BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

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In the Matter of:

DOCKET NO. 20180044-GU

CONSIDERATION OF THE TAX IMPACTS ASSOCIATED WITH TAX CUTS AND JOBS ACT OF 2017 FOR PEOPLES GAS SYSTEM.
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VOLUME 1
PAGES 1 through 116

PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING: CHAIRMAN ART GRAHAM
COMMISSIONER JULIE I. BROWN
COMMISSIONER GARY F. CLARK

DATE: Wednesday, September 12, 2018

TIME: Commenced: 1:00 p.m.
Concluded: 1:14 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: ANDREA KOMARIDIS
Court Reporter

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APPEARANCES:

ANDREW BROWN, ESQUIRE, McFarlane Law Firm, P.O. Box 1531, Tampa, Florida, 33601-1531, appearing on behalf of Peoples Gas System.

J.R. KELLY, PUBLIC COUNSEL; CHARLES REHWINKEL, DEPUTY PUBLIC COUNSEL; and VIRGINIA PONDER, ESQUIRE, Office of Public Counsel, c/o the Florida Legislature, 111 W. Madison Street, Room 812, Tallahassee, Florida 32399-1400, appearing on behalf of the Citizens of the State of Florida.

JON C. MOYLE, JR., and KAREN A. PUTNAL, ESQUIRES, Moyle Law Firm, P.A., 118 North Gadsden Street, Tallahassee, Florida 32301, appearing on behalf of Florida Industrial Power Users Group.

WALTER TRIERWEILER and KURT SCHRADER, ESQUIRES, FPSC General Counsel's Office, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, appearing on behalf of the Florida Public Service Commission Staff.

KEITH HETRICK, GENERAL COUNSEL; MARY ANNE HELTON, DEPUTY GENERAL COUNSEL; Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, advisor to the Florida Public Service Commission.

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P R O C E E D I N G S

CHAIRMAN GRAHAM: Good afternoon, everyone.

COMMISSIONER BROWN: Good afternoon.

CHAIRMAN GRAHAM: Let the record show it is September the 12th, just after 1:00 p.m. And we're here for hearing, Docket No. 20180044-GU. We'll call this hearing to order.

Staff, if I can get you to read the notice, please.

MR. TRIERWEILER: By notice issued on August 28th, 2018, this time and place has been set for a hearing in Docket No. 20180044-GU. The purpose of the hearing is to receive testimony and exhibits regarding the tax impacts to Peoples Gas System resulting from the passage of the Tax Cuts and Jobs Act of 2017, and any other matters that may be pending at this time.

CHAIRMAN GRAHAM: Okay. Let's take appearances.

MR. BROWN: Andy Brown of Macfarlane Ferguson on behalf of Peoples Gas. And I'm here with Carlos Aldazabal.

MS. PONDER: Virginia Ponder on behalf of the Office of Public Counsel. I'd also like to make an appearance for J.R. Kelly and Charles Rehwinkel.

MS. PUTNAL: Hello. Karen Putnal here today for Florida Industrial Power Users Group. And I'd also like to make an appearance for Jon Moyle.

MR. TRIERWEILER: Walt Trierweiler and Kurt Schrader for Commission staff.

MS. HELTON: Mary Anne Helton here as your advisor. I'd also like to make an appearance for your general counsel, Keith Hetrick.

CHAIRMAN GRAHAM: All right. Glad to see you all made it here safely today.

Staff, preliminary matters -- are there any?

MR. TRIERWEILER: Yes, there are. All witnesses have been excused and the parties wish to make opening statements.

There are proposed stipulations on Issues 1 through 5, 8 through 17, 19 and 21. Additionally, there's a proposed settlement agreement to resolve all remaining issues, 6, 7, 18, and 20. And there's a joint motion to supplement the record with an attachment to explain the settlement agreement regarding depreciation.

CHAIRMAN GRAHAM: Okay. Do any of the parties have any other preliminary matters before we do opening statements?

Okay. Let's start with opening statements.

Peoples.

MR. BROWN: Thank you. Good afternoon Commissioners. Thank you.

First of all, we would like to thank the Office of Public Counsel and the Florida Industrial Power User's Group for working with Peoples to reach the agreement that we believe is fair and balanced and resolves many complex issues associated with the calculations and impact of tax reform. Additionally, we would like to thank the staff and the timely and thorough review of the agreement that has helped get us to where we are today.

Similar to Tampa Electric's recent tax-reform settlement agreement, Peoples recognized the importance of passing on to customers the benefits of tax reform, and worked with the parties to reach a solution that allows the company to maintain reasonable earnings. Additionally, Peoples resolves an MPG obligation that would have resulted in earnings pressure over the next several years.

While the agreement appears simple, we can assure you that there were numerous discussions and many complex issues that had to be considered in order to reach the agreement.

The result before you today is a settlement agreement where Peoples' customers will enjoy a base-rate reduction of about 5 percent, commencing January 1st, 2019. And Peoples remains in a position where it can continue operating within its allowed earnings range.

I want to close by asking the Commission to approve the proposed settlement agreement as it being in the interest of Peoples' customers and the company.

Thank you.

CHAIRMAN GRAHAM: Thank you, sir.

OPC.

MS. PONDER: Thank you.

The Public Counsel supports the settlement before you. We firmly believe it to be in the public interest for a number of reasons. First, the settlement returns 100 percent of the tax savings to customers in the form of a $1-million base-rate reduction on January -- oh, sorry. Thank you. That's very -- I need my glasses, evidently -- 11 million. That's important.

CHAIRMAN GRAHAM: I understand the feeling.

(Laughter.)

MS. PONDER: All right. Sorry. Yeah, made

Carlos happy. Okay. $11 million base-rate reduction on January 1, 2019.

Unlike Gulf Power and Tampa Electric, PGS did not have a contractual obligation to fully reduce rates. Nevertheless, as a part of an overall compromise, they are still committed to doing the right thing for the customers by passing through all the tax savings. And we commend them for this.

For 2018, the parties have agreed that the 10.9-million windfall for this current year will be applied to fulfill an existing commitment to write off a large manufactured gas plant, or MGP, clean-up reserve balance by the end of 2020. This remaining balance of $10.9 million was to be absorbed in earnings over a five-year period.

In combination with the complete recognition of the Public Counsel's depreciation position in Docket No. 20160159-GU, the parties have here agreed that PGS could, with certainty, in 2018 complete the write-off of the full $32-million known MGP reserve balance while maintaining reasonable earnings for the foreseeable future.

As the Public Counsel views it, the 2018 tax savings are being properly utilized to conclusively settle an existing MGP-reserve-reduction commitment that the Commission has already recognized. In 2017, PGS made a conditional commitment to write this obligation off so long as it would not drive earnings below the bottom of the range.

The combination of the customer tax savings and decrease in depreciation guarantees that the $32-million MGP-regulatory-asset balance will be eliminated. This benefits customers by allowing PGS to provide service in the future free of its long-term historical cost obligation.

In addition to retiring the MGP obligation, the compromise ensured the capture and use for the customer's benefit -- excuse me -- of an additional one million for 2018 that was not being held subject to refund.

As part of this deal, the company has agreed to reduce its base rates in January of 2019 and keep them at that level until at least January 1, 2021, which is also a new benefit to customers.

In sum, and in concert with the 2017 agreement, the 2018 agreement enhances the tax-savings benefits that customers will receive, give some stability and certainty in rates, and reduces the costs that the company will incur in keeping rates stable for years to come. We urge your approval as being in the public interest.

Thank you.

CHAIRMAN GRAHAM: Thank you, Ms. Ponder.

FIPUG.

MS. PUTNAL: Thank you.

FIPUG has intervened and participated in a number of federal tax-reform dockets to date; namely the Gulf Power, Tampa Electric, and Duke Power matters. The Commission has considered these matters and voted to return monies to customers within a known and agreed time frame.

Today, the Commission has a settlement agreement that similarly provides that dollars resulting from the 2017 federal tax-reform legislation will be returned to customers.

FIPUG has made clear that the flowback of federal tax-reform dollars should be transparent and the return of tax savings should also occur promptly so that customers will be able to realize the tax savings sooner rather than later.

Today, FIPUG asks you to approve the settlement agreement before you so that Peop- -- customers of Peoples Gas can receive the benefits of the 2017 federal tax reform at the beginning of the year, and also thanks OPC and Peoples Gas for their cooperation in reaching an agreement.

Thank you.

CHAIRMAN GRAHAM: Thank you.

Okay. Staff, prefiled testimony.

MR. TRIERWEILER: Chairman, we ask that the prefiled testimony of all witnesses identified in Section 6, Page 4 of the pre-hearing order be inserted into the record as though read.

CHAIRMAN GRAHAM: We will insert all of the prefiled direct testimony of all witnesses into the record as though read.

MR. TRIERWEILER: Thank you.

(Prefiled testimonies entered into the record as though read.)

DOCKET NO. 20180044-GU
FILED: 05/31/2018

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED DIRECT TESTIMONY

OF

ALAN D. FELSENTHAL

ON BEHALF OF PEOPLES GAS SYSTEM

Q. Please state your name, address, occupation and employer.

A. My name is Alan D. Felsenthal. My business address is One North Wacker Drive, Chicago, Illinois 60606. I am a Managing Director at PricewaterhouseCoopers LLP ("PwC").

Q. Please describe your educational background and business experience.

A. I was graduated from the University of Illinois in 1971 and began my career at Arthur Andersen & Co ("Arthur Andersen"), where I was an auditor, and focused on audits of financial statements of regulated entities. In 2002, I joined PwC and became a Managing Director in their Utilities Group and continued performing audits for regulated entities. I was hired by Huron Consulting Group ("Huron") in 2008 and returned to PwC in November of 2010.

At both Arthur Andersen and PwC, I supervised audits of financial statements on which the firms issued audit opinions that were filed with the SEC, the Federal Communications Commission, the Federal Energy Regulatory Commission ("FERC") and various state commissions. At Arthur Andersen, PwC and Huron, I consulted on a significant number of utility rate cases and helped develop testimony for myself and others on a variety of issues, including construction work in progress in rate base, projected test years, lead-lag studies, cost allocation, several accounting issues (e.g., pension accounting, regulatory accounting, income tax accounting, cost of removal) and compliance with the income tax normalization requirements.

Q. Please describe your duties and responsibilities at PwC.

A. I lead PwC's regulatory support practice. Throughout my career, my focus has been on the regulated industry sector, primarily electric, gas, telecommunication and water utilities. I have focused on utility accounting, income tax and regulatory issues, primarily as a result of auditing regulated entities. The unique accounting standards applicable to regulated entities embodied in Accounting Standards Codification ("ASC") 980, Regulated Operations (formerly, Statement of Financial Accounting Standards ("SFAS") 71, FAS 90, FAS 92, FAS 101 and various Emerging

Issues Task Force ("EITF") issues, all need to be understood so that auditors can determine whether a company's financial statements are fairly presented in accordance with generally accepted accounting principles. I have witnessed the issuance of these standards and have consulted with utilities as to how they should be applied. At both Arthur Andersen and PwC, I worked with the technical industry, accounting and auditing leadership to communicate and consult on utility accounting and audit matters.

Q. Have you provided training on the application of Generally Accepted Accounting Principles ("GAAP") to regulated entities?

A. Yes. At Arthur Andersen, Huron and PwC, I developed and taught utility accounting seminars focusing on the unique aspects of the regulatory process and the resulting accounting consequences of the application of GAAP, including accounting and ratemaking for income taxes. I have presented seminars, as well as delivered training on an in-house basis. Seminar participants have included utility company and regulatory commission staff accountants, utility rate departments and internal auditors, tax accountants and others. I have also conducted these seminars for the FERC and several state commissions, and I have presented at various Edison Electric Institute and American Gas Association ratemaking and accounting seminars. The income tax training programs I have presented include topics such as the normalization requirements for public utilities in the Internal Revenue Code (“IRC”), protected and unprotected deferred taxes and the mechanics and application of the Average Rate Assumption Method (“ARAM”).

Q. Have you previously testified before the Florida Public Service Commission (“FPSC” or “Commission”)?

A. Yes. I have testified or filed testimony before this Commission in two dockets. The first was in connection with Central Telephone Company’s rate case filing in Docket No. 19891246-TL, in which I testified on the company’s approach to determining their projected test year. I also testified in Tampa Electric’s Docket No. 20080317-EI on the subject of income taxes.

Q. Have you previously testified before other government entities with regulatory authority over regulated telecommunications, electric or gas companies?

A. Yes. I have testified before the Arizona Corporation

Commission, the Illinois Commerce Commission, the Indiana Utility and Regulatory Commission, the Public Utility Commission of Ohio, the Public Utility Commission of Texas and the Washington Utilities and Transportation Commission on various utility ratemaking topics, including accounting and ratemaking for income taxes.

Q. What are the purposes of your direct testimony in this proceeding?

A. The purposes of my direct testimony are to: (1) discuss accounting for income taxes for public utilities like Peoples Gas System ("Peoples Gas" or "company") and related ratemaking principles, (2) describe the recent changes caused by the Tax Cuts and Jobs Act of 2017 ("TCJA") and the general impact of the changes on regulated utilities, (3) explain the ratemaking requirement in the TCJA for "protected excess deferred taxes" and (4) describe the work PwC performed to test the company's calculation of the impact of the TCJA on the company's 2018 income tax expense.

Q. Did you prepare any exhibits in support of your direct testimony?

A. Yes. Exhibit No.___ (ADF-1) was prepared under my direction and supervision. My exhibit consists of the following two documents:

Document No. 1   Depreciation Timing Difference Example
Document No. 2   ARAM Illustration

Q. As part of your work for Peoples Gas in this docket, have you read the prepared direct testimony of Mr. Jeffrey S. Chronister and Ms. Valerie Strickland?

A. Yes, I have. I have read all of Peoples Gas witness Jeffrey S. Chronister’s prepared direct testimony and exhibit as well as the prepared direct testimony and exhibit of Peoples Gas witness Valerie Strickland.

Q. Please provide a summary of your direct testimony.

A. After providing a framework for the accounting and regulatory treatment of income taxes and the impacts of the TCJA, I discuss how Peoples Gas’ proposal to reflect the effects of the TCJA from an accounting perspective is consistent and accurate and complies with Order PSC-2018-0104-PCO in Docket No. 20180013-PU as well as the IRC’s normalization requirements applicable to public utility property.

Accounting for Income Taxes
and Related Ratemaking Principles

Q. Can you please describe the accounting for income taxes required under GAAP?

A. Yes. Accounting for income taxes under GAAP is contained in the accounting literature in section ASC 740 (formerly SFAS No. 109, Accounting for Income Taxes) of the accounting codification. There are three major components to the calculation: currently payable income taxes, deferred income taxes, and investment tax credits.

Q. Please describe the first component, currently payable income taxes.

A. Currently payable income tax expense represents the estimated amount of current year income taxes payable based on current year taxable income. Taxable income for the year is determined in accordance with the IRC. For purposes of preparing an income tax return each year, the IRC contains procedures for determining if and when an item is "taxable" or "deductible." After considering the taxable and deductible amounts in the current year, "taxable income" is determined, which is then multiplied by the applicable statutory tax rate. This subtotal is further adjusted for any available income tax “credits”.

The result of calculating the amounts to be included on the annual tax return using the guidance in the IRC is a journal entry to record current income tax expense and current income tax payable.

Q. Are the IRC rules for determining what is taxable or deductible for completing the tax return the same as the GAAP rules for determining what items constitute revenues, income and expenses for the year?

A. No. The IRC rules for determining what is taxable or deductible often differ from what is reportable as revenue, income or expense under GAAP. For instance, certain expenses recorded on the financial statements under GAAP in one period may be deductible on the tax return in a different period. There are also instances where the amounts shown as deductions on the tax return in one period are not reflected on the financial statements until a later period. As a result, at the end of each reporting period, there will likely be accumulated differences of reported assets and liabilities resulting from different book treatment as opposed to tax return treatment of revenues, income and expenses.

The differences each year between book and tax return recognition are referred to as either “timing/temporary differences” or “permanent differences”, with the vast majority being of a timing/temporary nature.

Q. What is the distinction between a timing/temporary difference and a permanent difference?

A. A timing/temporary difference will enter into the determination of book/financial income (revenue, income or expense) in one period and into the determination of taxable income on the tax return (revenue, income/deduction) in another period. Over time, however, the total amount will ultimately enter into each statement equally. A permanent difference will enter into the determination of either book income or taxable income in one period but will not be included in the other.

Q. Can you further explain what is meant by a timing/temporary difference and provide an example?

A. Yes. One common timing/temporary difference is depreciation. For book purposes, when a company acquires a fixed asset, GAAP requires that the asset be depreciated over its estimated useful life in a systematic and rational manner. The cost of the fixed asset is "allocated" to the periods in which the fixed asset is being used to provide service. The annual allocation is known as depreciation expense. Most utilities, like Peoples Gas, depreciate their fixed assets for book purposes using the straight-line depreciation method. This method of calculating depreciation is different than the accelerated depreciation approach commonly used for determining the depreciation deduction on an income tax return. For income tax purposes that same asset may be depreciated for determining taxable income on the income tax return using an accelerated depreciation method or a different (generally shorter) estimated useful life permitted under the IRC.

When the annual depreciation charge for book purposes is compared to the annual depreciation for income tax purposes, there will likely be differences. In the early years of an asset’s life, tax depreciation will exceed book depreciation. In the later years, the reverse will be true because given the same capitalized asset cost, over the life of the asset, total depreciation will be the same. The sum of the annual depreciation differences results in accumulated depreciation differences when comparing the net book value and net tax value of fixed assets. As I will discuss later, it is important to understand that for any fixed asset book-tax depreciation difference there will be a period of time where tax depreciation is greater than book depreciation, and at some point, the reverse will occur and book depreciation will exceed tax depreciation. This pattern exists because the same amount (the fixed asset amount) will eventually be fully depreciated for tax purposes and book purposes.

Q. Can you provide an example of how depreciation book-tax differences arise and reverse?

A. Yes. An example of this is included in Document No. 1 of my exhibit. This example assumes that a utility acquires property, plant and equipment with an estimated useful life of 10 years for $10.0 million cash and, for simplicity, ignores salvage value and cost of removal. It also assumes that the asset qualifies under the IRC for a five-year tax depreciation using the Modified Accelerated Cost Recovery System ("MACRS").

The entry to record the acquisition of the asset is to debit property, plant and equipment and to credit cash. Using the straight-line method for book depreciation, the company would record $1.0 million of depreciation expense in its financial statements each year of useful life of the asset.

Under MACRS for a five-year asset, the tax depreciation deduction is 20 percent the first year, 32 percent in year two, 19.2 percent in year three, 11.52 percent in years four and five and 5.76 percent in year six. Six years are included in the MACRS table as the assumption of one-half year depreciation in the first and last years are considered. The annual depreciation charges for book and tax are shown on Document No. 1 of my exhibit.

At the end of year one, the net basis of the asset for book purposes would be $9.0 million ($10.0 million gross plant, less $1.0 million of accumulated book depreciation) while its tax basis would be $8.0 million ($10.0 million gross tax basis less $2.0 million of accumulated tax depreciation). Each year’s book depreciation expense would reduce the net book basis of the asset and each year’s tax depreciation would affect the tax basis of the asset. The difference between the book basis and tax basis of the asset represents a temporary difference under ASC 740.

However, because total depreciation expense/deductions are limited to the gross capitalized cost of the asset, accelerated income tax depreciation claimed in the early years (reducing income tax payments) will reverse in subsequent periods when book depreciation exceeds tax depreciation (increasing income tax payments) so that when the asset is retired, the depreciation temporary difference will have completely reversed. In this example, the reversal begins in year six because, during that year, book depreciation begins to exceed tax depreciation and that result continues until the book life ends.

Q. What are the accounting requirements for timing/temporary differences under ASC 740?

A. Under GAAP, particularly ASC 740, financial statements are required to assign the income tax benefits/expenses to the period in which the associated book income/expense is recorded, and therefore deferred income taxes are recorded on timing/temporary differences. As a result, income tax expense under GAAP includes both a currently payable component (as previously described, based on the tax return) as well as a "deferred" income tax component (based on timing/temporary differences).

To determine current tax expense and taxes currently payable for the year, the company will use the guidance for taxable income and tax deductions in the IRC, arriving at taxable income, applying the current income tax rate to that amount and consider any income tax credits. The result is recorded by the following journal entry:

Current Income Tax expense $XXX,XXX

Currently Payable Income Taxes $XXX,XXX

Q. What is the second component of the income tax calculation?

A. The second component of the income tax calculation is deferred income tax. To calculate this component, the revenue, income and deductible items that enter into the determination of taxable income are compared to those same items as shown on the company’s income statement. Where an item has reduced taxable income in an amount greater than the book amount, current income taxes are decreased. But when that additional amount shown on the tax return is an originating timing/temporary difference, the company will record a deferred tax expense. In each case, a deferred tax asset or deferred tax liability is recorded to recognize that there will be a future reversal of that timing/temporary difference. The currently enacted income tax rate will be used to measure the deferred income tax of an originating book-tax difference. The entry to record the deferred tax impacts of a timing/temporary differences is:

Deferred Income Tax Expense $XXX,XXX

Accumulated Deferred Income Taxes $XXX,XXX

Q. What do deferred income taxes represent?

A. Deferred income taxes reflect the liability or asset for income taxes payable or receivable in the future stemming from transactions recorded in the financial statements currently. The sum of the annual deferred tax provisions results in a balance sheet liability or asset referred to as Accumulated Deferred Income Taxes ("ADIT"). In other words, to the extent that accelerated tax depreciation is claimed on the income tax return in an amount that exceed book depreciation reported on the financial statements, a liability for future taxes results. This future tax liability is due to the fact that greater depreciation claimed in early years will "use up" the tax basis of assets at which point book depreciation will exceeds tax depreciation resulting in higher taxes in the future.

For regulated entities, such as Peoples Gas, the process of recording deferred income taxes on temporary differences is referred to as "normalization", "deferred tax accounting," or “comprehensive inter-period income tax allocation.”

Q. Can you please explain how current and deferred income taxes would be recorded on the financial statements for the depreciation difference example you discussed previously?

A. Yes. In year one of the example, the company would record on its books depreciation expense of $1.0 million in accordance with GAAP. In that same year, they would reduce taxable income on the income tax return by $2.0 million. Assuming a 35 percent income tax rate, by claiming a $2.0 million depreciation deduction, *current* taxes payable and *current* tax expense would be reduced by $700,000 (35 percent income tax rate times the $2.0 million tax depreciation deduction).

However, by claiming an additional $1.0 million of tax depreciation ($2.0 million tax depreciation compared to $1.0 million of book depreciation) the company will also record a *deferred* income tax liability and *deferred* tax expense of $350,000 (35 percent income tax rate times book-tax difference of $1.0 million). The deferred tax will begin becoming payable when the book depreciation exceeds tax depreciation. In other words, by claiming accelerated depreciation (compared to straight line book depreciation) in years 1-5, the company has incurred a deferred tax obligation that will become payable in years 6-10.

Q. Does claiming deductions for income tax purposes in excess of expenses recorded for book purposes provide incentives to the company that benefit customers?

A. Yes. By claiming tax deductions using accelerated depreciation, the company reduces its current income tax payments, but tax payments will be higher in the future when the temporary differences reverse. As a result, ADIT balances are often referred to as “interest free loans” from the U.S. Treasury. This was the objective Congress intended when it included accelerated depreciation provisions in the IRC. Congress believed that allowing companies to increase their tax depreciation deductions (and thereby reduce current income tax payments), would lower the financing costs of investments in capital assets and, therefore, companies would be incented to make such expenditures.

Q. Can you give an example of a book-tax difference that is permanent?

A. Yes. Certain items of revenue, income and expense are, over time, treated differently for financial reporting purposes than for income tax purposes and are included in only one of either taxable income or financial reporting income. These are referred to as permanent differences.

An example of a permanent difference is the cost of meals and entertainment. These costs are reported as expenses in the financial statements for a given period, but, based on the IRC, are not completely deductible in determining taxable income on the income tax return. Thus, over time, the financial statement reporting of meals and entertainment expenses will differ from the related amounts on the income tax return.

Deferred income taxes are not required on permanent differences because the difference will never reverse, it is “permanent”. In the case of meals and entertainment costs, in the period reported, current income taxes will be adjusted to reflect the non-deductibility of these costs and there will be no deferred income taxes since these amounts, under the current IRC, will never be deducted on the tax return.

Q. Is the distinction between permanent and temporary differences important in the income tax calculation?

A. Yes. Because permanent differences do not require deferred income tax accounting, the income tax effects of such items increase or decrease total income tax expense. With timing differences, each and every item that impacts current income tax expense has an equal and offsetting impact to deferred income tax expense. Because total income tax expense affects net income under GAAP and total income tax expense must be recovered in a rate case, permanent differences need to be separately identified and included in the income tax calculation.

Q. Please explain the third component, tax credits.

A. Tax credits, such as the investment tax credit, are direct offsets against taxes otherwise payable. The investment tax credit is calculated by applying a percentage to investments in property, plant and equipment, effectively reducing the net expenditure on such investment. For expenditures on public utility property, the journal entry to record the investment tax credit when claimed is:

Currently payable income taxes	**$XXX,XXX**	
Unamortized investment tax credit		**$XXX,XXX**

The unamortized investment tax credit is then amortized over the book lives of the property giving rise to the investment tax credit:

Unamortized investment tax credit	**$XX,XXX**	
Income tax expense		**$XX,XXX**

In this manner, the investment tax credit is deferred on the balance sheet when realized and allocated to the income statement as the property is being depreciated. The accounting and ratemaking treatment of the investment tax credit was not directly impacted by the TCJA.

Ratemaking Treatment of Income Taxes

Q. Is deferred income tax accounting appropriate for ratemaking purposes?

A. Yes. Income tax expense in a given year is the result of that year's economic activity. In determining the revenue requirement, it is important for regulatory commissions to consider the recovery of all appropriate costs of providing service, including the associated income tax effects of the costs.

During the ratemaking process, regulators consider all items of revenues, income and expenses and makes a finding as to whether the individual revenues, income and expenses should be allowed in the determination of revenue requirements. Once regulators determine the allowable costs excluding income taxes, the income tax consequences, both current and deferred, can be calculated. This is because income taxes do not exist independently. They are dependent on and result from a determination of income and expenses. The revenue, income and expenses are generally determined on an accrual basis and the tax consequences of income and expenses must be determined on that same accrual basis (both current and deferred income taxes).

As I discussed earlier, the accelerated depreciation (the major component of deferred taxes for capital intensive entities such as Peoples Gas) of assets was meant to lower the cost of financing assets by providing the company an interest free loan. The ADIT balance (the interest free loan from the U.S. Treasury) is a zero-cost source of capital in the cost of capital computation thereby giving the benefit of reduced financing costs to ratepayers.

Q. Has the FERC taken a position on the appropriateness of deferred income tax accounting?

A. Yes. The FERC requires comprehensive inter-period income tax allocation for all book-tax timing/temporary differences. Orders 144 and 144A provide guidance in this area. This has been the FERC methodology since the early 1980's. The FERC Uniform System of Accounts ("FERC USOA") and many FERC rate orders require normalization.

Q. Has the FPSC taken a position on the appropriateness of deferred income tax accounting?

A. Yes. The FPSC has long acknowledged that normalization is appropriate for revenues, income and expenses that are recognized at different times for book and tax purposes.

Q. Does the IRC contain requirements addressing deferred income tax accounting?

A. Yes. The IRC contains specific requirements that are applicable to the use of accelerated depreciation on public utility property. These requirements, called the "normalization requirements," mandate that in order for a public utility to be eligible to claim accelerated depreciation for income tax purposes, the regulator must permit recovery of deferred income taxes on the difference resulting from using accelerated depreciation for income tax purposes and straight-line depreciation for book purposes.

The penalty for violating the normalization requirements is the loss of the ability to claim accelerated depreciation for income tax purposes on all assets as of the violation date and on subsequent additions. It is a severe penalty.

Q. How do the terms "protected" and "unprotected" deferred income taxes relate to the normalization requirements for public utility property under the IRC?

A. The income tax normalization requirements in the IRC pertain to accelerated depreciation on public utility property, excess ADIT and investment tax credits. Certain contributions in aid of construction must also be normalized. Book-tax differences that require the provision of deferred taxes, as well as appropriate treatment of the resulting ADIT, are known as “protected” accumulated deferred taxes. Book-tax differences where deferred tax expense is not required to be applied in the ratemaking process are called “unprotected.”

Q. Document No. 1 in Exhibit No. __(VS-1) of Peoples Gas witness Valerie Strickland includes a presentation of the company’s income tax calculation in the format required for Minimum Filing Requirement Schedule C-21. Referring to that document, can you identify which book-tax differences are protected and which are unprotected?

A. Yes. Witness Strickland’s Document No. 1 lists the individual book-tax differences which gave rise to the ADIT balances recorded as of December 31, 2017. The protected ADIT’s relate to accelerated depreciation and are described as:

- ADIT related to differences caused by using straight-line depreciation for determining book depreciation and an accelerated depreciation method for determining tax depreciation (method difference).

- ADIT related to differences caused by using shorter depreciation lives for determining tax depreciation than for determining book depreciation (life difference).

In short, depreciation related method and life differences are considered “protected.” All other temporary book-tax differences are considered “unprotected.”

Q. Does the distinction between protected and unprotected ADIT matter under the TCJA?

A. Yes. The distinction between protected ADIT and unprotected ADIT is critical. The TCJA contains specific language on how excess ADIT relating to protected ADIT is to be treated in order to avoid a normalization violation. Similar guidance does not exist for excess unprotected ADIT. I will discuss these provisions later in my direct testimony.

Tax Cuts and Jobs Act of 2017

Q. Please generally describe the TCJA.

A. The TCJA was enacted by the United States Congress on December 20, 2017 and was signed into law by the President on December 22, 2017. *See Tax Cuts and Jobs Act of 2017*, Pub. Law 115-97, 131 Stat. 2054 (2017). The TCJA amends the IRC and includes the most significant set of changes to the federal income tax laws since the Tax Reform Act of 1986. The TCJA makes major changes in many areas of our nation's tax laws, some of which directly affect regulated utilities like Peoples Gas.

Q. What are the most significant parts of the TCJA for regulated utilities?

A. Although there may be other portions of the TCJA that may have some effect on regulated utilities, the most significant changes in the TCJA to regulated utilities and their ratepayers can be summarized as follows:

(a) The TCJA reduces the federal corporate income tax rate from 35 percent to 21 percent effective January 1, 2018.

(b) The TCJA exempts regulated utilities from the immediate expensing of certain capital additions and applies the MACRS rules to regulated utility property additions, without a provision for “bonus” (accelerated) tax depreciation.

(c) The TCJA exempts regulated utilities from an interest deductibility limitation.

(d) The TCJA retains the corporate deduction for state and local taxes.

(e) The TCJA includes normalization provisions for public utility property that requires application of the ARAM to the flow-back of “protected” excess deferred income taxes.

(f) The TCJA leaves unchanged the 2015 renewable credit tax arrangement and the Electric Vehicle tax credit.

(g) The TCJA eliminates the Alternative Minimum Tax.

(h) The TCJA eliminates the Section 199 manufacturing deduction.

Q. Please describe the provisions of the TCJA that will have the greatest impact on regulated utilities like Peoples Gas and their customers.

A. The TCJA will have significant, though varying impacts on most utilities in terms of reported tax expenses charged against the company’s operations, cash flows and the calculation of revenue requirements and cost of service.

The most significant provision of the TCJA for regulated utilities, including Peoples Gas, is the reduction of the Federal Income Tax Rate from 35 percent to 21 percent, which will reduce current income tax expense and originating deferred tax expense. As a result of the lower 21 percent income tax rate becoming effective under the TCJA, all companies, including public utilities, were required under ASC 740 to “remeasure,” as of December 31, 2017, the amounts of ADIT in their financial statements. Regulated utilities reclassified the reduction in ADIT to a regulatory liability representing the excess ADIT that will be used to reduce future revenue requirements.

The loss of bonus tax depreciation on plant additions going forward will also have a significant impact as regulated utilities will now be limited to MACRS, with no bonus tax depreciation, reducing the amount of available ADIT.

Some of the TCJA effects will occur immediately while others will occur over time. However, in each of these cases, cash flow decreases.

Q. Can you explain how the reduction in the federal corporate income tax rate will affect Peoples Gas’ current and deferred income taxes, including excess ADIT?

A. Yes. The Federal corporate tax rate is reduced from 35 percent to 21 percent for tax years beginning after January 1, 2018. At a 35 percent tax rate, revenue of $1.5385 was required to provide $1.00 of after-tax income. A corporate tax rate of 21 percent requires $1.2685 of revenue to generate $1.00 of after tax income. This reduction in the cash outflow from the company to the U.S. Treasury to pay currently payable income taxes is offset by reduced cash flows (revenue requirements) from ratepayers.

With respect to deferred Federal income taxes, those related to originating book-tax differences will be provided and collected at 21 percent rather than at 35 percent. Therefore, there will be reduced cash inflow because, at a 21 percent tax rate, for every $100 of accelerated depreciation or other book-tax difference, a utility will now have an interest-free loan from the U.S. Treasury of $21 compared to $35 under the previous income tax rate. However, initially there is no corresponding reduction in cash outflow from the company.

With respect to reversing book-tax differences, there will be no change in cash flow because the effects of reversing book-tax differences will continue to be computed and passed onto ratepayers at the tax rate used when the book-tax difference originated (generally 35 percent).

The effect of this reduced cash inflow will be an increase in outside financing requirements. The substitution of investor supplied capital having a financing cost of more than zero for interest-free ADIT will likely increase the company's overall cost of capital.

The TCJA continues the normalization requirements that deferred income taxes must be provided on depreciation timing/temporary differences between the financial statements and the tax return. The Federal ADIT on the company's books as of December 31, 2017 were, in most cases, stated at 35 percent of the related timing/temporary difference. For regulatory or ratemaking purposes, the reversals of the ADIT are credited to income as the related timing/temporary difference reverse, and that credit to income is computed as 35 percent of the reversing timing/temporary difference. The amount credited to income in future years with respect to all Federal ADIT at December 31, 2017 will not change as a result of the TCJA. In fact, the TCJA affirms the existing accounting for timing/temporary difference reversals as to ADIT related to protected book-tax differences (depreciation method and life timing differences) by requiring that these ADIT be flowed back in rates and on the books using ARAM.

Q. How is the ARAM computed?

A. The ARAM requires the development of an average rate which is determined by dividing the aggregate normalized protected timing/temporary differences into the ADIT that have been provided on such timing/temporary differences. The average rate so calculated is applied to reversing timing differences to derive the deferred taxes that are credited to income tax expense. Under this approach, protected ADIT are reduced over the remaining lives of the property which gave rise to the ADIT as the timing/temporary differences reverse. Public utilities must take care to properly apply ARAM to protected ADIT because a normalization violation could occur if the amount of protected excess ADIT is reduced more rapidly or to a greater extent than under ARAM.

The normalization violation would result in an increase in current income taxes payable for the amount of the more rapid reduction plus, more importantly, accelerated depreciation methods could not be used for income tax purposes going forward. Rather, book depreciation would have to be used for income tax purposes.

Q. What are "excess" ADIT and how are they calculated?

A. Excess ADIT means the ADIT balance existing immediately prior to the reduction in the corporate tax rate less the amount that would have been in the ADIT balance had that balance been determined using the revised lower corporate income tax rate.

Q. Can you summarize the net impacts of the tax rate reduction on utility revenue requirements?

A. The net effect of the tax rate change on taxes currently payable is to decrease tax expense. The net effect of the tax rate change on deferred taxes is that the provision on originating book-tax differences would be reduced, the reversals of previously provided deferred income taxes would not be changed (continue to reverse such existing ADIT at the average rate they had been provided) and the amount of ADIT at the time of enactment would decline. The decline in this zero-cost source of capital will likely cause the weighted cost of capital to increase compared to the cost if the TCJA had not been enacted.

Q. Other than the reduction in tax rates which will have an effect on current and deferred income taxes, what is another impact of the TCJA for utilities such as Peoples Gas?

A. For capital intensive industries, the use of accelerated depreciation to determine the tax liability is significant. The TCJA allows many companies to deduct, for income tax purposes, significant portions (in some cases, all) of their capital expenditures. However, the utility industry is specifically excluded from being able to apply this provision. Instead, public utility property continues to be subject to the MACRS without a provision for “bonus” (accelerated) depreciation. Prior to the TCJA, the utility industry had been permitted to apply for “bonus” (accelerated) depreciation.

As a result of losing bonus depreciation, all else being equal, aggregate cash flow will decrease as taxes currently payable will be higher and the deferred provision and resulting ADIT will be lower. Since ADIT will be lower, the weighted cost of capital will be higher reflecting the replacement of zero cost capital with investor funds containing a cost greater than zero.

Protected Excess Deferred Income Taxes

Q. Please provide more detail on how the TCJA prescribes the ratemaking treatment for “protected” excess deferred income taxes.

A. The TCJA requires that excess ADIT be reversed, over the lives of the related property as temporary/timing differences reverse using the ARAM, or, if the records needed to compute the ARAM are unavailable, through an alternative procedure known as the Reverse South Georgia Method ("RSGM"). ARAM is required for excess ADIT for those "protected" book-tax differences subject to the aforementioned normalization rules. Peoples Gas has the records to apply ARAM and, as discussed in the direct testimony of Valerie Strickland, has done so in this case.

Q. Does the TCJA prescribe a method for excess ADIT on "unprotected" excess ADIT?

A. No. Prior to the TCJA, the ADIT provided on all book-tax differences typically reversed at the tax rate used to record the deferred tax expense when the book-tax difference originated; however, the TCJA does not contain such a requirement on the excess ADIT on unprotected book-tax differences. The balance of unprotected ADIT is thus up to a decision by the company and the regulator. I understand that Peoples Gas is proposing a 10-year amortization of the unprotected excess ADIT existing at December 31, 2017.

Q. Have you prepared an exhibit that demonstrates how the ARAM is to be calculated?

A. Yes, Document No. 2 of my exhibit shows the originating and reversing book-tax differences and the required ADIT each year. The example in Document No. 2 is based on the assumptions used in my previous example describing depreciation book-tax differences and how such differences originate and reverse. However, in this example I begin with an income tax rate of 35 percent in the early years that is reduced to 21 percent before the asset is fully depreciated. The example again assumes a $1 million asset placed in service in 2016 with a 10-year book life and a five-year MACRS life, with no bonus tax depreciation. The MACRS rate is shown in Column B and each year’s tax depreciation is shown in Column C. Book depreciation is $100,000 each year and Column F contains the difference between tax and book depreciation each year. Column G contains the income tax rates, beginning with 35 percent in 2016 and 2017, reducing that rate to 21 percent at the beginning of 2018. Columns H and I show each year’s deferred tax expense, with Column H showing the deferred tax expense on originating book-tax differences and Column I showing the deferred tax expense on reversing book-tax differences. Column K shows the ADIT balance, increasing and decreasing the previous year’s balance by the deferred tax expense.

Q. Can you walk through the determination of excess ADIT and how the ARAM is used to reverse the ADIT for the tax rate change?

A. Yes. When the tax rate changed at the end of 2017, the balance of ADIT was $112,000 (Column K). This balance was derived by applying the 35 percent tax rate to the 2016 and 2017 originating book-tax differences in Column F ($100,000 + $220,000 = $320,000). The excess ADIT is calculated by applying the new 21 percent tax rate to those cumulative book-tax differences at the time of the rate change ($320,000 x 21 percent = $67,200) and comparing that amount to the then existing ADIT balance with the difference representing the excess ADIT ($112,000-$67,200 = $44,800).

Under the ARAM, this excess ADIT balance does not begin reversing until 2021 when the book-tax difference begins to reverse. In 2018 through 2020, book-tax differences continue to originate, now at the lower 21 percent income tax rate with no reversal permitted for excess ADIT.

At the end of 2020 the ADIT balance is $137,704 (Column K) and the cumulative book-tax difference is $442,400 (the

2016 through 2020 differences in Column F). The average rate at which the $137,704 ADIT balance was accumulated is thus 31.1266 percent ($137,704 / $442,400). This is the average rate that must be applied to the book-tax differences reversing in each year beginning in 2021 (Column F) producing the reversal of the deferred tax expense each year (Column I).

At the end of its useful life, the originating and reversing deferred tax expense equal one another and the ADIT balance is 0.

Q. If a rate higher than 31.1266 percent were used to reduce the reversing ADIT or if any of the excess ADIT were reversed prior to 2020 what would happen?

A. Flowing back protected ADIT more rapidly than permitted under the ARAM will result in a violation of the normalization rules. The TCJA specifies the penalty for violating the normalization rules is severe and two-fold: (1) currently payable income tax is increased by the amount by which the utility reduced its excess tax reserve more rapidly than permitted under the ARAM or the RSGM, and (2) the utility will be unable to claim accelerated depreciation for income tax purposes.

Q. Once the excess ADIT related to protected differences are identified, is it fair to characterize the remaining excess ADIT as relating to unprotected book-tax differences?

A. Yes.

Q. Are any of the unprotected book-tax differences related to property, plant and equipment?

A. Yes. The more significant unprotected book-tax differences with some elements of property, plant and equipment accounting are book-tax differences for the treatment of repairs (deducted currently for tax, capitalized and depreciated for books), different amounts capitalized into the book and tax bases of depreciable property, plant and equipment (overheads) and cost of removal.

Q. Please describe the cost of removal book-tax difference.

A. For most commercial and industrial companies, when computing book depreciation, the concept of 'salvage value' is taken into consideration when determining the book basis to be depreciated. When a fixed asset is placed in service, the book basis subject to book depreciation is the amount incurred in rendering that asset ready for service less any expected salvage value that will be received when that asset is retired. So for instance, if an asset placed in service cost $1,000, with a five-year life and $50 of salvage is expected to be received upon retirement, the book basis to be depreciated is $950. Annual book depreciation charges will be $190 ($950/5=$190).

Most regulated entities, including Peoples Gas, do not receive a net salvage upon the retirement of property, plant and equipment. Instead, they incur the opposite, a "cost of removal" upon retirement, meaning there are additional expenditures required to remove such property, plant and equipment. The costs to remove, dispose or otherwise permanently retire an asset from service including the costs of dismantling, tearing down or demolishing, meet the cost of removal definition. When depreciation rates are established for regulated entities, such rates are increased to reflect the estimated cost of removal. If, when expending the removal cost, there is some salvage received, the salvage is netted against the cost of removal to produce a net cost of removal or "negative net salvage." For book purposes, this treatment charges the customers who benefit from using the property, plant and equipment, with the cost to remove that asset at the end of its depreciable life.

For instance, if the cost of property, plant and equipment is $1,000 and there is a $50 estimated cost associated with removing that asset when it is retired, the annual book depreciation charge is $210 ($1,050 / 5 = $210). In the utility's depreciation study, depreciation rate for this asset would be 21 percent -- 20 percent to recover the incurred cost of $1,000 over five years and 1 percent to recover the estimated cost of removal in years 1 to 5 (1 percent x $1,000 each year = $10 per year). In this manner, year 5 to cover the actual removal cost incurred upon retirement.

Q. How is cost of removal treated for income tax purposes?

A. For income tax purposes, cost of removal is deducted when the actual removal costs are expended. Because book depreciation includes an estimated component to recover cost of removal, but for tax purposes the cost is not deductible until expended, a book-tax difference results.

Q. Please explain the deferred income tax consequences of cost of removal.

A. As explained above, the impact to deferred tax of cost of removal is the opposite of, for example, the impact of accelerated depreciation because the book expense (the cost of removal component of book depreciation expense) is deducted for income tax purposes in later years when the cost of removal is expended. The effect is to create an ADIT asset (rather than liability) when book depreciation initially exceeds tax depreciation by the amount of the cost of removal component of book depreciation. The ADIT for cost of removal is reversed when the tax depreciation deduction for cost of removal is expended and subsequently deducted.

Q. Is the cost of removal a protected or unprotected book-tax difference?

A. Cost of removal is an unprotected book-tax difference. Cost of removal, or negative salvage value, is not a depreciation method or life difference. Unlike accelerated versus straight-line depreciation differences which are required to be normalized in order to permit the utility to enjoy the benefits of the interest free loan by accelerating recovery of depreciation tax deductions, cost of removal does not provide an up-front tax deduction. This view is shared by the Edison Electric Institute and my Firm. I am not aware of any applicable guidance from the Internal Revenue Service to the contrary covering the specific issue of cost of removal when the net cost of removal produces a net cost. Private letter rulings in this area, if applicable, are confusing or not on point.

Q. What is Peoples Gas proposing for reducing revenues and customer bills for the excess ADIT related to unprotected book-tax differences resulting from the TCJA?

A. As mentioned previously, there is no requirement in the IRC for excess ADIT which applies to unprotected book-tax differences. While one approach is to use an ARAM-type approach to unprotected excess ADIT reversing the excess ADIT as the related book-tax difference reverses, Peoples Gas is proposing to amortize the unprotected excess ADIT balance over 10 years.

The calculation of the amortization is straight-forward. The company’s unprotected ADIT balance as of December 31, 2017 was divided by 10 and this amount was factored into the revenue requirement calculation beginning January 1, 2019. Peoples Gas has an unprotected ADIT asset and will increase tax expense to reflect the amortization.

Q. You have stated that the effects of the tax rate reduction and the loss of the ability to claim bonus tax depreciation will have a negative effect on cash flows because there will be less ADIT. What is the significance of a decrease in cash flows?

A. A decrease in cash flow, all else being equal, is often considered a negative factor by investors when they evaluate the quality of a security. There will be a negative factor in this instance, because there will be a reduction in zero-cost capital due to a lower amount of ADIT which must be replaced by investor funds which typically have a cost greater than zero.

In addition, other effects of the TCJA which would likely be considered negatively by investors include a reduction in pretax coverage ratios and an increase in the invested capital per dollar of property, plant and equipment. In addition, because of the reduction in the tax rates, the company's shareholders will now share losses and declines in earnings with the U.S. Treasury in the ratio of 79 percent to 21 percent rather than 65 percent to 35 percent. The existence of these negative factors will likely be recognized in the cost of capital.

PWC Procedures

Q. What procedures did PWC perform with respect to Peoples

Gas's 2018 income tax expense calculations in this docket?

A. The following procedures were performed by me or under my direction and supervision:

1. We read Document Nos. 1 through 4 included as the exhibit to Peoples Gas witness Valerie Strickland's prepared direct testimony.
2. We analyzed the roll-forward of the company's ADIT from December 31, 2017 noting that adjustments to such balances primarily reflected minimal differences as a result of adjusting balances to agree with amounts to be included in the 2017 income tax return filing as well as reclassifying the cost of removal ADIT from the accelerated depreciation ADIT line item to separate line items.
3. We obtained management's schedule identifying which of the company's book-tax differences and related excess ADIT were identified as protected or unprotected differences based on their descriptions. We obtained documentation supporting these conclusions and agreed with management's classification.
4. We obtained management's calculation of amounts determined to represent reversal of protected excess ADIT or amortization of unprotected excess ADIT. We tested the schedule for mathematical accuracy and

agreed management's schedule to standard system reports.

5. On a sample basis, we tested the ARAM by examining book depreciation by vintage by asset compared to tax depreciation by vintage by asset noting the reversal in 2018 and that the appropriate tax rate was applied. The detail support is maintained in the company's Power Plan property and income tax software systems.

6. We recalculated the company's break out and allocation of the cost of removal excess ADIT from the book-tax depreciation ADIT line item by tax vintage.

Q. As a result of applying the above procedures and your understanding of ADIT and the TCJA, do you agree with Peoples Gas' calculations of excess ADIT, the flow back of protected excess ADIT using ARAM and the amortization of unprotected excess ADIT in the 2018 tax calculations prepared by Ms. Strickland?

A. Yes.

Q. Does this conclude your prepared direct testimony?

A. Yes, it does.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED DIRECT TESTIMONY

OF

VALERIE STRICKLAND

Q. Please state your name, address, occupation and employer.

A. My name is Valerie Strickland. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by TECO Services Inc. ("TSI") as the Director of Corporate Taxes.

Q. Please describe your duties and responsibilities in that position.

A. I am responsible for managing TSI's tax department which provides tax services to Peoples Gas System ("PGS" or "company"). My responsibilities include the preparation and filing of all tax returns, all tax accounting for both internal and external purposes, all tax planning as well as managing all federal and state tax audits. The only taxes I do not oversee are payroll taxes, which are the responsibility of TSI's payroll department.

Q. Please provide a brief outline of your educational background and business experience.

A. I was educated in Europe where I received a Master's degree in Accounting & Finance from the "Institut de l'Administration and Gestion" in Paris, France. Upon graduation in 1992, I joined Coopers & Lybrand LLC, an independent accounting firm, as a tax professional. In 1998, Coopers & Lybrand LLC merged with Price Waterhouse and became PriceWaterhouseCoopers LLP ("PwC"). I continued to work for PwC as a Tax Manager until I joined the TECO Energy Tax department in 2000. I am also an active participant of the Edison Electric Institution ("EEI") Taxation Committee.

Q. What are the purposes of your direct testimony in this proceeding?

A. The purposes of my direct testimony are to explain how the company is accounting for the impacts of the Tax Cuts and Jobs Act of 2017 ("TCJA") and to sponsor the company's calculation of its forecasted income tax expense for 2018 as shown in its 2018 Forecasted Earnings Surveillance Report (filed March 15, 2018) and as adjusted to reflect the impact of the TCJA.

Q. Did you prepare any exhibits in support of your direct testimony?

A. Yes. Exhibit No. ____ (VS-1) was prepared under my direction and supervision. My exhibit consists of four documents, as described below.

Document No. 1	MFR C-21 With and Without Tax Reform
Document No. 2	Estimated Excess ADIT as of December 31, 2017
Document No. 3	Revised Estimate of Excess ADIT
Document No. 4	2018 Tax Expense Under the TCJA

Q. As part of your work for Peoples Gas System in this docket, have you reviewed Order No. PSC-2018-0104-PCO-PU in Docket No. 20180013-PU, Issued February 26, 2018 regarding the Commissions jurisdiction over the TCJA revenue requirement impacts?

A. Yes, I have.

Q. Please provide a summary of your direct testimony.

A. The key drivers of the impact of the TCJA as reflected in the 2018 Forecasted Earnings Surveillance Report are changes in the Federal Income Tax Rate, elimination of bonus depreciation, and the flow back of excess deferred taxes generated by the rate change. I have quantified the company's total excess accumulated deferred income tax resulting from the TCJA, as well as quantified the protected and unprotected amounts related to those excess deferred taxes and their respective flow back amounts under IRS rules and the Company's proposed treatment of unprotected excess deferred tax flowback.

Accounting for the Impact of TCJA

Q. What changes to the Internal Revenue Code in the TCJA have made the biggest impact on PGS?

A. Although the TCJA includes other changes that impact the way PGS calculates income tax expense, the decrease in federal income tax expense from 35 percent to 21 percent and the flowback of protected and unprotected excess deferred taxes have the greatest impact on PGS.

Q. What steps has the company taken to properly account for the impact of the TCJA?

A. The company became aware that tax reform had become a priority of the federal government in 2017 and began participating in internal and external discussions with PwC and EEI to better understand the potential impacts of tax reform.

The change in the federal tax rate was made in accordance with FASB Accounting Standards Codification (“ASC”) Topics 740 (Accounting for Income Taxes) and 980 (Accounting for Regulated Operations) and Rule 25-14.013 Par (10), Florida Administrative Code.

The company reviewed the book-tax differences that factor into the calculation of income tax expense to determine whether and the extent to which the TCJA would impact the differences. These differences are reflected in Document No. 1 of my exhibit, which presents the company’s 2018 income tax expense calculation in the format required by MFR C-21.

The company separately identified and evaluated tax credits to ensure that they would be properly accounted for in the calculation of income tax and the valuation of deferred tax balances.

The company then re-measured its non-tax credit related accumulated deferred income tax (“ADIT”) balances and calculated the related excess ADIT balances. Excess ADIT arise from the re-measurement of the company’s deferred federal income tax assets and liabilities at the new applicable corporate tax rate.

Since Peoples Gas uses the PowerPlan Provision module from a software company called PowerPlan to calculate its current and deferred tax expense, the company has worked with PowerPlan consultants to configure the system to generate the required journal entries in accordance with ASC Topics 740 and 980. As of December 31, 2017, the company's excess deferred income taxes liability was $66.7 million. This is shown in Document No. 2 of my exhibit.

In early 2018, the company engaged PowerPlan to assist with the implementation of the Average Rate Assumption method ("ARAM") for protected timing differences. The company analyzed its records to segregate protected versus unprotected timing differences in order to derive the correct amount of protected for ARAM flowback. Witness Felsenthal describes the ARAM in greater detail in his prepared direct testimony. I will discuss the amounts and treatment of the protected versus unprotected excess deferred taxes in more detail later in my testimony.

In May 2018, the TSI Tax department completed PGS's 2017 federal corporate income tax return for plant related book-tax differences to derive the best possible estimate of the company's excess deferred income taxes. As a result of this activity, the company revised its estimate of excess ADIT as of December 31, 2017 to $69.1 million which is $2.4 million higher than the original amount recorded in the company's December 31, 2017 Audited Financial Statements. This revision is reflected in Document No. 3 of my exhibit.

Q. What are "protected" excess deferred taxes?

A. Protected excess deferred taxes are excess ADIT associated with the use of accelerated tax depreciation under Internal Revenue Code ("IRC") Section 167 and 168. Book-tax differences related to depreciation occur when the method and life used to compute depreciation are different for tax and book purposes. The normalization provisions of the TCJA specify that protected excess ADIT may not be used to reduce protected excess tax reserves more rapidly or to a greater extent than the reserve would be reduced using ARAM. Under ARAM, excess ADIT are reduced and flowed back into the calculation of income tax expense as the timing difference giving rise to the deferred taxes reverse. Under ARAM, the calculation of the average tax rate is made as of the beginning of the year in which temporary differences in the vintage account begin to reverse, namely, in the first year in which the book depreciation exceeds tax depreciation. Any method that results in the flowback of a taxpayer's excess deferred tax reserve more rapidly than the ARAM is a violation of the depreciation normalization requirements.

As of December 31, 2017, the company originally estimated its protected excess deferred taxes to be $54.6 million. In May 2018, the company completed a detailed analysis to refine the amounts of its deferred tax balances related to method and life book-tax differences. This information was not readily available in the existing records. For example, the book depreciation amount contains reversal amounts of book depreciation related to unprotected ADIT such as cost of removal, basis adjustments, and tax repairs. The company therefore identified and reclassified the book depreciation related to these timing differences to the unprotected category. As shown in Document No. 3 of my exhibit, the company reclassed $32.4 million of excess ADIT from the original estimate developed as of December 31, 2017 resulting in a revised total protected excess ADIT balance of $87.0 million.

Q. What are "unprotected" excess deferred taxes?

A. Any book-tax differences other than method and life depreciation differences are not "protected" by the normalization rules. The original estimated amount of unprotected deferred taxes is $12.1 million as shown on Document No. 2 of my exhibit. However, as mentioned previously, the company went through a detailed analysis to determine the proper categorization of book depreciation reversal amounts that belong in the unprotected category. The company identified the need to reclassify deferred tax assets in the amount of $30.0 million and the revised unprotected deferred tax balance estimate is an excess tax deficiency of $17.9 million as shown in Document No. 3 of my exhibit.

Q. What is the amount associated with "tax repairs" and why is that amount considered unprotected?

A. The company uses the tax repairs module within PowerPlan to optimize the tax repairs deduction allowed under IRC section 162. The company is currently maximizing its tax deduction by expensing qualifying capital costs for Distribution repairs for tax purposes. For book purposes, however, these costs are capitalized and depreciated over the life of the asset. Therefore, tax repairs deductions generate significant deferred tax liability every year. Even though the book-tax timing difference is directly related to plant, it is not considered protected since it is not related to method or life the amount of excess ADIT associated with the tax repairs book-tax difference is $17.5 million, as shown on Document No. 3 of my exhibit.

Q. What are the amounts associated with cost of removal?

A. The total excess ADIT deficiency related to cost of removal is $23.2 million as shown on Document No. 3 of my exhibit.

Q. Why does the company consider ADIT related to cost of removal to be unprotected?

A. The company believes that excess ADIT related to cost of removal are unprotected. A timing difference is protected if there is tax depreciation on an asset that falls within IRC section 168. Cost of removal generates no tax depreciation, rather it generates a tax deduction when payments occur at the end of the asset’s life. For book purposes, depreciation expense includes a factor for this estimated cost of removal. The book depreciation in excess of the future tax deduction related to that asset creates a deferred tax asset which was embedded in accumulated book depreciation. Therefore, Tampa Electric reclassified cost of removal amounts to the unprotected excess ADIT category. Witness Felsenthal’s direct testimony describes how cost of removal originates and reverses in greater detail. The amount of PGS’ reclassification for cost of removal is a $33.6 million deferred tax asset as shown on Document No. 3 of my exhibit.

Q. What guidance does the TCJA provide for protected and unprotected excess deferred taxes?

A. With respect to “protected” excess deferred income taxes, defined as those that arise from the re-measurement of those deferred federal income tax assets and liabilities at the new applicable corporate tax rate(s), those excess deferred taxes have historically been governed by the Tax Reform transition rule. The TCJA prescribes ARAM as the transition rule for a category of excess deferred taxes known as “protected excess deferred taxes.”

With respect to “unprotected” excess deferred taxes, the company has used a 10-year flow back period in its calculation of the revenue requirement amount related to tax reform.

Calculation of 2018 Income Tax Expense

Q. Have you prepared calculations showing the impact of the TCJA on the company’s 2018 financial forecast?

A. Yes. Document No. 4 of my exhibit shows the calculation of the company’s forecasted 2018 income tax expense with and without the impact of the TCJA. The amount of tax expense I identified in this document, without the impact of the TCJA, was included in the company's 2018 forecasted earnings surveillance report filed with this Commission on March 15, 2018 and included in witness Chronister's prepared direct testimony as Document No. 3 of Exhibit No. ___ (JSC-1).

In an effort to be transparent, I have also provided our calculation of the company's 2018 projected income tax expense, with and without the effects of the TCJA, in the format normally seen in a base rate proceeding as MFR C-21. This presentation shows each of the temporary and permanent book-tax differences that impact the calculation of current and deferred income tax expense and is included as Document No. 1 of my exhibit.

Then in accordance with Order No. PSC-2018-0104-PCO-PU in Docket No. 20180013-PU the company implemented an effective date of February 6, 2018 to determine the budgeted tax benefits of the TCJA.

Q. Please explain how the calculation of tax expense under the new tax laws is different than the calculation under the old tax laws.

A. The tax expense under TCJA was calculated using the rules in effect as of January 1, 2018, with major changes including the decrease of the Federal Income Tax Rate from 35 percent to 21 percent, transition rules with respect to former bonus depreciation provision, new 100 percent asset expensing exemption for regulated utilities and the calculation of flow back of excess deferred taxes. As provided in Document No. 4 of my exhibit, the total 2018 tax expense without Tax Reform is $26.9 million, and the total 2018 tax expense with Tax Reform is $17.3 million. The change in the total 2018 tax expense between the new law and the former law is a decrease of $9.6 million.

Q. How did the company reflect the “write-down” or “flowback” of excess deferred income taxes in its calculation of income tax expense under the TCJA?

A. The flowback of protected excess deferred taxes for 2018 was calculated using ARAM as required by the TCJA and reduces 2018 income tax expense by $2.1 million.

The flowback of unprotected excess deferred taxes was accomplished by reflecting one-tenth of the balance of unprotected excess deferred taxes as of January 1, 2018 as a $1.8 million expense to 2018 deferred income tax expense.

In his direct testimony, witness Felsenthal describes the work PwC performed to test and verify the company's calculation of the impact of the TCJA on the company's 2018 forecasted income tax expense.

Q. Are the amounts you have identified in calculating the company's 2018 income tax expense under the TCJA subject to change?

Yes, although I have provided the company's best estimates at this time, it is possible that there may be a need to true-up the calculated amounts. Once PGS has filed its 2017 federal and state income tax returns in October 2018, the company will provide revised unprotected excess deferred tax amounts if a true-up is needed. In addition, if the IRS issues clarification rules with respect to the treatment of cost of removal or application of the previous bonus depreciation rules, and these rulings are different than the company's proposed treatment of these items, then PGS will true-up those amounts.

Impact of the TCJA on the Company

Q. Are there any impacts from the TCJA that can adversely impact the company?

A. Yes. Deferred taxes generally benefit a regulated utility and its customers by allowing the company to utilize that source of capital to fund its operations. Flowing back those deferred taxes causes the utility to replace that source of capital with debt or equity, which could have an adverse impact on the credit metrics of the company. Witness Chronister discusses these impacts in more detail in his direct testimony.

Summary

Q. Please summarize your direct testimony.

A. The key drivers of the impact of the TCJA as reflected in the 2018 Forecasted Earnings Surveillance Report are changes in the Federal Income Tax Rate, bonus depreciation, and the flowback of excess ADIT generated by the rate change. I have quantified PGS' total excess ADIT resulting from the TCJA, as well as quantified the protected and unprotected amounts related to those excess deferred taxes and their respective flowback amounts under IRS rules and the company's proposed treatment of unprotected excess deferred flowback.

Q. Does this conclude your direct testimony?

A. Yes.

PEOPLES GAS SYSTEM
DOCKET NO. 20180044-GU
FILED: 05/31/2018

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED DIRECT TESTIMONY

OF

JEFFREY S. CHRONISTER

Q. Please state your name, address, occupation and employer.

A. My name is Jeffrey S Chronister. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Tampa Electric Company as Controller, Tampa Electric and Peoples Gas System ("Peoples Gas") (collectively "the company").

Q. Please describe your duties and responsibilities in that position.

A. I am responsible for maintaining the financial books and records of the company and for the determination and implementation of accounting policies and practices for Peoples Gas. I am also responsible for budgeting activities within the company.

Q. Please provide a brief outline of your educational background and business experience.

A. I graduated from Stetson University in 1982 with a Bachelor of Business Administration degree in Accounting. Upon graduation I joined Coopers & Lybrand, an independent public accounting firm, where I worked for four years before joining the company in 1986. I started in Tampa Electric's Accounting department, moved to TECO Energy's Internal Audit department in 1987, and returned to the Accounting department in 1991. I am a Certified Public Accountant in the State of Florida and I am a member of both the American Institute of Certified Public Accountants ("AICPA") and the Florida Institute of Certified Public Accountants ("FICPA"). I have served in my current position as Controller of Tampa Electric and Peoples Gas since July 2009.

Q. Have you previously testified before the Florida Public Service Commission ("FPSC"or "Commission")?

A. Yes, I have testified or filed testimony before this Commission in several dockets. Most recently, I filed testimony for Tampa Electric in Docket No. 20130040-EI, which was Tampa Electric's last base rate proceeding, on the same topics I testify to in this case. I testified in Docket No. 20080317-EI, Tampa Electric's Petition for An Increase In Base Rates And Miscellaneous Service Charges.

I filed testimony in Docket No. 19960007-EI, Tampa Electric’s Environmental Cost Recovery Clause, Docket No. 19960688-EI, Tampa Electric’s environmental compliance activities for purposes of cost recovery, and most recently Docket No. 20170271-EI Tampa Electric’s Petition for recovery of costs associated with named tropical systems during the 2015, 2016, and 2017 hurricane seasons and replenishment of storm reserve subject to final true-up.

Q. What are the purposes of your direct testimony in this proceeding?

A. The purposes of my direct testimony are to: (1) provide background information relevant to the calculation of the revenue requirement amount associated with the recent changes in the Internal Revenue Code (“IRC”), (2) sponsor the calculation of the annual revenue requirement amount, and (3) present information about how the recent federal income tax law changes will impact the company’s financial condition in the future.

Q. How does your prepared direct testimony relate to the prepared direct testimony of Peoples Gas witnesses Alan Felsenthal and Valerie Strickland?

A. Mr. Felsenthal's direct testimony discusses accounting for income taxes and related ratemaking principles, the recent changes caused by the Tax Cuts and Jobs Act of 2017 ("TCJA") and their general impact on regulated utilities, the ratemaking requirement in the TCJA for "protected excess deferred taxes" and the work his firm performed to test and verify Peoples Gas' calculation of the impact of the TCJA on the Peoples Gas' 2018 forecasted income tax expense.

Ms. Strickland sponsors the company's calculation of the Peoples Gas' forecasted income tax expense for 2018 as originally prepared in November 2017 in conjunction with the company's approved 2018 operating budget and as adjusted to reflect the impact of the TCJA.

The calculation of the revenue requirements associated with the TCJA in my direct testimony uses Ms. Strickland's calculations of income tax expense before and after the TCJA as verified by Mr. Felsenthal.

Q. Did you prepare an exhibit in support of your direct testimony?

A. Yes. Exhibit No._______(JSC-1) was prepared under my direction and supervision. My exhibit consists of the following six documents:

Document No. 1	2018 Forecasted Earnings Surveillance Report as filed on March 15, 2018
Document No. 2	2018 Forecasted Earnings Surveillance Report updated for Effect of TCJA
Document No. 3	Calculation of Annual Revenue Requirement Amount
Document No. 4	Calculation of 2018 Rate Base Change
Document No. 5	Calculation of 2018 Overall Rate of Return Change
Document No. 6	Calculation of February 6, 2018 through December 31, 2018 TCJA Amount

Q. Please provide a summary of your direct testimony.

A. My direct testimony quantifies the amount of Peoples Gas' annual revenue requirement TCJA impact. My direct testimony also includes a discussion of the future impacts of the TCJA on Peoples Gas. The TCJA decreases future operating cash flows and reduces zero cost of capital accumulated deferred income taxes. This adversely impacts Peoples Gas' earned Return on Equity ("ROE") and overall financial integrity.

Background Information

Q. Has the Commission approved any agreements that address the impact of the TCJA on Peoples Gas' revenue requirement?

A. Yes. On February 26, 2018 the Commission issued Order No. PSC-2018-0104-PCO-PU in Docket No. 20180013-PU whereby the Commission asserted jurisdiction as of February 6, 2018 over the potential significant revenue requirement impacts that the TCJA could produce for Florida utilities regulated by the Commission that did not have a settlement agreement in place addressing the treatment of tax reform benefits.

Tax Reform Annual Revenue Requirement Calculation

Q. What procedures and principles were utilized to guide the company after Congress passed the TCJA?

A. As explained in the prepared direct testimony of Mr. Felsenthal, the TCJA prescribes the Average Rate Assumption Method ("ARAM") as the transition rule for a category of excess deferred taxes known as "protected excess deferred taxes." As discussed in the prepared direct testimony of Ms. Strickland, Peoples Gas calculated protected excess deferred taxes in the amount of $87.0 million as of December

31, 2017 and has used the ARAM to calculate the “flow-back” of protected excess deferred taxes in its calculation of the revenue requirement amount for tax reform. With respect to deferred taxes not governed by a transition rule (“unprotected deferred taxes”), Peoples Gas used a flow-back period of ten years. As explained in the prepared direct testimony of Ms. Strickland, Peoples Gas calculated an unprotected deficient deferred taxes balance in the amount of $17.9 million as of December 31, 2017.

Also, as explained in the prepared direct testimony of Ms. Strickland, Peoples Gas estimated the total excess accumulated deferred income taxes recorded in its accounting books and records as of December 31, 2017 in the amount of $69.1 million to account for the revaluation of Peoples Gas’ deferred income tax at the lower income tax rate.

The change in the tax rate from 35 percent to 21 percent for net operating income (“NOI”) was the final calculation component. The provisions of the TCJA became effective January 1, 2018, so Peoples Gas used its forecasted earnings surveillance report (“ESR”)for 2018, reflected in Document No. 1 and Document No. 2 of my exhibit, to compute the impact of the TCJA on Peoples Gas’ revenue requirement.

Q. Based on these principles and procedures, what is the initial NOI impact to account for the effects of TCJA?

A. The initial NOI impact to account for the effects of TCJA, considering the first-year income tax expense, is $8,902,629.

Q. How was this impact amount calculated?

A. The impact amount was calculated by comparing the NOI in two forecasted earnings surveillance reports – one without the effects of tax reform and one with the effects of tax reform.

Q. How were the two forecasted earnings surveillance reports prepared?

A. The preparation began with the creation of the 2018 budget using the company’s normal budgeting process. To deal with the issue of tax reform appropriately, the board-approved budget was updated to reflect December 2017 actual general ledger account balances, which reflected the necessary 2017 postings related to the TCJA. This 2018 budget was used as the basis of both the company’s 2018 forecasted ESR, filed with the Commission on March 15, 2018 without the impact of tax reform and the 2018 forecasted ESR updated for the effects of the TCJA.

Q. Please provide additional detail on how the impact amount was calculated.

A. The calculation began with the company's 2018 forecasted ESR filed with the Commission on March 15, 2018. This ESR was prepared based on the company's 2018 operating budget adjusted for year-end 2017 balance sheet amounts, which was approved by the company's management in November 2017 and reflects income tax expense calculated on a pre-TCJA basis. Peoples Gas' forecasted FPSC adjusted year-end NOI in the ESR is $52,955,009, a number I will refer to as the "Benchmark NOI".

The next step was to adjust Peoples Gas' forecasted 2018 ESR to reflect the impact of the TCJA. Document No. 2 of my exhibit contains the company's forecasted 2018 ESR adjusted for the impact of the TCJA and includes the post-TCJA tax expense amount calculated by Ms. Strickland. Peoples Gas' forecasted FPSC adjusted NOI per the 2018 forecasted ESR as adjusted for tax reform is $61,857,638, a number I will refer to as the "Post-TCJA NOI".

The third step in the calculation was to compare the Post-TCJA NOI amount in Document No. 2 of my exhibit to the Benchmark NOI amount in Document No. 1 of my exhibit to determine the TCJA impact on NOI resulting from the change in income tax expense. The NOI impact due to the TCJA change in income tax expense of $8,902,629 is reflected in Document No. 3 of my exhibit.

Q. Does TCJA impact rate base?

A. Yes. As you can see in Document No. 4 of my exhibit, there is a decrease in rate base because there is an increase in current year taxes payable, which is a component of working capital. Current taxes payable increases due to the increase in taxable income that results from the elimination of bonus depreciation. In addition, there is an increase in interest accrued due to the decrease in operating cash flows.

Q. Does TCJA impact overall rate of return?

A. Yes. As shown in Document No. 5 of my exhibit there is a decrease in zero cost of capital Accumulated Deferred Income Taxes ("ADIT") due to the TCJA elimination of bonus depreciation. The reduction in zero cost of capital ADIT must be replaced by equity and debt in the capital structure.

Q. What was the next step in the calculation process?

A. The next step was to determine the required 2018 NOI resulting from changes in rate base and the overall rate of return. In order to determine those impacts I have prepared a couple of documents that reflect the change in rate base and the change in the overall rate of return. Document No. 4 of my exhibit shows the decrease in 2018 rate base resulting from TCJA. Document No. 5 of my exhibit reflects the changes to the overall rate of return. The rate base change and overall rate of return change due to the TCJA are both reflected in Document No. 3 of my exhibit. The overall capital structure impact from the post-TCJA change in rate base and overall rate of return is an offsetting $243,367 against the $8,902,629 NOI impact mentioned above in the third step.

Lastly, the total NOI difference considering all elements described above is then grossed up for state and federal income taxes to arrive at the annual revenue requirement amount. Using the state income tax rate of 5.5 percent and the new federal income tax rate of 21 percent, the new

Peoples Gas effective tax rate is 25.345 percent. The new tax gross up factor equals 1 / (1 - 25.345%), which equals 1.3395. The annual revenue requirement calculated amount is the difference between the Post-TCJA NOI amount and the Benchmark NOI less the offsetting impact of the change in rate base and overall return, the sum of which is multiplied by the tax gross up factor. This calculation, which reflects the overall effects of TCJA considering the first-year income tax expense and capital structure impacts, is shown in Document No. 3 of my exhibit.

Q. So, with that explanation, what is the annual revenue requirement impact of the TCJA?

A. Peoples Gas calculated a first-year annual revenue requirement impact from tax reform of $11,599,038. A document summarizing the calculation of this amount is included as Document No. 3 of my exhibit.

Q. How was the TCJA revenue requirement amount associated with the period February 6, 2018 to December 31, 2018 determined?

A. To determine the TCJA revenue requirement amount for the period February 6, 2018 through December 31, 2018, Peoples Gas subtracted from the annual revenue requirement the portion related to the period January 1, 2018 through February 5, 2018. To determine the January 1 through February 5, 2018 impact on the annual revenue requirements, Peoples Gas removed the TCJA impacts for the full month of January and the respective prorated portion of February, or 5 out of 28 days of February. Excluding the January 1 through February 5, 2018 amount from Peoples Gas' annual revenue requirement calculation results in a February 6, 2018 through December 31, 2018 TCJA amount of $9,920,560. A document summarizing the calculation of the amount is included as Document No. 6 of my exhibit.

Future Impacts of TCJA

Q. In his prepared direct testimony, Mr. Felsenthal describes the general effects the TCJA will have on regulated utilities like Peoples Gas. Has the company looked beyond 2018 to assess the impacts the TCJA will have on its financial condition?

A. Yes. It is important for the company and the Commission to consider the impacts of the TCJA beyond 2018, because it will impact the company's financial integrity in three ways: (1) the TCJA decreases operating cash flows, (2) the TCJA increases required equity support in the capital structure due to the reduction in ADIT balances, and (3) the TCJA increases the overall weighted cost of capital.

Q. How does the TCJA decrease operating cash flows?

A. The decrease in operating cash flows results from the flow back of excess deferred taxes plus the elimination of bonus depreciation for regulated utilities. As discussed in the prepared direct testimony of Ms. Strickland, the TCJA exempted regulated utilities from the new 100 percent asset expensing provision. The TCJA phase out of bonus depreciation and the exemption from 100 percent asset expensing will result in reduced deferred taxes and greater current taxes payable, which reduces operating cash flows. This will adversely impact Peoples Gas' credit metrics, specifically Funds From Operations to Debt.

Q. Please explain why the company's deferred tax balances will change as a result of the TCJA.

A. Starting in the year 2002, the IRS established bonus depreciation as an income tax deduction. Bonus depreciation allowed companies like Peoples Gas to deduct a large percentage (50 percent in most years) of an asset's cost as tax depreciation in the first year of service. Bonus depreciation deductions substantially reduced taxable income, reduced current taxes payable and increased ADIT. Peoples Gas used bonus depreciation in its tax calculations since 2002. Doing so, together with the normalization requirement, generated large amounts of deferred taxes and caused a substantial increase in the company’s ADIT balances.

As noted by witnesses Felsenthal and Strickland, however, the TCJA eliminated the use of bonus depreciation for regulated utilities, and substituted the Modified Accelerated Cost Recovery System (“MACRS”) in its place. Although the MACRS is a form of accelerated cost recovery and will still generate deferred taxes in the early years of an asset’s life, the elimination of bonus depreciation over time will substantially reduce the relative dollar value of ADIT on the company’s balance sheet.

Furthermore, as witnesses Felsenthal and Strickland have explained in detail, the company has revalued its ADIT balances as of December 31, 2017 to reflect the tax rate reduction in the TCJA and identified “excess deferred taxes” that must be flowed back to customers as a reduction of income tax expense in accordance with the IRC. Over time, the flowback of excess ADIT will further reduce the amount of ADIT in the company’s capital structure.

Q. How do the changes in Peoples Gas’ deferred tax balances affect the elements of the company’s capital structure?

A. As noted by witness Felsenthal, ADIT are often considered a no interest loan and, in Florida, are considered a zero-cost source of capital in a public utility’s capital structure. Since the company’s rate base and capital structure are synchronized in the ratemaking process, a relative reduction in the amount of zero-cost ADIT must be made up with relatively higher amounts of debt and equity, both of which have a cost. The financial equity ratio can remain constant, but the relative reduction in the dollar amount of ADIT drives a need for debt and equity dollar support to be higher. Because both debt and equity have a cost and ADIT does not, tax reform and the relative reduction of ADIT will cause the overall weighted average cost of capital (“WACC”) to increase. Since the WACC is an important part of the revenue requirement calculation, the portions of the TCJA that reduce ADIT actually put upward pressure on the revenue requirement of a public utility like Peoples Gas.

Q. How are the changes in equity support of rate base likely to impact the company’s ability to earn a reasonable rate of return on equity with pre-TCJA NOI levels?

A. As I previously stated, the required equity dollar support of rate base will increase in future years. With an increasing equity denominator, unchanging projected NOI levels will produce a lower ROE percentage in the future. Thus, the relative reduction of ADIT and the corresponding increase in equity support caused by the TCJA will cause earned ROE to be lower than it would otherwise be without the TCJA.

Q. Has the company modeled this ADIT decrease and the corresponding earned ROE reductions?

A. Yes. Due to the higher cost of capital and projected growth in Peoples Gas’ distribution system, Peoples Gas’ 2019 ROE is expected to fall below the 9.25 percent bottom of the company’s allowed ROE range agreed to in the 2016 Settlement Agreement.

Q. Due to the general effects of the TCJA on Peoples Gas’ financial integrity, when should the adjustments for the TCJA be implemented?

A. Peoples Gas has provided the calculations of impacts associated with the TCJA but believes discussions with stakeholders on when and how to flow back the tax reform benefits to customers when considering the general effects on the company’s financial integrity are necessary. As noted by the Commission in Order No. PSC-2018-0104-PCO-PU in Docket No. 20180013-PU, the TCJA is complex with many moving parts some of which will increase revenue requirements and some of which will reduce revenue requirements. Peoples Gas believes a limited proceeding where detailed information on the overall impacts of the TCJA as well as discussions with stakeholders are necessary to ensure that the impact of the TCJA does not result in an outcome where the company is earning below its authorized rate of return.

Q. Does this conclude your prepared direct testimony?

A. Yes, it does.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

JEFFREY S. CHRONISTER

Q. Please state your name, address, occupation, and employer.

A. My name is Jeffrey S Chronister. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Tampa Electric Company as Vice President, Finance for Tampa Electric and Peoples Gas System ("Peoples Gas"), (collectively "the company").

Q. Are you the same Jeffrey S. Chronister who submitted prepared direct testimony in this docket?

A. Yes, I am.

Q. Have your duties and responsibilities changed since your direct testimony was submitted?

A. Yes. I was promoted to Vice President, Finance in July 2018. In addition to the responsibilities I had in my previous position as Controller, I now oversee Tampa Electric and TECO Energy corporate accounting and reporting, including consolidation and external reporting.

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

A. The purpose of my rebuttal testimony is to rebut certain statements made by Office of Public Counsel ("OPC") witness Ralph Smith in his testimony submitted in this docket on June 29, 2018.

Q. To which of witness Smith's findings or recommendations do you wish to respond?

A. I address two of Mr. Smith's findings. The first is his statement that "net 2018 revenues of approximately $11.3 million should be refunded to customers," at page 12 lines 15-16. Second, I respond to his recommendation that the company be required to seek a Private Letter Ruling ("PLR") from the Internal Revenue Service ("IRS") regarding the classification of the excess accumulated deferred income taxes for cost of removal/negative net salvage ("cost of removal") as unprotected.

Q. What is the company's position on Mr. Smith's finding that

$11.3 million is the amount of 2018 revenues should be refunded to customers?

A. Peoples Gas disagrees with Mr. Smith's position, because he seeks a refund of revenues from prior to the date the Commission ordered the company to begin holding revenues subject to refund and the amount of his proposed reduction does not take into account the company's forecasted position within its allowed Return on Equity ("ROE") range during this period.

Specifically, Mr. Smith used the annual revenue requirement impact for 2018 of approximately $11.6 million, net of the $326,000 rate base/overall rate of return impact, to arrive at the $11.3 million in revenues he believes should be refunded to customers. I believe Mr. Smith's testimony reflects a misunderstanding, as the $11.6 million is already net of the $326,000 rate base/overall rate of return impact. However, as I stated in my prepared direct testimony, the 2018 tax reform impact must be adjusted for the effective date the Commission established, which is February 6, 2018[1].

[1] On February 26, 2018 the Commission issued Order No. PSC-2018-0104-PCO-PU in Docket No. 20180013-PU whereby the Commission asserted jurisdiction as of February 6, 2018 over the potential significant revenue requirement impacts that the TCJA could produce for Florida utilities regulated by the Commission that did not have a settlement agreement in place addressing the treatment of tax reform benefits.

Once adjusted for the appropriate period, the maximum amount to reduce revenue to reflect the effects of the Tax Cuts and Jobs Act of 2017 (“TCJA”) for February 6, 2018 through December 31, 2018 is no more than $9.9 million. The calculation of this amount is shown in my direct testimony on Document No. 6 of Exhibit No. ___ (JSC-1) and described at page 12, line 20, through page 13, line 11.

Q. Should the Commission order a refund to reflect the impacts of the TCJA during 2018?

A. No. The company believes that a refund to reflect the impacts of the TCJA from February 6, 2018 through December 31, 2018 is inappropriate at this time, since the calculation of a potential refund should be dependent on where the company is forecasted to end the year in its authorized rate of return range. Peoples Gas is operating within its allowed ROE range and is expected to continue operating within its allowed range even with the impacts of the TCJA; therefore, a refund for 2018 is unwarranted.

Q. Should the full $11.6 million annual revenue requirement impact for 2018 play a role in this docket?

A. Yes. Although the full $11.6 million revenue requirement impact for 2018 should not be refunded for 2018 as suggested by Mr. Smith, it does represent the absolute maximum revenue requirement reduction to be reflected in new base rates to be effective during the first billing cycle in January 2019, if the company was operating above its allowed ROE range. However, in light of the company’s forecasted financial results for future years and the impact that the loss of bonus tax depreciation is expected to have on the company’s capital structure, the company believes it would be in the best interests of customers for any revenue requirement reduction reflected in new 2019 base rates to be limited to $4.1 million, which is the revenue requirement reduction needed to reduce the company’s forecasted 2019 return on equity to the midpoint of its authorized range.

This kind of adjustment would be consistent with the Commission’s long-standing practice of setting base rates using the midpoint of an authorized range of returns on equity. It will also moderate the need to seek rate relief in the future as reductions in the amount of zero-cost accumulated deferred income taxes in the company’s capital structure put pressure on the company’s ability to earn within its authorized range.

Q. What process should the Commission use to implement any refund and base rate changes arising from this proceeding?

A. Given the timing of this docket, and the need for new base rates to be approved by the Commission to ensure that adequate notice to customers is provided, the company believes that if a refund for the impacts of the TCJA from February 6 to December 31, 2018 is ordered by the Commission, then it should be refunded to customers of record on December 31, 2018 as a one-time credit in March of 2019 to all customers utilizing the ECCR methodology to determine applied percentages and credited to all rate classes on a pro rata basis. If the Commission determines an annual revenue requirement reduction for tax reform is warranted because the company would be operating above the midpoint of its authorized range, it should direct the company to submit revised tariffs for approval that apply the revenue requirement reduction on a pro rata basis across all rate classes and rates, to be effective with the first billing cycle in January 2019.

Q. What is the company’s position on Mr. Smith’s recommendation regarding the PLR?

A. As stated in the rebuttal testimony of witness Valerie Strickland submitted on behalf of Tampa Electric in Docket

No. 20180045-EI on this date, while the company believes its proposed treatment of excess accumulated deferred income taxes related to cost of removal/net negative salvage is appropriate, it is not opposed to requesting a PLR as suggested by OPC. The company believes this can be accomplished through a single PLR submitted by Tampa Electric since the two companies are owned by the same parent company and request the same treatment.

Q. Please describe the process to obtain a PLR and the associated timing and costs.

A. The process generally involves retaining a tax attorney experienced with utility income tax issues and normalization requirements to assist in the process of filing a PLR request, working with the attorney to develop a draft PLR request, sharing the draft with the Commission’s staff and the other parties to this docket for their feedback, and submitting the request to the IRS. The process typically takes about seven months from start to receiving the ruling. Tampa Electric estimates the out of pocket costs to obtain a PLR to be between $70,000 and $90,000.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

DIRECT TESTIMONY

OF

RALPH SMITH

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 20180044-GU

I. INTRODUCTION

Q. WHAT ARE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS?

A. My name is Ralph Smith. I am a Certified Public Accountant licensed in the State of Michigan and a senior regulatory consultant at the firm Larkin & Associates, PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan, 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC.

A. Larkin & Associates, PLLC, ("Larkin") is a Certified Public Accounting and Regulatory Consulting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin has extensive experience in the utility regulatory field as expert witnesses in over 600 regulatory proceedings, including numerous electric, water and wastewater, gas and telephone utility cases.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION?

A. Yes, I have testified before the Florida Public Service Commission ("FPSC" or "Commission") previously. I have also testified before several other state regulatory commissions.

Q. HAVE YOU PREPARED AN EXHIBIT DESCRIBING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Exhibit RCS-1, which is a summary of my regulatory experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Larkin & Associates, PLLC, was retained by the Florida Office of Public Counsel ("OPC") to review the impacts on public utility revenue requirements associated with the Tax Cuts and Jobs Act of 2017 ("TCJA" or "2017 Tax Act"). My testimony addresses the impacts of the TCJA on Peoples Gas System ("PGS" or "Company") on behalf of the OPC. Accordingly, I am appearing on behalf of the Citizens of the State of Florida.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I am presenting OPC's recommendations regarding certain aspects of the TCJA impacts on the Company.

Q. WHAT INFORMATION DID YOU REVIEW IN PREPARATION OF YOUR TESTIMONY?

A. I reviewed the Company's May 31, 2018 filing, including the Company's direct testimony and exhibits. I reviewed the Company's responses to OPC's formal and informal discovery and other materials pertaining to the TCJA and its impacts on regulated public utilities such as PGS. I also reviewed Rule 25-14.011, Florida Administrative Code ("F.A.C."), concerning procedures for processing requests for rulings to be filed with the Internal Revenue Service ("IRS").

Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

A. I first summarize the Company's quantifications and proposals related to the TCJA impacts. I then present the OPC's recommendations.

II. PEOPLES GAS MAY 31 FILING CONCERNING TCJA IMPACTS

Q. WHAT ARE THE PRIMARY IMPACTS OF THE TCJA THAT THE COMPANY HAS QUANTIFIED IN ITS MAY 31, 2018 FILING?

A. The Company has identified two major impacts from the TCJA: (1) a net regulatory liability for excess accumulated deferred income taxes of approximately $69.082 million and (2) an annual revenue requirement reduction of approximately $11.6 million for 2018.

Specifically, on Exhibit ___(JSC-1), Document No. 6, attached to the direct testimony of Jeffrey Chronister, the Company identifies an annual revenue requirement reduction of approximately $11.6 million for 2018, of which it indicates approximately $9.92 million relates to the period February 6 through December 31, 2018. On Exhibit ___(JSC-1), Document No. 3, the Company identifies an (increased) revenue requirement impact of approximately $326,000 for the rate base and (lower) overall rate of return impact of the $11.6 million TCJA annual 2018 revenue requirement that was identified by the Company on Exhibit ___(JSC-1), Document No. 6.

Concerning the net regulatory liability for excess accumulated deferred income taxes, the Company has identified the amount of $69.082 million on Exhibit ___(VS-1), Document No. 3, attached to the direct testimony of Valerie Strickland. That document also shows the Company's classification of each of the identified balances between "protected" and "unprotected".

Q. WHAT ARE ACCUMULATED DEFERRED INCOME TAXES?

A. Accumulated Deferred Income Taxes ("ADIT") represent a source of non-investor supplied cost-free capital to rate regulated utilities. Under the Uniform System of Accounts ("USOA"), utilities in the electric and gas utility industry record ADIT in specified accounts, such as accounts 190, 281, 282 and 283. The amounts recorded in account 190 typically represent an asset, and the amounts recorded in accounts 281, 282 and 283 represent liabilities.

Q. HOW IS THE UTILITY'S ADIT IMPACTED BY THE TCJA?

A. The utility's ADIT must be revalued at the new 21 percent corporate federal income tax rate.

All non-property related ADIT (FERC account 190 and 283 for electric utilities and gas distribution utilities) that had previously been recorded at a higher federal income tax rate, such as the 35 percent rate in effect prior to January 1, 2018, will be reduced.

Additionally, property related ADIT (FERC account 282) will also need to be revalued at the new corporate tax rates.

Q. WHAT IS "EXCESS" ACCUMULATED DEFERRED INCOME TAXES ("EXCESS ADIT" OR "EADIT")?

A. Regulated public utilities will be required to identify the portions of their ADIT balances that represent "excess" ADIT based on recalculations using the difference between the old federal income tax (“FIT”) rate (typically 35%) under which the ADIT was originally accumulated and the new federal corporate income tax rate of 21% provided for in the TCJA. Basically, utility ADIT must be revalued at the new FIT rate and the amounts that have been accumulated using federal income tax rates higher than the current 21% flat rate will represent "excess" ADIT.

Q. HOW DO IRS NORMALIZATION REQUIREMENTS AFFECT THE CATEGORIZATION OF ADIT AND EXCESS ADIT?

A. IRS normalization requirements will apply to the portion of the property-related ADIT that relates to the use of accelerated tax depreciation (including bonus tax depreciation). This will result in two general categories of excess ADIT: (1) "protected" (i.e., subject to the normalization requirements) and (2) "unprotected" property and non-property related excess ADIT.

Q. HOW DOES THE CATEGORIZATION OF "PROTECTED" OR "UNPROTECTED" AFFECT THE AMORTIZATION OF THE EXCESS ADIT?

A. The 2017 Tax Act provides that the Average Rate Assumption Method ("ARAM") must be used for the protected portion. The flow back of the "protected" excess ADIT, therefore, must follow the prescribed method to comply with normalization requirements.

In contrast, the flow back of the unprotected portion of the excess ADIT will be up to the discretion of the Commission. Unprotected ADIT is not subject to normalization requirements and will be revalued at the lower 21% tax rate, creating balances of excess unprotected ADIT that can be flowed back to customers over amortization periods to be determined by the Commission or applied in some other manner (e.g., such as for the recovery of regulatory assets) to be determined by the Commission.

Q. HOW DID THE COMPANY CLASSIFY ITS EXCESS ADIT BETWEEN THE "PROTECTED" AND "UNPROTECTED" CATEGORIES?

A. As shown on Exhibit No. ___(VS-1), Document No. 3, attached to the direct testimony of Company witness Valerie Strickland, PGS classified the excess ADIT relating to the following book-tax differences as "protected":

Schedule M Item	Excess ADIT
Depreciation - Book	$ 124,326,756
Depreciation - Book Tax Diff Federal	(40,598,404)
Depreciation - Book Tax Diff State	3,239,980
Total Protected Excess ADIT Liability	86,968,332

The "protected" items for PGS are comprised of differences between tax and book depreciation that relate to the depreciation method and life.

The Company classified all of the other EADIT, including book-tax differences related to repairs deductions, cost of removal/negative net salvage, and contributions in aid of construction ("CIAC"), as well as other book-tax differences, as "unprotected".

The Company's adjusted results shown on Exhibit No.___(VS-1), Document No. 3, show a "protected" net EADIT liability of $86.968 million, and an "unprotected" EADIT asset of $17.886 million, for a net EADIT liability of $69.082 million.

The flowback of the "protected" EADIT is done according to the ARAM. The flowback of the "unprotected" EADIT asset is done on a straight-line basis over 10 years. The impacts of the EADIT amortization are included in the derivation of the (lower) revenue requirement amount of $11.6 million.

Q. DO YOU DISAGREE WITH THE COMPANY'S CLASSIFICATION OF THE EADIT BETWEEN THE "PROTECTED" AND "NON-PROTECTED" CATEGORIES?

A. I have no disagreement with the Company’s classification of EADIT. However, it should be noted that there is some degree of uncertainty as to the classification of the EADIT related to at least one of the large book-tax differences, specifically to the EADIT relating to cost of removal/negative net salvage. At page 10 of her direct testimony, Ms. Strickland identifies the asset (debit balance) related to the cost of removal EADIT for PGS to be $23.2 million, which is also shown on Document No. 3 of her exhibit.

Q. WHAT ARE THE COMPANY'S REASONS FOR CLASSIFYING COST OF REMOVAL AS "UNPROTECTED"?

A. As explained in the direct testimony of Company witnesses Strickland at pages 10-11 and Alan Felsenthal at pages 40 through 41, the Company has identified the following reasons for classifying the EADIT related to cost of removal/negative net salvage as "unprotected":

- A timing difference is "protected" if there is tax depreciation or an asset that falls within Internal Revenue Code Section 168, and cost of removal generates no tax depreciation;
- cost of removal/negative net salvage is not a depreciation method or life difference;
- the Edison Electric Institute supports the "unprotected" classification for cost of removal/negative net salvage;
- PricewaterhouseCoopers ("PwC") as a firm supports the "unprotected" classification for cost of removal/negative net salvage; and
- Existing private letter rulings in this area "are confusing or not on point."

Q. DO YOU HAVE AN OPINION AS TO WHETHER THE EADIT RELATED TO COST OF REMOVAL/NEGATIVE NET SALVAGE IS "PROTECTED" OR "UNPROTECTED"?

A. Yes, I do. Based on currently available guidance, it is also my opinion that the EADIT related to cost of removal/negative net salvage is "unprotected." This is because the tax deduction for cost of removal is not addressed under §167 or §168 of the Internal Revenue

Code ("IRC" or "Code"), which are the sections pertaining to the use of accelerated tax depreciation and the sections which contain the normalization requirements pertaining to the continued use of accelerated tax depreciation. Deductions that are provided for under other sections of the Code are not subject to the normalization requirements associated with the utility's ability to continue to use accelerated depreciation for federal income tax purposes.

Q. IS THERE SOME UNCERTAINTY IN THIS AREA?

A. Yes, there is. The comparison of utility book and tax depreciation for purposes of tracking the method/life and other differences can be very complex. Utility book depreciation rates typically include a component for negative net salvage (as well as for the recovery of original cost over the estimated useful life of the assets). The normalization process involves comparing book and tax depreciation; however, the calculations can be very complex. Such calculations are typically done by larger utilities (such as PGS and its affiliate, Tampa Electric Company ("TECO")), using specialized software, such as PowerPlan and PowerTax, and the proper application can require significant additional analytical work by the utility and the vendor. Because the comparison of book and tax depreciation involves complex calculations and the fact that utility book depreciation typically includes an element for negative net salvage, there have been concerns raised in some jurisdictions (e.g., New York) and by some Florida utilities (e.g., Duke Energy Florida) about the cost of removal/negative net salvage component of book depreciation and the risks presented for potential normalization violations. Another large Florida regulated utility, Duke Energy Florida, appears to be taking a different position than PGS and TECO concerning the treatment of cost of removal/negative net salvage and has proposed to treat that item as "protected," pending receipt of additional guidance.

Q. IS THERE A GOOD WAY TO OBTAIN SPECIFIC GUIDANCE CONCERNING THE CLASSIFICATION BY PGS AND TECO OF THE EADIT RELATING TO THE COST OF REMOVAL/NEGATIVE NET SALVAGE AS "UNPROTECTED"?

A. Yes. One potential source of such additional guidance, which would apply directly to the utility to whom it is issued, would be from the IRS in a private letter ruling. Seeking a private letter ruling from the IRS which addresses that utility's specific fact situation and interpretation is one of the best ways of obtaining guidance and providing clarity.

III. FINDINGS AND RECOMMENDATIONS

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO THE COMPANY'S QUANTIFICATIONS OF THE TCJA IMPACTS AT THIS TIME?

A. No, I am not. The Company's quantifications do not appear to be unreasonable for the purposes of estimating the 2018 revenue requirement impact and EADIT related to the TCJA.

Q. WHAT AMOUNT SHOULD BE USED FOR COMPUTING THE ANNUAL REVENUE REQUIREMENT REDUCTION?

A. The $11.6 million annual 2018 revenue requirement reduction, net of the $326,000 rate base/overall rate of return impact, should be used as the annual revenue requirement reduction. This represents the estimated net revenue requirement for calendar year 2018.

Q. SHOULD THE COMPANY BE REQUIRED TO SEEK CLARITY REGARDING ITS CLASSIFICATION OF THE EADIT FOR COST OF REMOVAL/NEGATIVE NET SALVAGE AS "UNPROTECTED"?

A. Yes. A private letter ruling ("PLR") request should be submitted to the IRS by the Company to obtain clarity. Since the factual situation is similar for PGS and for its affiliate, TECO, concerning cost of removal/negative net salvage as it relates to EADIT, it may be practical for both companies to submit the PLR request. The PLR request should be drafted by the Companies but should be subject to review and input by the Commission, Staff, and OPC prior to being submitted to the IRS, pursuant to the administrative procedure specified in Rule 25-14.011, F.A.C. This pre-submission review is to ensure that it presents the Company’s fact situation and analysis accurately and in a neutral manner (i.e., is not an "advocacy piece").

Q. SHOULD AN UNDERSTANDING BE IN PLACE CONCERNING HOW AN AFFIRMATIVE OR NEGATIVE RESULT OF THE PLR APPLICATION WILL BE ADDRESSED?

A. Yes. There should be an understanding in place concerning the application of an affirmative or negative result of the PLR, which I will address below.

Q. WHAT IS YOUR RECOMMENDATION FOR APPLICATION OF A PLR?

A. Pursuant to the procedure described in Rule 25-14.011, F.A.C., the Company should report the results to the Commission, the OPC and intervenors. If the ruling is affirmative (i.e., agrees with the Company's classification of the EADIT related to cost of removal/negative net salvage as "unprotected"), no adjustment to the Company's EADIT amortization will be necessary. On the other hand, if the PLR is negative (i.e., rules that the EADIT related to cost of removal/negative net salvage should instead be treated as "protected"), along with the notification, the Company should provide updated calculations of its "unprotected" EADIT amortization, and for the "protected" portion of the EADIT, recalculations of the ARAM results. The Company's notification should also identify the related revenue requirement impacts of a reclassification of the EADIT related to cost of removal/negative net salvage from "unprotected" to "protected" if the PLR indicates such treatment is necessary.

Q. ARE THERE ANY OTHER IMPACTS AFFECTING 2018 THAT NEED TO BE ADDDRESSED?

A. Yes. The $11.6 million annual 2018 revenue requirement reduction, net of the $326,000 rate base/overall rate of return impact, which combined represent the estimated net revenue requirement for calendar year 2018, should be refunded to customers. That is, net 2018 revenues of approximately $11.3 million should be refunded to customers.

Q. DOES THIS COMPLETE YOUR PREFILED TESTIMONY?

A. Yes, it does.

CHAIRMAN GRAHAM: Exhibits.

MR. TRIERWEILER: Chairman, we have stipulated a comprehensive exhibit list, which includes the prefiled exhibits attached to the witness' testimony in this case.

The list has been provided to the parties, the Commissioners, and the court reporter. This list is marked as the first hearing exhibit. And the other hearing exhibits should be marked as set forth in the chart.

Exhibit 15 reflects the contents that are the subject of the joint motion to supplement the record, which explains the settlement agreement regarding depreciation.

CHAIRMAN GRAHAM: Commissioners, I need somebody to move the joint motion to augment the record for identify- -- as identified in Exhibit 15.

COMMISSIONER BROWN: Mr. Chairman, I would move the joint motion to supplement the record, which is identified as Exhibit 15 in the comprehensive exhibit list.

CHAIRMAN GRAHAM: All right.

COMMISSIONER CLARK: Second.

CHAIRMAN GRAHAM: That's been moved and

second. Any discussion?

All in favor, say aye.

(Chorus of ayes.)

CHAIRMAN GRAHAM: By your action, you have moved the joint motion into the record.

Staff, other exhibits.

MR. TRIERWEILER: We ask that the comprehensive exhibit list, marked as Exhibit No. 1, be moved into the record.

CHAIRMAN GRAHAM: We'll move that.

(Whereupon, Exhibit No. 1 was marked for identification and admitted into the record.)

MR. TRIERWEILER: We also ask that Exhibits 2 through 17 be moved into the record, as set forth in the comprehensive exhibit list.

CHAIRMAN GRAHAM: Okay. We'll do that as well.

(Exhibit Nos. 2 through 17 were marked for identification and admitted into the record.)

CHAIRMAN GRAHAM: Decision time. Staff?

MR. TRIERWEILER: Chairman, we recommend that, if the Commission decides that a bench decision is appropriate at this time, that the proposed stipulations for Issues 1 through 5, 8 through 17, 19 and 21, listed on Pages 9 through 12 of the pre-hearing order, be approved.

CHAIRMAN GRAHAM: Okay. Commissioners.

COMMISSIONER CLARK: Mr. Chairman, I move to approve Issues 1 through 5, 8 through 17, 19 and 21.

COMMISSIONER BROWN: Second.

CHAIRMAN GRAHAM: It's been moved and second. Any further discussion?

Seeing none, all in favor, say aye.

(Chorus of ayes.)

CHAIRMAN GRAHAM: Any opposed?

By your action, you've approved that motion.

Staff?

MR. TRIERWEILER: Chairman, if the Commission decides that a bench decision is appropriate to resolve the remaining issues in this docket, the proposed settlement agreement resolves Issues 6, 7, 18, and 20, and is before you for a decision.

CHAIRMAN GRAHAM: Commissioners.

COMMISSIONER CLARK: Mr. Chairman --

CHAIRMAN GRAHAM: I think we need a motion for the settlement agreement on the remaining issues of this docket.

COMMISSIONER CLARK: Mr. Chairman, I move to approve the settlement agreement as presented.

COMMISSIONER BROWN: Mr. Chairman, I second it, but I do just want to make a -- a quick statement.

CHAIRMAN GRAHAM: Okay. We've got a motion and a second.

Commissioner Brown.

COMMISSIONER BROWN: I just wanted to commend the parties for coming together and collaborating. We are really fortunate to be sitting here today as a result of the Tax Cuts and Jobs Act passed into law last year. I think this is tremendous. Savings are going to be passed on to customers for years to come.

So, thank you, all. Looking forward to your participation in future dockets as well.

And with that --

CHAIRMAN GRAHAM: Okay. All in favor, say aye.

(Chorus of ayes.)

CHAIRMAN GRAHAM: Any opposed?

By your action, you have approved the second motion.

Okay. Now, it looks like we need a motion to -- to move all new tariffs.

COMMISSIONER BROWN: So moved.

COMMISSIONER CLARK: Second.

CHAIRMAN GRAHAM: It's been moved and second.

All in favor, say aye.

(Chorus of ayes.)

CHAIRMAN GRAHAM: Any opposed?

By your actions, you have approved that third motion.

Okay. So, it looks like this is concluding the hearing. Are there any other matters to come before us before we close this out?

MR. TRIERWEILER: Chairman, there are no other matters. Since this Commission has made a bench decision, post-hearing filings are unnecessary. The final order will be issued no later than October 2nd, 2018.

CHAIRMAN GRAHAM: Thank you.

I want to thank you guys. You know, as always, I love it when you guys are here and not yelling at me and not yelling at each other and -- and the fact that you guys handled this -- I'm sure the ratepayers -- you know, as quickly as you did -- they're going to appreciate that as well.

I want to thank my pre-hearing officer for her diligent work and not forcing myself and Commissioner Clark to be here all week long.

And that all being said -- staff, I also want to thank you for your -- your time and your effort and your help.

That all being said, we're adjourned. Please, all -- everybody, travel safe.

(Whereupon, proceedings concluded at 1:14 p.m.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, ANDREA KOMARIDIS, Court Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 21st day of September, 2018.

ANDREA KOMARIDIS
NOTARY PUBLIC
COMMISSION #GG060963
EXPIRES February 9, 2021