DW 18-054

NH Brown Law

Environmental Law ▪ Utility Law

Marcia A. Brown
Attorney at Law

NHPUC 2APR'18PM1:01

March 30, 2018

Debra A. Howland, Executive Director
N.H. Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, NH 03301

Re: Docket No. IR 18-001
Investigation to Determine Rate Effects of Federal and
State Corporate Tax Reductions
Aquarion Water Company of New Hampshire, Inc.'s Response

Dear Director Howland,

On January 3, 2018, the Commission issued Order No. 26,096 to all public utilities regulated by the Commission. In the Order, the Commission directed that the utilities provide information as to how changes in State and Federal tax rates will affect the utility's need for deferred tax reserves. The Commission requested financial information sufficient to establish a revenue requirement that reflects, prospectively, the impact of those changes. This letter is to respond to the Commission's inquiry.

Overview

As noted in Order No. 26,096, the Federal Tax Cuts and Jobs Act, ("2017 Tax Act") was enacted on December 22, 2017. The 2017 Tax Act reduced the corporate tax rate from 35 percent to 21 percent, effective January 1, 2018. The Commission also informed the utilities that certain New Hampshire taxes will also decline.

Having reviewed these changes in federal and state tax rates, Aquarion Water Company of New Hampshire, Inc. ("Aquarion-NH" or "Company") expects this change to impact its revenue requirement in the following ways:

1. The lower tax rates will act to reduce the cost of service and thereby lower the Company's revenue requirement effective January 1, 2018; and

2. The lower tax rates reduced the Company's accumulated deferred income tax liability ("ADIT"). The resulting Excess Deferred Income Taxes ("EDIT") were re-classified to a regulatory liability at December 31, 2017 and will be amortized over the average life of the Company's assets.

Commission Order

The Commission ordered that the utilities calculate the difference between the 2017 and 2018 taxes and enter it on the utilities' books as a deferred liability as follows:

P.O. Box 1623 Concord, NH 03302-1623
603-219-4911 ▪ mab@nhbrownlaw.com ▪ www.nhbrownlaw.com

> The Commission directed each utility to take its current rate base, multiply it by its last-approved return on equity (for Aquarion-NH, that is 9.6 percent[1]), to produce an equity return. The Commission next directed the utilities gross-up the calculated equity return using the old and new tax rates. The net difference is to be booked as a deferred liability until the utility's next rate case, unless the Commission authorizes a different treatment. The utilities are to also calculate the excess deferred tax reserve. The Commission also directed the utilities to project any future accrual between now and the time of the utilities' next rate case.

<u>Calculation of Deferred Liability</u>
Aquarion-NH calculates that the 2017 Tax Act and State tax changes will yield an excess revenue requirement of approximately $202,000 for 2018 and an annual amortization of the EDIT of $49,000. Please see the attached Schedule A, *Impact of Tax Reform on Revenue Requirement*.

It should be noted that for water utilities, the current customer rates do not reflect a federal tax rate equal to either the old 35 percent or new 21 percent. This is because the Internal Revenue Service's ("IRS") Tangible Property Regulations ("TPR") applicable to water utilities allow utilities to deduct large portions of their capital budgets for tax purposes.[2] This deduction has the profound impact of reducing the cost of service for water utilities, particularly those water utilities that utilize the "flow-through" method, as the Company does. Under the flow-through method, taxable income is significantly reduced, which, in turn, reduces the effective tax rate and income tax expenses of the utility. This is in contrast to a utility using the normalized taxpayer method where the deferred tax expense is recorded and recovered through the utility's cost of service. This nuance of the TPR deduction and resulting lower effective tax rate impacted the calculation above.

<u>Proposal for Customer Credit</u>
The Company proposes to pass the reductions in its revenue requirement back to customers through its annual WICA reconciliation mechanism. As detailed in Schedule A, the Company has determined the EDIT as of December 31, 2017, were $1,271,000. Amortizing this sum over the remaining useful lives of the underlying assets, creates an annual amortization of approximately $33,000, which equates to an excess revenue requirement of approximately $49,000 (after applying a 1.374 gross-up factor). This, combined with the 2018 reduction to the cost of service of $202,000, yields a revenue requirement reduction of $251,000.

---

[1] See Docket No. DW 12-085, *Aquarion Water Company of New Hampshire, Inc.,* Order No. 25,539 (June 28, 2013) at 22.

[2] As the Commission may recall, in September 2013, the IRS adopted final rules allowing taxpayers to expense certain repair and maintenance costs that had historically been capitalized for tax and ratemaking purposes. See Treasury Decision 9636 pertaining to Internal Revenue Code §§162(a), 167, 168, and 263(A). This resulted in a windfall of approximately $905,000, which the Commission authorized Aquarion-NH to credit to customers over three years (2015, 2016, and 2017) through its existing Water Infrastructure and Conservation Adjustment ("WICA"). See Commission Order No. 25,750, dated January 12, 2015.

To put this tax impact in perspective, the Company expects to incur $883,500 in capital spending for its 2018 WICA projects. The projects include main replacements on Sixth, Seventh, Ninth, and Tenth Streets and a portion of Mill Road. The 2018 WICA projects are expected to result in an increase in the allowed annual WICA revenues of $113,212. For 2019, the Company expects to incur $867,500 in capital spending which it expects to increase the allowed annual WICA revenues by $112,040. Applying the EDIT as a credit to offset the allowed annual WICA revenues has the potential to mitigate or, importantly, reduce current customer rates.

Using the WICA to pass the tax savings through to customers now is beneficial to both Aquarion-NH and its customers. Passing the tax savings through the WICA mechanism will allow Aquarion-NH to continue to invest through the WICA mechanism without the need for a rate case for a prolonged period of time. In the absence of passing the tax savings through the WICA mechanism, Aquarion-NH had anticipated filing its next general rate case in 2020, using a 2019 test year because it projects it will not earn its authorized rate of return in 2018. Because of these considerations, Aquarion-NH proposes refunding the tax savings through the WICA so as to pass the savings to customers quickly and delay a general rate case.

In conclusion, Aquarion-NH believes that the proposal to pass the savings to customers through the WICA is beneficial for the following reasons: (a) it will provide a direct and prompt benefit to customers in the amount by which the Company benefits from the changes in tax rates; (b) it will help stabilize or reduce customers' bills and offset the impact of anticipated future WICA surcharges; (c) the WICA is a ready true-up mechanism that is reviewed and audited by the Commission which will protect customers; (d) choosing the WICA mechanism will result in less regulatory costs than creating a separate mechanism to process the savings; and (e) the Commission approved the WICA as the preferred mechanism to pass savings to customers when the IRS changed the TPRs. See Order No. 25,750.

As to the Commission's directive to project future accruals, Aquarion-NH proposes to report to the Commission on the accrual and extinguishment of the deferred liability in its Annual Reports and annual WICA filings until its next general rate case.

Thank you for the opportunity to provide this response. Aquarion-NH looks forward to implementing its proposal. If the Commission needs further information, please do not hesitate to call or email.

Very Truly Yours,

Marcia A. Brown

Marcia A. Brown

cc: IR 18-001 Docket-Related Service List