSMo, Customer charges are finite, and have a greater degree of predictability to insure that bills are not reduced any more or less than the Commission intends. Changes to volumetric rate elements may vary based on consumption, which may be influenced by factors such as weather. This excess tax money has been, in fact, been collected from Empire's retail customers, and Empire's fixed charges are the more accurate mechanism to return that excess tax money back to Empire's retail customers, short of a direct refund. Because § 393.137, RSMo, authorizes single issue rate changes to enable customers to realize the benefits of the Tax Cuts and Jobs Act of 2017, OPC recommends those rate changes be implement through the customer charge.[68]

Empire and Staff's Position Does Not Comply with § 393.137, RSMo

The terms of Empire and Staff's opposed settlement agreement—*Non-Unanimous Stipulation and Agreement*, filed July 17, 2018–are that Empire will file revised retail tariff sheets to take effect October 1, 2018, that will reflect a reduction of $17,837,022 in Empire's annual base rate revenue due to the Tax Cuts and Jobs Act of 2017 change in the federal corporate income tax rate from 35% to 21% effective January 1, 2018, and that Empire will record in a regulatory liability account "the difference between the excess ADIT balances included in current rates,

[67] Ex. 5, OPC witness John S. Riley corrected direct testimony, p. 8.
[68] Ex. 5, OPC witness John S. Riley corrected direct testimony, p. 8.

which was calculated using the 35% federal corporate income taxes, versus the now lower federal corporate income tax rate of 21%," starting with the difference as of January 1, 2018. This agreement differs from what the legislature directs the Commission to do in § 393.137, RSMo.

As discussed above in the section of this brief titled, **"Meaning of § 393.137, RSMo**," § 393.137.3, RSMo, requires the Commission to reduce Empire's rates prospectively based only on the impacts of Tax Cuts and Jobs Act of 2017 on the income tax component of the revenue requirement used to set Empire's current rates, and to order Empire to book into a deferral account the same impacts on Empire for the period beginning January 1, 2018, through the implementation of the new rates.

Empire and Staff's settlement agreement does not include changing Empire's rates in this case for the difference between excess ADIT balances included in its current rates and excess ADIT balances based on a federal corporate income tax rate of 21% and it does not include Empire booking into a deferral account the effect from January 1, 2018, to when new rates take effect in this case of the effect of the Tax Cuts and Jobs Act of 2017 change in the federal corporate income tax rate from 35% to 21% effective January 1, 2018—a proportion of what Empire and Staff have quantified to be $17,837,022 annually.

Because Empire and Staff's position does not comply with § 393.137, RSMo, it would be unlawful for the Commission to adopt it.

Accounting Authority Order

An accounting authority order is not a remedy available to the Commission to issue in this case. The legislature has spoken that the Commission as to the authority it has conferred on the Commission with § 393.137, RSMo. As discussed early in this brief in the section analyzing the

meaning of § 393.137, RSMo, a plain reading of § 393.137.3, RSMo, is that the Commission has one-time authority to reduce Empire's rates prospectively based only on the impacts of Tax Cuts and Jobs Act of 2017 on the income tax component of the revenue requirement used to set Empire's current rates, and to order Empire to book into a deferral account the same impacts on Empire for the period beginning January 1, 2018, through the implementation of the new rates.

And a plain reading of § 393.137.4, RSMo, is that, only if Empire "shows good cause," then the Commission may, instead of taking the actions laid out in subsection three, allow Empire to defer, all or part, the financial impacts Empire would have experienced from revising its current rates on January 1, 2018, to reflect Empire's income tax expense based on a 21% rate rather than a 35% and to reflect Empire's excess accumulated deferred income tax balance.

Nothing in § 393.137, RSMo, authorizes the Commission to issue an accounting authority order, and the Commission expressly stated the following in its June 6, 2018, *Order Opening Case, Directing Notice, Establishing Time to Intervene, and Scheduling a Procedural Conference*:

> Section 393.137 of Missouri's statutes, passed as part of Senate Bill 564 during the second regular session of the 99th General Assembly, gives the Commission one-time authority to order an adjustment to the electric rates of an electrical corporation in light of the recently enacted Tax Cuts and Jobs Act of 2017. Because it contains an emergency clause, that section became effective on June 1, 2018, when Senate Bill 564 was signed by the Governor. The section allows the Commission only ninety days after its effective date to act on the granted authority.
>
> The Commission will open this case to adjust the electric rates of The Empire District Electric Company.

Consistent with its order, the Commission captioned this case as follows: "In the Matter of a Proceeding Under Section 393.137 (SB 564) to Adjust the Electric Rates of The Empire District Electric Company." "In administrative proceedings, notice is sufficient so long as it fairly apprises the noticee of the grounds upon which action is to be taken. *State ex rel. Powell v. Wallace*, 718 S.W.2d 545, 548 (Mo. App., E.D. 1986); *Sorbello v. City of Maplewood*, 610 S.W.2d 375, 376 (Mo. App., E.D. 1980)." *Jackson v. Dir. of Revenue*, 784 S.W.2d 913, 915 (Mo.

App. 1990). As it is currently postured, accounting authority orders are unavailable to the Commission in this case.

Conclusion

For all the above reasons, the Commission should order Empire to reduce its rates designed to reduce its annual revenues by the following amounts: $17,469,270 for the prospective impacts of the reduction of the federal corporate income tax rate from 35% to 21%; $8,729,631 for protected excess accumulated deferred income tax; and for unprotected excess accumulated deferred income tax $2,282,553; order Empire to track the difference between its actual protected and unprotected excess accumulated deferred income tax and the amounts upon which the rate reductions are based; state that it is not the Commission's intent to create a tax normalization violation; order Empire to seek an IRS private letter ruling as to whether this order creates a tax normalization violation; and quantify the impacts of the reduction of the federal corporate income tax rate from 35% to 21% from January 1, 2018, until new rates take effect in this case consistent with OPC's recommendation to use the number of calendar days divided by 365, order Empire to defer the result and determine a four-year amortization period for flowing the deferred balance to Empire's retail customers; and order the rate reduction in this case be applied to Empire's customer charges.

Respectfully,

/s/ Nathan Williams

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 30th day of July 2018.

/s/ Nathan Williams

Safe Harbor for Inadvertent Normalization Violations

Rev. Proc. 2017-47

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor concerning inadvertent or unintentional uses of a practice or procedure that is inconsistent with §§ 50(d)(2) and 168(i)(9) of the Internal Revenue Code of 1986, as amended (Code), which require the use of the Normalization Rules (as defined in section 4.04 of this revenue procedure). If the safe harbor under section 5 of this revenue procedure applies, the Internal Revenue Service (Service) will not assert that a taxpayer's inadvertent or unintentional use of a practice or procedure that is inconsistent with §§ 50(d)(2) and 168(i)(9) of the Code constitutes a violation of the Normalization Rules. This revenue procedure does not limit or change the process by which a taxpayer may request a letter ruling or a referral for a technical advice memorandum that the taxpayer's proposed practice or procedure is consistent or inconsistent with the Normalization Rules.

SECTION 2. BACKGROUND

In general, normalization is a system of accounting used by regulated public utilities to reconcile the tax treatment of the Investment Tax Credit (ITC) or accelerated depreciation of public utility assets with their regulatory treatment. Under normalization, a utility receives the tax benefit of the ITC or accelerated depreciation in the early years

of an asset's regulatory useful life and passes that benefit on to ratepayers ratably over the regulatory useful life in the form of reduced rates. The remainder of this section 2 describes the intent of Congress in adopting the Normalization Rules and their operation under the Code and Income Tax Regulations.

.01 Congressional Intent. Congress had two principal objectives in adopting the Normalization Rules. The first objective was to preserve the utility's incentive to invest. Congress enacted the ITC and accelerated depreciation to stimulate investment. These incentives were not intended to subsidize the consumption of any products or services, including utility products or services. Recognizing that public utility rates are set based on the utility's costs incurred to provide the utility service, including federal income tax expense, Congress enacted a set of rules to assure that some or all of the value of the incentives it provided for utility capital investment would not be diverted from investment by utilities to lower prices for consumption by customers of utilities.

The second objective was to protect the government's tax revenue. Congress reasoned that when a utility elected accelerated depreciation and its regulator lowered rates to reflect the resulting tax benefit, the federal government would experience a reduction in tax revenue twice: once from the added accelerated depreciation deductions taken by the utility, and again from the decline in the revenue received by the utility as a result of its lower rates. See S. Rep. No. 91-552, at 17 (1969). The same impact results if a utility is permitted to flow through the benefit of its ITC to customers.

.02 Depreciation. Section 168 of the Code provides taxpayers generally with the

benefits of the accelerated cost recovery system in the computation of their depreciation deduction for federal income tax purposes. Section 168(f) provides the description of certain property for which the benefits of § 168 do not apply. Section 168(f)(2) provides that § 168 does not apply to any public utility property, as defined in § 168(i)(10), if the taxpayer does not use a normalization method of accounting. In general, § 168(i)(10) defines "public utility property" as property used predominantly in the trade or business of furnishing or selling (A) electrical energy, water, or sewage disposal services, (B) gas or steam through a local distribution system, (C) certain communications services, or (D) the transportation of gas or steam by pipeline, if rates for such furnishing or sale are established or approved by a State (including the District of Columbia) or political subdivision thereof, any agency or instrumentality of the United States, or a public service or public utility commission or other body of any State or political subdivision thereof.

Section 168(i)(9) describes what constitutes a "normalization method of accounting." The rules provided in § 168(i)(9) recognize that the rates a regulated public utility is permitted to charge its customers are established or approved by regulators based on the utility's cost of service taking into account the depreciation of assets and federal income tax expense. The Normalization Rules under § 168(i)(9)(A)(i) require the taxpayer to compute the federal income tax expense taken into account in setting its rates using a depreciation method that is the same as, and a depreciation period that is no shorter than, the method and period used to compute the depreciation expense for purposes of computing rates. Under § 168(i)(9)(A)(ii), a taxpayer must account for any

difference between its federal income tax expense taken into account in computing its rates and the actual federal income tax it pays as a reserve for deferred taxes. If the taxpayer uses estimates or projections in determining for rate-making purposes its tax expense, depreciation expense, or reserve for deferred taxes, the Normalization Rules under § 168(i)(9)(B) require the use of consistent estimates or projections with respect to the other two items and rate base.

Section 1.167(l)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under § 167 of the Code and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account.

.03 Investment Tax Credit. Section 46 of the Code sets forth certain investment credits against income tax. Section 50(d) provides special rules for certain taxpayers to qualify for those credits, including § 50(d)(2), which provides that rules similar to the limitations provided under former § 46(f) applicable to public utility property prior to the enactment of the Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, Title XI, 104 Stat. 1388, shall apply to certain regulated companies. The Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, repealed the ITC generally with respect to public utility property placed in service after 1985; however, due to the long useful life of much public utility property, these provisions retain their vitality.

Under the general rule of former § 46(f), those regulated companies are not entitled to the ITC if either the taxpayer's cost of service or rate base for ratemaking purposes is reduced by any portion of the credit. However, the statute provides important exceptions. Former § 46(f)(1) provides that the ITC may not be used to reduce the taxpayer's cost of service, but may be used to reduce rate base, if such reduction is restored not less rapidly than ratably. Former § 46(f)(2) provides an election under which a taxpayer is permitted to take into account a ratable portion of the ITC for purposes of determining cost of service, but is not permitted to reduce the base to which the taxpayer's rate of return for ratemaking purposes is applied by any portion of the credit. A utility taxpayer elects either former § 46(f)(1) or former § 46(f)(2) and that choice applies to all public utility property of the taxpayer. A taxpayer that does not specifically elect former § 46(f)(2) is subject to the general rule of former § 46(f)(1).

Former § 46(f)(6) provides that for purposes of determining ratable portions, the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account is to be used. Under § 1.46-6(g)(2) of the Income Tax Regulations, "ratable" is determined by considering the period of time actually used in computing the taxpayer's regulated depreciation expense for the property for which a credit is allowed. "Regulated depreciation expense" is the depreciation expense for the property used by a regulatory body for purposes of establishing the taxpayer's cost of service for ratemaking purposes.

.04 Application of Sanctions for Failure to Use a Normalization Method of Accounting. Former § 46(f)(4)(A) provides that there is no disallowance of a credit

before the first final inconsistent determination is put into effect for the taxpayer's former § 46(f) property. Section 1.46-6(f)(4) provides that the ITC is disallowed for any former § 46(f) property placed in service by a taxpayer (a) before the date a final inconsistent determination by a regulatory body is put into effect, and (b) on or after such date and before the date a subsequent consistent determination is put into effect.

Section 1.46-6(f)(7) provides that the term "determination" refers to a determination made with respect to former § 46(f) property (other than property to which an election under former § 46(f)(3) applies) by a regulatory body described in former § 46(c)(3)(B) that determines the effect of the credit (a) for purposes of former § 46(f)(1), on the taxpayer's cost of service or rate base for ratemaking purposes, or (b) for a taxpayer that made an election under former § 46(f)(2), on the taxpayer's cost of service, for ratemaking purposes or in its regulated books of account, or on the taxpayer's rate base for ratemaking purposes.

Section 1.46-6(f)(8)(i) provides that "inconsistent" refers to a determination that is inconsistent with former § 46(f)(1) or former § 46(f)(2). For example, a determination to reduce the taxpayer's cost of service by more than a ratable portion of the ITC would be a determination that is inconsistent with former § 46(f)(2). Section 1.46-6(f)(8)(ii) provides that the term "consistent" refers to a determination that is consistent with former § 46(f)(1) or former § 46(f)(2). Section 1.46-6(f)(8)(iii) provides that the term "final determination" means a determination by a regulatory body with respect to which all rights of appeal or to request a review, a rehearing, or a redetermination have been exhausted or have lapsed.

The Senate Finance Committee Report to the Tax Reduction Act of 1975 addressed the importance of the final determination by stating that "if a regulatory agency requires the flowing through of a company's additional investment credit at a rate faster than permitted, or insists upon a greater rate base adjustment than is permitted, the additional investment credit is to be disallowed, but only after a final determination . . . is put into effect." S. Rep. No. 94-36, at 44-45 (1975).

Unlike most tax provisions the sanctions imposed under the Normalization Rules were not intended to directly increase or decrease federal tax revenues. They were intended to discourage the flow through of tax benefits to customers in order to allow utilities to benefit from the underlying depreciation and ITC provisions and prevent the loss of revenue the federal government would suffer if the benefits were flowed through to customers.

In addition, in discussing the limitations on the ratemaking treatment of the ITC under § 46(e)(1) and (e)(2), the Senate Finance Committee Report concerning the Revenue Act of 1971, P.L. 92-178, 85 Stat. 497, indicates that the Committee hoped that the sanctions of disallowance of the ITC would not have to be imposed. S. Rep. No. 92-437, at 41 (1971).

SECTION 3. SCOPE

.01 This revenue procedure applies to a taxpayer that:

(1) owns Public Utility Property (as defined in section 4.03 of this revenue procedure);

(2) has inadvertently or unintentionally failed to follow a practice or procedure that

is consistent with the Normalization Rules (as defined in section 4.04 of this revenue procedure) in one or more years;

(3) upon recognizing its failure to comply with the Normalization Rules, the taxpayer changes its Inconsistent Practice or Procedure (as defined in section 4.06 of this revenue procedure) to a Consistent Practice or Procedure (as defined in section 4.05 of this revenue procedure) at the Next Available Opportunity (as defined in section 4.07 of this revenue procedure) in a manner that totally reverses the effect of the Inconsistent Practice or Procedure, provided the Taxpayer's Regulator (as defined in section 4.01 of this revenue procedure) adopts or approves the change; and

(4) retains contemporaneous documentation that clearly demonstrates the effects of the Inconsistent Practice or Procedure and the change to a Consistent Practice or Procedure adopted or approved by the Taxpayer's Regulator.

.02 For purposes of section 3.01(2) of this revenue procedure, a taxpayer's Inconsistent Practice or Procedure is neither inadvertent nor unintentional if the Taxpayer's Regulator specifically considered and specially addressed the application of the Normalization Rules to the Inconsistent Practice or Procedure in establishing or approving the taxpayer's rates even if at the time of such consideration the Taxpayer's Regulator did not believe the practice or procedure was inconsistent with the Normalization Rules.

SECTION 4. DEFINITIONS

.01 Taxpayer's Regulator

Taxpayer's Regulator means a State (including the District of Columbia) or political

subdivision thereof, any agency or instrumentality of the United States, or a public service or public utility commission or other body of any State or political subdivision thereof that establishes or approves the rates of the taxpayer.

.02 Rate Proceeding

Rate Proceeding means a proceeding in which the Taxpayer's Regulator establishes or approves the taxpayer's rates.

.03 Public Utility Property

Public Utility Property has the meaning provided in former § 46(f)(5) or in § 168(i)(l0), and the applicable Income Tax Regulations.

.04 Normalization Rules

The Normalization Rules mean, in the case of the ITC, the rules provided by former § 46(f), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990, and the Income Tax Regulations thereunder, and, in the case of the accelerated cost recovery system for depreciation, the rules provided by § 168(i)(9), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990, and the Income Tax Regulations thereunder.

.05 Consistent Practice or Procedure

A Consistent Practice or Procedure means a practice or procedure followed by the taxpayer and the Taxpayer's Regulator that is consistent with the Normalization Rules.

.06 Inconsistent Practice or Procedure

An Inconsistent Practice or Procedure means a practice or procedure followed by the taxpayer and the Taxpayer's Regulator that is inconsistent with the Normalization Rules.

.07 Next Available Opportunity

(1) In the case of a taxpayer without a Rate Proceeding pending before the Taxpayer's Regulator, the Next Available Opportunity means the next Rate Proceeding.

(2) In the case of a taxpayer with a Rate Proceeding currently pending before the Taxpayer's Regulator, the Next Available Opportunity means the currently pending proceeding, unless the rules of the Taxpayer's Regulator or applicable state or federal law (at the time the Inconsistent Practice or Procedure is identified) preclude the taxpayer from initiating a change from an Inconsistent Practice or Procedure to a Consistent Practice or Procedure in the currently pending proceeding, in which case the currently pending proceeding shall not be the Next Available Opportunity, and the Next Available Opportunity means the next Rate Proceeding.

(3) If, at the conclusion of a Rate Proceeding, the taxpayer has a private letter ruling request pending before the Service to address whether or not a practice or procedure addressed in the Rate Proceeding is a Consistent Practice or Procedure, and the Taxpayer's Regulator later establishes or approves rates subject to adjustment from the effective date of the unadjusted rates in order to conform to the Service's ruling, the taxpayer shall have corrected its Inconsistent Practice or Procedure at the Next Available Opportunity.

SECTION 5. APPLICATION

.01 For any taxpayer described in section 3 of this revenue procedure, the Service will not assert that the Inconsistent Practice or Procedure constitutes a violation of the Normalization Rules and will not deny that taxpayer the benefits of the ITC and/or

accelerated depreciation. In any tax year ending after the taxpayer has identified an Inconsistent Practice or Procedure, but in which the taxpayer has not changed to a Consistent Practice or Procedure because the taxpayer has not reached the year that presents the taxpayer with its Next Available Opportunity, the taxpayer must include in its return a statement described in section 5.02 of this revenue procedure. If the taxpayer makes the representation described in section 5.02(3) of this revenue procedure, the Service will not assert that the Inconsistent Practice or Procedure is a violation of the Normalization Rules and will not challenge the taxpayer's use of the identified Inconsistent Practice or Procedure unless the taxpayer does not change to a Consistent Practice or Procedure at the Next Available Opportunity.

.02 A statement is described in this section 5.02 if:

(1) The top of the statement is marked "FILED PURSUANT TO REV. PROC. 2017-47";

(2) The statement identifies the taxpayer's Inconsistent Practice or Procedure; and

(3) The statement includes a representation by the taxpayer of its intention to change to a Consistent Practice or Procedure at the Next Available Opportunity.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2016. However, the Service will not challenge any Inconsistent Practice or Procedure in any earlier taxable year provided that the requirements of sections 3 and 5 of this revenue procedure are satisfied by the taxpayer with respect to the

Inconsistent Practice or Procedure in such taxable year.

SECTION 7. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-2276.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information are in sections 3 and 5 of this revenue procedure and are required for a taxpayer to apply the safe harbor provided by this revenue procedure. This information is required to be collected and retained to clearly demonstrate the effects of a taxpayer's Inconsistent Practice or Procedure and the taxpayer's change to a Consistent Practice or Procedure adopted or approved by the Taxpayer's Regulator. The taxpayer must also include a statement in its federal income tax return identifying the Inconsistent Practice or Procedure and representing its intention to change to a Consistent Practice or Procedure at the Next Available Opportunity. The likely respondents are corporations or partnerships that are regulated public utilities.

The estimated total annual reporting burden is 1,800 hours.

The estimated annual burden per respondent varies from 10 hours to 14 hours, depending on individual circumstances, with an estimated average burden of 12 hours to collect and retain contemporaneous documentation and to complete the statement required under this revenue procedure. The estimated number of respondents is 150.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by § 6103.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure contact Ms. Bernardini on (202) 317-6853 (not a toll free call).

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **AM2018-001**
Release Number: 2/23/2018
CC:PSI:B06:
POSTS-132120-17

UILC: 168.00-00

date: February 06, 2018

to: Gloria Sullivan, Executive Officer
(Large Business & International)

from: Holly Porter, Associate Chief Counsel
(Passthroughs & Special Industries)

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subject: Clarification of Revenue Procedure 2017-47; Safe Harbor for Inadvertent Normalization Violations

This Generic Legal Advice Memorandum (GLAM) responds to your request for assistance. This GLAM may not be used or cited as precedent.

ISSUE

What is the scope of the phrase "in a manner that totally reverses the effect of the Inconsistent Practice or Procedure" in section 3.01(3) of Revenue Procedure 2017-47, 2017-38 I.R.B. 233?

CONCLUSION

The phrase "in a manner that totally reverses the effect of the Inconsistent Practice or Procedure" in Revenue Procedure 2017-47 requires only that the taxpayer change its Inconsistent Practice or Procedure to a Consistent Practice or Procedure on a going forward basis. It does not require reversal of the prior financial effects of the Inconsistent Practice or Procedure, for example through retroactive ratemaking by the Taxpayer's Regulator.

LAW AND ANALYSIS

On September 18, 2017, the Internal Revenue Service (Service) published the Safe Harbor for Inadvertent Normalization Violations, Revenue Procedure 2017-47. This

revenue procedure provides a safe harbor concerning inadvertent or unintentional uses of a practice or procedure that is inconsistent with §§ 50(d)(2) and 168(i)(9) of the Internal Revenue Code (Code), which require the use of the Normalization Rules.[1]

If a taxpayer complies with the procedural requirements of Revenue Procedure 2017-47, the Service will not assert that the taxpayer's inadvertent or unintentional use of a practice or procedure that is inconsistent with §§ 50(d)(2) and 168(i)(9) of the Code constitutes a violation of the Normalization Rules.

To satisfy the safe harbor provided by Revenue Procedure 2017-47, a taxpayer that has inadvertently or unintentionally failed to follow a practice or procedure that is consistent with the Normalization Rules in one or more years must, upon recognizing its failure to comply with the Normalization Rules, change its Inconsistent Practice or Procedure[2] to a Consistent Practice or Procedure[3] at the Next Available Opportunity[4] in a manner that totally reverses the effect of the Inconsistent Practice or Procedure. The revenue procedure also requires that the Taxpayer's Regulator[5] adopt or approve the change and that the taxpayer retain contemporaneous documentation that clearly demonstrates the effects of the Inconsistent Practice or Procedure and the change to a Consistent Practice or Procedure adopted or approved by the Taxpayer's Regulator.

We are issuing this GLAM in response to concerns expressed by interested taxpayers that the phrase "in a manner that totally reverses the effect of the Inconsistent Practice or Procedure" could be read to require retroactive ratemaking in order to take advantage of the safe harbor. This GLAM clarifies that the change from the Inconsistent Practice or Procedure to a Consistent Practice or Procedure need only apply going forward and does not contemplate taking into account any differences between the Inconsistent Practice or Procedure prior to the change and the Consistent Practice or Procedure after the change such as through requiring retroactive ratemaking by the Taxpayer's regulator.

Please call Jennifer Bernardini at (202) 317-6853 if you have any further questions.

[1] As defined in section 4.04 of Rev. Proc. 2017-47.
[2] As defined in section 4.06 of Rev. Proc. 2017-47.
[3] As defined in section 4.05 of Rev. Proc. 2017-47.
[4] As defined in section 4.07 of Rev. Proc. 2017-47.
[5] As defined in section 4.01 of Rev. Proc. 2017-47.

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-119381-16

Date:
December 02, 2016

LEGEND:

Taxpayer	=
Parent	=
State	=
Commission A	=
Commission B	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Case	=
Year 1	=
Year 2	=
Director	=

Dear :

This letter responds to the request, dated June 15, 2016, submitted by Parent on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is an integrated electric utility headquartered in State. Taxpayer is a wholly owned subsidiary of Parent and is included in Parent's consolidated federal income tax return. Taxpayer employs the accrual method of accounting and reports on a calendar year basis.

Taxpayer's business includes retail electric utility operations regulated within State by Commission A and Taxpayer is subject to the regulatory jurisdiction of Commission B with respect to terms and conditions of its wholesale electric

transmission service and as to the rates it may charge for the provision of such services. Taxpayer's rates are established on a cost of service basis.

On Date 1, Taxpayer filed a rate case application (Case) with Commission B requesting authorization to change from charging stated rates for wholesale electric transmission service to a formula rate mechanism pursuant to which rates for wholesale transmission service are calculated annually in accordance with an approved formula. The proposed formula consisted of updating cost of service components, including investment in plant and operating expenses, based on information contained in Taxpayer's annual financial report filed with Commission B, as well as including projected transmission capital projects to be placed into service in the following year. The projections included are subject to true-up in the following year's formula rate.

In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized and were not flowed thru to ratepayers.

In its rate case filing, Taxpayer anticipated that it would claim accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available. Taxpayer incurred a net operating loss (NOL) in each of Year 1 through Year 2 due to Taxpayer's claiming bonus depreciation, producing a net operating loss carryover (NOLC).

On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries – a "deferred tax asset" and a "deferred tax expense" – that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of a NOLC.

In the setting of utility rates by Commission B, a utility's rate base is offset by its ADIT balance. In its rate case filing, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It based this position on its determination that this net amount represented the true measure of federal income taxes deferred on account of its claiming accelerated tax depreciation

deductions and, consequently, the actual quantity of "cost-free" capital available to it. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules.

On Date 2, Commission B issued an order accepting Taxpayer's revisions to its rates. On Date 3, new rates went into effect, subject to refund. Several intervenors submitted challenges to the rate case and on Date 4, Taxpayer and those intervenors entered into a Settlement Agreement, which was filed with Commission B. On Date 5, Commission B issued an order accepting the Settlement Agreement, which allows for the inclusion of the ADIT related to the NOLC asset in rate base.

Commission B further stated in the order that it is the intent of Commission B that Taxpayer comply with the normalization method of accounting and tax normalization regulations. The order also requires Taxpayer to seek a private letter ruling (PLR) from the Service regarding Taxpayer's treatment of the ADIT related to the NOLC asset. Commission B also noted that after the Service issues a PLR, Taxpayer shall adjust, to the extent necessary, its ratemaking treatment of the ADIT related to the NOLC asset prospectively from the date of the PLR.

Taxpayer requests that we rule as follows:

1. In order to avoid a violation of the normalization requirements of § 168(i)(9) and Treasury Regulation § 1.167(l)-1, it is necessary to include in rate base the Accumulated Deferred Income Tax (ADIT) asset resulting from the Net Operating Loss Carryforward (NOLC), given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation.

2. The exclusion from rate base of the entire ADIT asset resulting from the NOLC, or the inclusion in rate base of a portion of that ADIT asset that is less than the amount attributable to accelerated tax depreciation, computed on a "with and without" basis, would violate the normalization requirements of § 168(i)(9) and § 1.167(l)-1.

Law and Analysis

Section 168(f)(2) of the Code provides that the depreciation deduction determined under § 168 shall not apply to any public utility property (within the meaning of § 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting, § 168(i)(9)(A)(i) requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under

§ 168(i)(9)(A)(ii), if the amount allowable as a deduction under § 168 differs from the amount that-would be allowable as a deduction under § 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under § 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) provides that one way the requirements of § 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under § 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under § 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

Former § 167(l) generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former § 167(l)(3)(G) in a manner consistent with that found in § 168(i)(9)(A). Section 1.167(l)-1(a)(1) provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under § 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.

Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (1) method for purposes of determining the taxpayer’s reasonable allowance under § 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under § 167(a) using a subsection (1) method, then the amount and time of the deferral of tax liability

shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under § 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under § 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under § 167(a).

Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under § 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.

Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under § 1.167(l)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so. Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount

of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

Regarding the first issue, § 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the reserve account for deferred taxes (ADIT), reduces rate base, it is clear that the portion of the net operating loss carryover (NOLC) that is attributable to accelerated depreciation must be taken into account in calculating the amount of the ADIT account balance. Thus, the order by Commission to include in rate base the ADIT asset resulting from the NOLC, given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation is in accord with the normalization requirements.

Regarding the second issue, § 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these specific facts, any method other than the "with or without" method would not provide the same level of certainty and therefore the use of any other methodology in computing the portion of the ADIT asset attributable to accelerated depreciation is inconsistent with the normalization rules.

We rule as follows:

1. In order to avoid a violation of the normalization requirements of § 168(i)(9) and Treasury Regulation § 1.167(l)-1, it is necessary to include in rate base the Accumulated Deferred Income Tax (ADIT) asset resulting from the Net Operating Loss Carryforward (NOLC), given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation.

2. The exclusion from rate base of the entire ADIT asset resulting from the NOLC, or the inclusion in rate base of a portion of that ADIT asset that is less than the amount attributable to accelerated tax depreciation, computed on a "with and without" basis, would violate the normalization requirements of § 168(i)(9) and § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Patrick S. Kirwan
Chief, Branch 6
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: