

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION**

IN RE: THE NARRAGANSETT ELECTRIC COMPANY :
d/b/a NATIONAL GRID – ELECTRIC AND GAS : **DOCKET NO. 4770**
DISTRIBUTION RATE FILING :
EXCESS DEFERRED INCOME TAX TRUE-UP :

ORDER

I. Summary of the Filings

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 was signed into law (Tax Act).¹ As part of the Tax Act, the federal corporate income tax rate was reduced from 35% to 21% which affected both the annual income tax expense and the balances of the Accumulated Deferred Income Tax and Excess Deferred Federal Income Tax. Distribution rates were previously set based on a 35% tax rate. On December 21, 2017, the Public Utilities Commission (PUC or Commission) issued a data request in this docket to The Narragansett Electric Company d/b/a National Grid (National Grid or Company) for a quantification of the expected tax savings.²

On March 2, 2018, as part of its Distribution Rate Filing, then pending before the PUC, the Company filed a revised distribution revenue requirement to account for certain expected tax impacts resulting from the Tax Act for the period commencing September 1, 2018, the requested start of the rate year.³ On August 24, 2018, the PUC approved an Amended Settlement between National Grid, the Division of Public Utilities and Carriers (Division), and fifteen other parties

¹ Pub. L. No. 115-97, 131 Stat. 2054 (the Tax Act).

² National Grid’s Response to PUC 4-1 (Docket No. 4770); [http://www.ripuc.org/eventsactions/docket/4770-NGrid-DR-PUC4-1%20Supplemental%20\(Book%201%20Pages%205\)%20March%2028,%202018.pdf](http://www.ripuc.org/eventsactions/docket/4770-NGrid-DR-PUC4-1%20Supplemental%20(Book%201%20Pages%205)%20March%2028,%202018.pdf).

³ National Grid’s Revised Filing (Mar. 2, 2018); http://www.ripuc.org/eventsactions/docket/4770-NGrid-Transmittal-RevSchedules_4-3-18.pdf.

that, in part, addressed the excess accumulated deferred income tax and required a true-up to be filed by March 1, 2019, following the Company's filing of its 2018 federal income tax return.⁴

Per the terms of the Amended Settlement, the Company had recorded estimates of \$116 million and \$51 million of customer-related excess deferred income tax for Narragansett Electric and Narragansett Gas, respectively.^{5,6} These were the estimated amounts to be credited to customers. A credit of \$5.1 million was included in the Company's electric revenue requirement and \$2.0 million was included in the gas revenue requirement for the twelve-month period commencing September 1, 2018.⁷ These were the amounts subject to the true-up.

Of these total amounts, a portion was made up of "property-related [sic] excess deferred taxes" and a portion was made up of "non-property excess deferred taxes."⁸ Certain property related excess deferred taxes are referred to as "protected" while others are considered "unprotected." The Tax Act limited the speed at which the benefits of the protected excess deferred taxes could be credited to customers but there were no restrictions on the return of benefits of the non-protected amounts.⁹ The flow-back of protected excess deferred taxes can be no faster than the flow-back calculated under the average rate assumption method.^{10,11}

⁴ Amended Settlement, Article II, Section C.22.a, at Bates 80-81(Aug. 16, 2018); <http://www.ripuc.org/eventsactions/docket/4770-4780-NGrid-ComplianceFiling-Book%201%20through%207%20-%20August%2016,%202018.pdf>.

⁵ Bushmich et al. Jt. Test. at 7; [http://www.ripuc.org/eventsactions/docket/4770-NGrid%20Book%201%20Deferred%20Income%20Tax%20True-Up%20\(3-1-19\).pdf](http://www.ripuc.org/eventsactions/docket/4770-NGrid%20Book%201%20Deferred%20Income%20Tax%20True-Up%20(3-1-19).pdf). The Narragansett Electric Company d/b/a National Grid is the name of both the electric and gas distribution utilities. For clarity, the PUC is using Narragansett Electric to denote the electric distribution company and Narragansett Gas to denote the gas distribution company.

⁶ Deferred taxes are primarily the result of differences in the timing of when a cost is expensed (deducted) on the Company's federal income tax return and when it is expensed on the Company's books. *Id.* at Attach.NG-1. The Commission typically requires expenses to be depreciated or amortized on a "straight-line" basis whereas the tax code allows for accelerated treatment of the expense in certain instances. This results in a timing difference for the Company.

⁷ Bushmich et al. Jt. Test at 8.

⁸ *Id.*

⁹ *Id.* at 12, Attach. NG-1.

¹⁰ *Id.*, Efron Test. at 3; http://www.ripuc.org/eventsactions/docket/4770-DIV-SurrebuttalTestimony_4-29-19.pdf.

¹¹ *Understanding the potential impact of tax reform on 2018 net revenues*, Tax Insights from Power and Utility, PricewaterhouseCoopers LLP (Mar. 14, 2018); <https://www.pwc.com/gx/en/services/people->

On March 1, 2019, the Company submitted its required excess deferred income tax true-up filing to adjust the credit based on the federal income tax return. On April 29, 2019, the Company filed revised direct testimony to correct errors found during the discovery period in this matter.¹² The Company's witnesses explained that the main differences between the original estimates and the true-up figures resulted from plant differences for the repair deduction and bonus depreciation offset by an increase to net operating loss.¹³

The Company reported \$96,441,410 million and \$78,179,984 million of customer-related excess deferred income tax for Narragansett Electric and Narragansett Gas, respectively. The non-property related amount was \$11,038,111 for Narragansett Electric and (\$440,844) for Narragansett Gas. The protected property amount was \$67,576,451 for Narragansett Electric and \$33,713,982 for Narragansett Gas while the unprotected property amount was \$17,826,847 for Narragansett Electric and \$44,906,846 for Narragansett Gas.¹⁴ The Company also reported net operating losses of \$15,617,564 as an offset to the Narragansett Electric protected property balance and \$20,468,920 as an offset to the Narragansett Gas protected property balance prior to calculating the revised revenue requirement and rate impact for each of the three rate years subject to the Amended Settlement Agreement.¹⁵

[organisation/publications/assets/pwc-the-potential-impact-of-tax-reform-on-2018-net-revenues.pdf](#) (last visited May 16, 2019).

The excess [adjusted deferred income tax] normalization provision requires that excess deferred income taxes be used to reduce revenue requirements and revenue no sooner than would occur as the book/tax difference reverses. Under this method — referred to as the Average Rate Assumption Method (ARAM) — the utility identifies the deferred tax reversal pattern (comparing book depreciation versus tax depreciation) and reverses the excess [adjusted deferred income tax] beginning when book depreciation exceeds tax depreciation and the deferred tax turnaround occurs.

¹² Bushmich et al. Revised Jt. Test.; [http://www.ripuc.org/eventsactions/docket/4770-NGrid-ADIT-RevisedTestimony%20\(4-29-19\).pdf](http://www.ripuc.org/eventsactions/docket/4770-NGrid-ADIT-RevisedTestimony%20(4-29-19).pdf).

¹³ *Id.* at 11 of 31.

¹⁴ Bushmich Jt. Reb. Test. at Rev. Supp. Compliance Attach. 31, Bates 269-270 (Apr. 29, 2019).

¹⁵ *Id.*

Consistent with its explanation in response to PUC 4-1,¹⁶ referenced in the Amended Settlement Agreement, the Company indicated that the protected excess deferred taxes would be passed back to customers through the end of the depreciable book life of the last fully depreciated asset that was placed into service prior to January 1, 2018. The unprotected property excess deferred taxes would be amortized over a twenty-two-year period for Narragansett Electric and a twenty-five-year period for Narragansett Gas, while non-property excess deferred taxes would be passed back over a ten-year period.¹⁷ The result of National Grid's calculation was an increase in the electric revenue requirement and a decrease to gas. The recovery of the increase and decrease would be partially accomplished through base distribution rates in rate years two and three, and partially through the electric revenue decoupling mechanism and distribution adjustment charge effective July 1, 2019, and November 1, 2019, respectively.

On April 12, 2019, and April 29, 2019, the Division submitted the direct and rebuttal testimonies of David J. Effron, its consultant. Mr. Effron did not dispute the Company's derivation of nor the categorization of the amounts of excess deferred income tax. Rather, Mr. Effron disputed the Company's methodology for returning the protected property excess deferred taxes to customers. Mr. Effron argued that using net operating losses to totally offset the amount of protected property excess deferred taxes was inconsistent with the understanding of the parties at the time the Amended Settlement Agreement was signed. He explained that National Grid had amortized the total protected property and then offset the annual amount by the total net operating losses until those losses were exhausted. He argued that the total net operating losses should be

¹⁶ PUC 4-1 - Supplemental (Distribution Rate Case); [http://www.ripuc.org/eventsactions/docket/4770-NGrid-DR-PUC4-1%20Supplemental%20\(Book%201%20Pages%205\)%20March%2028,%202018.pdf](http://www.ripuc.org/eventsactions/docket/4770-NGrid-DR-PUC4-1%20Supplemental%20(Book%201%20Pages%205)%20March%2028,%202018.pdf).

¹⁷ *Id.* at 4.

subtracted from the total protected property amount and then amortized over the same time period as the protected property excess deferred taxes.

Both methodologies, however, would return the funds to customers. The Company's proposal would result in increases to the electric revenue requirement in the first three years, whereas the methodology Mr. Effron claimed to have agreed to in the settlement negotiations would decrease the revenue requirement in all three years.¹⁸ Neither methodology would violate Internal Revenue Service regulations or guidance.¹⁹ In response to National Grid's claim that its treatment was more in line with its ordinary tax treatment of expenses, Mr. Effron argued that his proposal was exactly what was presented in the Company's illustrative example referenced by the Amended Settlement Agreement.²⁰

II. Hearing

On May 6, 2019, the PUC conducted an evidentiary hearing to consider the testimony from both parties. The Company presented Pamela Bushmich, Melissa Little, Michael Pini, and Adam Crary to support the Company's filing. On cross examination, Ms. Bushmich conceded that one could interpret the Company's response to PUC 4-1 as being consistent with the methodology employed by Mr. Effron in this proceeding.²¹ She agreed that during discovery in the underlying distribution rate case, the Company had twice presented the total estimated excess deferred income tax net of the net operating loss, amortized over a single number of years.²²

Ms. Bushmich confirmed that the Company's response to PUC 4-1 was referenced in and attached to the Amended Settlement Agreement and compliance filing in the underlying

¹⁸ Effron Test. at 3-6; <http://www.ripuc.org/eventsactions/docket/4770-DIV-Effron-True-up%204-12-19.pdf>; Effron Surrebuttal Test. at 1-3; http://www.ripuc.org/eventsactions/docket/4770-DIV-SurrebuttalTestimony_4-29-19.pdf.

¹⁹ Bushmich Jt. Rebuttal Test. at 7; Hr'g. Tr. at 48, 69 (May 6, 2019).

²⁰ Effron Surrebuttal Test. at 3.

²¹ Hr'g. Tr. at 49.

²² Hr'g. Tr. at 50-51, referencing the Company's responses to PUC 4-1 and DIV 31-1; <http://www.ripuc.org/eventsactions/docket/4770-NGrid-DR-Div%2031%20%20March%2028%202018.pdf>.

distribution rate case.²³ She confirmed that in PUC 4-1, the Company showed that it would amortize the net operating losses over the same period as the protected property amortization period.²⁴ She agreed that the Company was now proposing to utilize the net operating losses as quickly as possible. The Company's current proposal would not directly match the deferred tax amortization to the net operating loss amortization.²⁵ Under either methodology, the net amount of the return of the deferred tax benefits to ratepayers would ultimately be the same.²⁶

Ms. Bushmich indicated that the Company changed the methodology after receiving actual figures for the numbers that had previously been estimated.²⁷ She stated that the Company's proposal would smooth out the return of the tax benefits. Non-property amortization would fully return the benefits to customers over ten years. The Company's proposal would result in the property-related benefit being realized to ratepayers at approximately the same time as the expiration of the non-property credits. Therefore, the rate impact would be smoother under the Company's current proposal. Under the methodology included in PUC 4-1, ratepayers would realize larger benefits up front that would be reduced after approximately ten years.²⁸ Upon further questioning, she estimated that under the Company's proposal, the impact on the revenue requirement at the expiration of the ten-year period would be less than \$600,000, or less than one percent of revenues.²⁹

According to Ms. Bushmich's testimony, the Company's proposal would result in a higher revenue requirement than the methodology supported by Mr. Effron.³⁰ Ms. Little clarified that the

²³ Hr'g. Tr. at 53-54.

²⁴ *Id.* at 66-67.

²⁵ *Id.* at 67.

²⁶ *Id.* at 68.

²⁷ *Id.* at 69.

²⁸ *Id.* at 70-72.

²⁹ *Id.* at 73-74. For comparison, the Company's electric energy efficiency budget is approximately \$108,000,000 which results in a per kWh charge of approximately \$0.011.

³⁰ *Id.* at 77.

Company did not oppose the methodology supported by Mr. Effron.³¹ She opined that it might affect certain credit metrics the Company places on its departments based on cash flow. She did not believe, however, that the \$1.7 million difference in the electric revenue requirement between the two methodologies would adversely affect the credit metrics.³² On redirect, Ms. Bushmich testified that the methodology supported by the Division would result in lower revenues to the Company and would not provide the corresponding tax reduction expected under the Tax Act.³³

National Grid had also argued that if the Company returned the tax benefits to ratepayers too quickly and there was another change in tax law, they would need to reverse the credit. Ms. Bushmich, with twenty-three years of experience in the tax department of a regulated utility, acknowledged, however, that ratemaking decisions are typically made based on current law.³⁴

The Division presented Mr. Effron in support of its position on the appropriate methodology to return the tax benefit to ratepayers. Mr. Effron testified that while the Amended Settlement Agreement in the underlying distribution rate case did not specify an exact methodology, the reference to PUC 4-1 led him to expect, when reviewing this portion of the settlement for the Division, that the illustrative methodology was the one that would be used.³⁵ He further noted that the Company's argument that its current proposal should be approved because it would smooth out the rates was never discussed during settlement negotiations.³⁶ He confirmed that the methodology he supported would reduce the Narragansett Electric revenue requirement by \$1.7 million and the Narragansett Gas revenue requirement by \$22,000 from what the Company had proposed.³⁷

³¹ *Id.* at 79.

³² *Id.* at 79-80.

³³ *Id.* at 81-84.

³⁴ *Id.* at 75.

³⁵ *Id.* at 85-86.

³⁶ *Id.* at 87.

³⁷ *Id.* at 88.

III. Commission Findings

At an Open Meeting held on May 17, 2019, the Commission considered the evidence and ruled that the methodology supported by Mr. Effron on behalf of the Division was appropriate for the return of the property-related excess deferred tax. The calculation shall subtract the net operating losses from the total protected property balance and then amortize the net amount. There was no dispute over the calculation of the total excess deferred taxes, the allocation to property (protected and non-protected), or the allocation to non-property.

The Commission first considered whether the Amended Settlement Agreement provided guidance on the methodology for the treatment of the net operating losses. The Commission was persuaded that the inclusion in the Amended Settlement Agreement of a reference to a specific explanation of the treatment of deferred taxes evidenced an intent by the parties. It was clear from Mr. Effron's testimony that, in advising the Division on the appropriateness of the settlement in the underlying rate case, he relied on that referenced explanation which included an illustrative calculation.³⁸ Thus, the Commission found that the Company's proposal in its March 2, 2019 filing is different from that which was contemplated in the Amended Settlement Agreement.³⁹

The Commission next considered whether either methodology for the treatment of net operating losses was legally flawed. Based on the uncontroverted testimony, the Commission found that either methodology could properly be applied. The Company favored its methodology because it would increase the revenue requirement by lowering the tax liability. According to Ms. Bushmich, the Tax Act reduced the Company's revenues and, in exchange, was supposed to provide a tax-related cash benefit. The Division preferred the methodology described in the

³⁸ The Commission noted that the Company's response to PUC 4-1 also referenced additional discovery responses.

³⁹ To the extent there is a difference in opinion on the appropriate interpretation, the PUC notes that under rules of contract interpretation, the ambiguities are decided against the drafter; in this case, that is the Company.

attachment to the Amended Settlement Agreement because it would provide a lower revenue requirement and more immediate rate relief to ratepayers than would the Company's proposal. The PUC found that, based on the entire record, there was no legal impediment to approving the methodology supported by the Division.

Accordingly, it is hereby

(23615) ORDERED:

1. The Narragansett Electric Company d/b/a National Grid's Excess Deferred Income Tax True-Up Filing is hereby approved except for the methodology to be used in returning the benefits of the protected property balance to ratepayers.
2. The Narragansett Electric Company d/b/a National Grid shall subtract the net operating losses from the total protected property balance and then amortize the net amount.
3. The Narragansett Electric Company d/b/a National Grid shall file compliance schedules reflecting this decision.

EFFECTIVE AT WARWICK, RHODE ISLAND ON MAY 17, 2019 PURSUANT TO AN OPEN MEETING DECISION. WRITTEN ORDER ISSUED JUNE 11, 2019.

PUBLIC UTILITIES COMMISSION



Margaret E. Curran, Chairperson

Marion S. Gold, Commissioner

Abigail Anthony, Commissioner

NOTICE OF RIGHT OF APPEAL: Pursuant to R.I. Gen. Laws § 39-5-1, any person aggrieved by a decision or order of the PUC may, within seven days from the date of the order, petition the Rhode Island Supreme Court for a Writ of Certiorari to review the legality and reasonableness of the decision or order.