BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

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In the Matter of:

DOCKET NO. 20180047-EI

CONSIDERATION OF THE TAX IMPACTS ASSOCIATED WITH TAX CUTS AND JOBS ACT OF 2017 FOR DUKE ENERGY FLORIDA, LLC.
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PROCEEDINGS: HEARING

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

DATE: Tuesday, January 8, 2019

TIME: Commenced: 12:00 p.m.
Concluded: 12:12 p.m.

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

REPORTED BY: ANDREA KOMARIDIS
Court Reporter

PREMIER REPORTING
114 W. 5TH AVENUE
TALLAHASSEE, FLORIDA
(850) 894-0828

APPEARANCES:

DIANNE M. TRIPLETT, ESQUIRE, 299 First Avenue North, St. Petersburg, Florida 33701; MATTHEW R. BERNIER, ESQUIRE, 106 East College Avenue, Suite 800, Tallahassee, Florida 32301-7740, appearing on behalf of Duke Energy Florida, LLC.

J.R. KELLY, PUBLIC COUNSEL; CHARLES REHWINKEL, DEPUTY PUBLIC COUNSEL; TAD DAVID, 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.

JAMES W. BREW, ESQUIRE, Stone Matheis Xenopoulos & Brew PC, 1025 Thomas Jefferson Street, NW, Eighth Floor, West Tower, Washington, DC 20007, appearing on behalf of PCS PHOSPHATE - WHITE SPRINGS.

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.

ROBERT SCHEFFEL WRIGHT and JOHN T. LAVIA, III, ESQUIRES, Gardner, Bist, Wiener, Wadsworth, Bowden, Bush, Dee, LaVia & Wright, P.A., 1300 Thomaswood Drive, Tallahassee, Florida 32308, appearing on behalf of the Florida Retail Federation.

APPEARANCES (Continued):

ADRIA HARPER and MARGO DUVAL, 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.

I N D E X

WITNESSES

EXHIBITS

NUMBER:	ID	ADMITTED
1 - Comprehensive exhibit list	51	51
2 through 18 (as identified on the comprehensive exhibit list)	51	51

P R O C E E D I N G S

CHAIRMAN GRAHAM: Okay. Good afternoon, everyone.

THE AUDIENCE: Good afternoon.

CHAIRMAN GRAHAM: Let the record show it is Tuesday, January the 8th, and this is the hearing, Docket No. 20180047-EI.

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

MS. DuVAL: By notice issued December 19th, 2018, this time and place was set for hearing in Docket No. 20180047-EI. The purpose of the hearing is set out in the notice.

CHAIRMAN GRAHAM: Okay. Let's take appearances.

MR. BERNIER: Good afternoon, Commissioners. Matt Bernier on behalf of Duke Energy. And I'd also enter an appearance for Dianne Triplett.

MR. REHWINKEL: Good afternoon, Commissioners. Charles Rehwinkel, Tad David, and J.R. Kelly, on behalf of the customers, with the Office of Public Counsel.

MR. MOYLE: Good morning. Jon Moyle and Karen Putnal on behalf of the Florida Industrial Power Users Group, FIPUG.

MR. WRIGHT: Thank you, Commissioners. Robert Scheffel Wright and John T. LaVia, III, on behalf of the Florida Retail Federation. Thanks.

MR. REHWINKEL: Commissioners, Jay Brew with PCS Phosphate has been excused from the hearing, but I am authorized to state that he is fully in support of the stipulation, even though he's not here.

MS. DuVAL: Margo DuVal and Adria Harper on behalf of staff.

MS. HELTON: And Mary Anne Helton. I'm here as your advisor, along with your general counsel, Keith Hetrick.

CHAIRMAN GRAHAM: Margo, this is just a big day for you, isn't it?

MS. DuVAL: It is.

CHAIRMAN GRAHAM: Are there any preliminary matters?

MS. DuVAL: Yes, Chair. On Friday, November 2nd of 2018, Duke and OPC filed a joint motion to approve stipulated positions and suspend procedural dates that resolves all issues identified in this proceeding, with FIPUG, FRF, and PCS Phosphate taking no position on the proposed stipulations. This has been marked on the comprehensive exhibit list as Exhibit No. 18.

Also, staff notes that all witnesses have been excused. And, as Mr. Rehwinkel said, PCS Phosphate has been excused from attending today's hearing.

CHAIRMAN GRAHAM: Are there any other preliminary matters from the other parties?

Okay. Let's address the record. Staff, the prefiled testimony.

MS. DuVAL: Staff requests that the prefiled testimony of Witnesses Matt Gordon, Marcia J. Olivier, and Ralph Smith be inserted into the record as though read.

CHAIRMAN GRAHAM: We'll insert Matt Gordon, Marcia Olivier, and Ralph Smith's prefiled direct testimony into the record as though read.

(Whereupon, Witnesses Gordon, Olivier, and Smith's prefiled direct testimonies were inserted into the record as though read.)

IN RE: CONSIDERATION OF THE TAX IMPACTS ASSOCIATED WITH TAX CUTS AND JOBS ACT OF 2017 FOR DUKE ENERGY FLORIDA, LLC

FPSC DOCKET NO. 20180047-EI

DIRECT TESTIMONY OF MATT GORDON

MAY 31, 2018

Q. Please state your name and business address.

A. My name is Matt Gordon. My business address is 550 South Tryon Street, Charlotte, North Carolina, 28202.

Q. By whom are you employed and what is your position?

A. I am employed by Duke Energy Business Services as Director of Tax Asset.

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

A. I am responsible for advising the various jurisdictions, including Duke Energy Florida, LLC ("DEF" or "the Company") with respect to tax treatment of assets. I oversee all aspects of tax depreciation and deferred taxes associated with Property, Plant, and Equipment (PP&E).

Q. Please describe your educational background and professional experience.

A. I have worked at Duke Energy for 33 years as an accountant in various departments within Finance. I have been in Tax for 8 years and spent over 20 years in Asset

Accounting handling the book accounting for Property, Plant, and Equipment. I am a Certified Public Accountant in the state of North Carolina.

Q. What is the purpose of your testimony?

A. My testimony is to summarize the key components of the recently enacted Tax Cuts and Jobs Act (Tax Act)[1] and its overall impact on income tax expense and accumulated deferred income tax (ADIT). I explain the requirements of the Tax Act both in terms of the change in the federal corporate tax rate, changes in the treatment of bonus depreciation, and other deductions, as well as the law's requirements for the treatment of excess ADITs. Since the excess ADITs are based on estimates that will be trued-up once DEF files its tax return in September, I also describe the process for updating the excess ADITs and amortization percentages. DEF witness Marcia Olivier will describe the process for flowing back the tax savings associated with the Tax Act to customers.

Q. Have you prepared, or caused to be prepared under your direction, supervision, or control, exhibits in this proceeding?

A. I am sponsoring the following exhibit:

Exhibit No. ___ (MG-1), "Protected and Unprotected Detail of Deferred Accounts."

This exhibit is true and accurate.

Q. Please briefly describe the Tax Act.

[1] Tax Cuts and Jobs Act, H.R. 1, Public Law 115-97, 131 Stat. 2054 (Dec. 22, 2017).

A. On December 22, 2017, President Donald Trump signed the Tax Act into Law. This legislation represents the most significant revision to the Federal Tax Code in the last thirty years. The voluminous Tax Act brings comprehensive change to the individual, corporate and international tax law. The headline change to the corporate tax code is a reduction of the statutory corporate tax rate from 35% to 21%, but this reduction in rate is accompanied by many other provisions that serve to broaden the tax base and to "pay for" the effect of the 21% tax rate. Most provisions of the Tax Act take effect beginning January 1, 2018.

Q. What are the key provisions of the Tax Act as it relates to DEF?

A. Most changes to the corporate tax code apply to all U.S. corporations equally; while a limited set of others affect regulated utilities uniquely. For utilities in general, and DEF in particular, the key provisions of the Tax Act that will affect customer rates are as follows: (1) reduction of the corporate tax rate from 35 percent to 21 percent; (2) retention of net interest expense deductibility; (3) elimination of bonus depreciation; (4) elimination of the manufacturing deduction; and (5) normalization of excess ADITs resulting from the Tax Act.

Q. Please summarize how these key provisions could impact DEF and customer rates.

A. REDUCTION IN CORPORATE TAX RATE: The new statutory income tax rate of 21% represents a 40% reduction from the previous rate of 35%. This will lower a key component of cost of service, i.e., income taxes. In combination with the elimination of bonus depreciation (see below), a lower corporate tax rate will slow the accumulation of deferred income taxes, a cost free source of capital, which will have an increasing effect on the required rate of return on rate base, thereby causing an effect that is opposite to the lower cost of service effect.

INTEREST EXPENSE DEDUCTIBILITY: The Tax Act generally provides that net interest expense is deductible only to the extent it does not exceed a stated percentage of an adjusted taxable income calculation, a calculation that becomes even more restrictive four years hence. However, regulated utilities are exempt from this limitation provision and may deduct their interest expense without limitation.

BONUS DEPRECIATION: The Tax Act generally provides that corporations may immediately expense capital as it is placed in service, akin to 100% bonus depreciation. However, the Tax Act specifically prohibits the immediate expensing of capital by regulated utilities. Instead, utilities are directed to use MACRS (modified accelerated cost recovery system) depreciation for capital investment placed in service. Though no longer accompanied by "bonus" depreciation, MACRS still represents a significantly accelerated rate of depreciation compared to book depreciation. As a result, deferred taxes will continue to accrue under MACRS, but will do so at a slower rate compared to bonus depreciation and at a much slower rate under the lower 21% corporate tax rate (see above) — this will cause a more rapid increase to the required rate of return on rate base relative to pre-Tax Act.

MANUFACTURING DEDUCTION: Prior to the Tax Act, domestic manufacturers were granted a tax deduction based on a certain percentage of qualifying manufacturing income, and the production of electricity qualified for this tax benefit.

In order to avail itself of this deduction, a corporation had to be in a taxable income position—this was often not the case recently for most regulated utilities because of the impact of bonus depreciation. Unfortunately, the elimination of bonus depreciation for utilities in the Tax Act coincided with the elimination of this tax deduction for all manufacturers, which is directionally detrimental to customer rates.

EXCESS ADIT: At the end of 2017, DEF has a significant net deferred tax liability, booked at a 35% corporate tax rate and driven overwhelmingly by accelerated and bonus depreciation of fixed assets for tax purposes. Because a deferred tax liability represents taxes collected from customers but not yet paid to taxing authorities, and because the ultimate payment of these taxes will now occur at a 21% corporate tax rate (down from 35%), the balance of deferred tax liability must be remeasured. The resulting "excess" ADIT balance becomes a regulatory liability. The Tax Act requires that excess ADITs generally associated with property, and specifically connected to the accelerated depreciation of property, must be normalized into customers' rates in a highly-prescribed manner that mimics the remaining life of the underlying assets. These are known as "protected" excess ADITs. All other excess ADITs may be treated by the commission like any other regulatory liability in the rate-setting process.

Q. How does the Tax Act address the accounting treatment of Excess ADITs?

A. Because of the passage of the Tax Act, the deferred tax assets and liabilities on the Company's books as of December 31, 2017, which were established at a rate of 35 percent, will be revalued at a rate of 21 percent creating "excess" ADITs.

Under the Tax Act, the protected excess ADIT reserve may be reduced with a corresponding reduction in the revenue that the utility collects from ratepayers no more rapidly than the reserve would be reduced under the Average Rate Assumption Method (ARAM).[2]

Q. Does the Company have an estimate of the value of the Excess ADITs for DEF at this time?

A. The Company has computed an estimate of the total excess ADIT balance to be $809 million. $560 million of that balance is protected and $249 million is unprotected. Exhibit No. __ (MG-1),“Protected and Unprotected Detail of Deferred Accounts” provides a listing of the underlying book tax timing differences for each deferred tax account.

Q. How did DEF determine which deferred tax amounts were protected and which were unprotected?

A. DEF considered all deferred tax balances that are not related to property, plant and equipment (PP&E) as unprotected with the exception of deferred taxes associated with the net operating loss (NOL). PP&E deferred taxes can be broken into two categories. The first category relates to the deferred taxes resulting from method and

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

life depreciation differences. Book accounting generally uses a straight line depreciation method but tax generally uses an accelerated method such as MACRS or bonus depreciation. Book accounting also may use a different depreciation life than tax depreciation. Deferred taxes associated with all method or life differences are considered protected by the IRS. The second category of PP&E related deferred taxes includes those associated with book and tax basis differences. Examples of basis differences include assets which are capitalized for book purposes but are expensed for tax purposes, or taxable contributions in aid of construction which reduce the cost of the asset for book purposes but are considered taxable income for tax purposes. The NOL deferred taxes are considered to be protected because the NOL was created as a result of having a significant amount of accelerated depreciation (bonus and MACRS).

Q. Please explain whether DEF treated the cost of removal (COR) component of excess ADIT as protected or unprotected

A. DEF treated the COR component of excess ADIT as both protected and unprotected with the majority being treated as protected. This approach is an effort to avoid any normalization violations. Some utilities are treating COR as a basis difference which would result in COR being classified as unprotected. DEF has reviewed the IRS rules extensively and believes the rules require utilities to use all of the book depreciation amounts included in its utility operations in the normalization ARAM calculations. The regulations require that "salvage" be taken into account when determining the depreciation amount. DEF's book depreciation "salvage" amount is a "net salvage" amount which means that COR is a component of the depreciation rate. A portion of book depreciation gets assigned to book tax basis differences (portions of a book asset that is depreciated for book purposes but not for tax purposes). Examples of this would be AFUDC debt, tax repair projects, taxable contributions in aid of construction (taxable CIAC), etc. Therefore, some of the COR gets assigned to the method/life protected deferred taxes and some gets assigned to the basis differences unprotected amounts. DEF believes this method does not result in a normalization violation as we are proposing that COR be normalized along with the other components of book depreciation. COR results in a deferred tax asset and this method is to the benefit of customers as it slows down the recovery of the regulatory asset created from excess deferred taxes because the majority of the COR is showing up in protected deferred taxes which is recovered over a longer period of time than if deemed unprotected.

Q. What will DEF do if the IRS rules that COR is unprotected?

If a ruling or other guidance is issued by the IRS proclaiming that COR is not protected, then DEF will reclassify all COR excess ADIT amounts to unprotected. This will change the total amount of amortization of excess ADITs. Therefore, as further explained in Marcia Olivier’s testimony, DEF would file updated schedules with the Commission and adjust the amortization of excess ADITs and the flow-back amount charged to storm costs retroactive to January 2018.

Q. What is the amortization percentage for protected Excess ADITs and how was that amount calculated?

A. DEF estimates that 4.82% of the protected excess deferred taxes will be amortized in 2018. This amount was calculated using our PowerTax system. PowerTax starts amortizing the excess deferred taxes on a specific asset when deferred taxes start to reverse (when book depreciation exceeds tax depreciation). In the first year of the reversal PowerTax computes an average deferred tax rate using the current balance of the deferred taxes. This average rate will then be used to amortize the excess deferred taxes over the remaining life of the specific asset. The 4.82% is an estimate because the actual amount of excess deferred taxes will not be known until the 2017 tax return is complete. Therefore, DEF will adjust the ARAM percentage retroactive to January 2018 upon completion of the 2017 tax return in September, and DEF will adjust the amount flowed back to customers as further explained in Marcia Olivier's testimony.

Q. How does DEF propose to flow back these benefits from the Tax Act to customers?

A. DEF witness Ms. Marcia Olivier explains the relevant provisions of the 2017 Settlement and how those provisions will be implemented.

Q. Does this conclude your direct testimony?

A. Yes.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: CONSIDERATION OF THE TAX IMPACTS ASSOCIATED WITH TAX CUTS AND JOBS ACT OF 2017 FOR DUKE ENERGY FLORIDA, LLC

FPSC DOCKET NO. 20180047-EI

DIRECT TESTIMONY OF MARCIA J. OLIVIER

MAY 31, 2018

I. INTRODUCTION AND QUALIFICATIONS.

Q. Please state your name and business address.

A. My name is Marcia J. Olivier. My current business address is 299 First Avenue North, Saint Petersburg, FL 33701.

Q. By whom are you employed and what are your responsibilities?

A. I am employed by Duke Energy Florida, LLC as Director of Rates and Regulatory Planning. I am currently responsible for overseeing rate cases, reporting actual and projected earnings surveillance results, overseeing storm cost recovery filings, and ensuring compliance with the 2017 Second Revised and Restated Settlement Agreement.

Q. Please summarize your educational background and professional experience.

A. I hold a Bachelor of Science degree in Accounting and a Bachelor of Science degree in Finance from the University of South Florida and have over 20 years of utility experience, primarily in the regulatory department.

II. PURPOSE AND SUMMARY OF TESTIMONY.

Q. What is the purpose of your direct testimony?

A. The purpose of my testimony is to present for Commission approval the amount of the tax impacts and explain the process for flowing back those tax impacts to customers. The tax impacts can be categorized into two components; 1) the effect of the lower income tax rate (aka "Tax Savings") on earnings, and 2) the effect of the amortization of excess accumulated deferred income taxes ("Excess ADIT") on earnings. Matt Gordon will present testimony on the calculation of the amount and amortization of Excess ADIT.

Q. Do you have any exhibits to your testimony?

A. Yes, I am sponsoring the following exhibit to my testimony:

- Exhibit No. __ (MJO-1), "Calculation of Tax Flow Back."

This exhibit was prepared under my direction and control, and is true and accurate to the best of my knowledge.

Q. Please summarize your testimony.

A. On November 20, 2017, the Commission approved DEF's 2017 Second Revised and Restated Settlement Agreement ("2017 Settlement") in Order No. PSC-2017-0451-AS-EU. Paragraph 16 of the 2017 Settlement sets forth the methodology for calculating tax impacts and flow back associated with tax reform. On December 22, 2017, the President signed into law the 2017 Tax Cuts and Jobs Act ("Tax Act"), which, among other things, reduced the federal corporate income tax rate from 35% to 21%. Finally, on February 26, 2018, the Commission approved a 2017 Settlement Implementation Stipulation ("Implementation Stipulation") in Order No. PSC-2018-0103-PCO-EI, which authorized DEF to apply the impacts of the Tax Act toward the storm reserve deficiency in lieu of increasing customer rates to recover storm costs and decreasing customer rates to flow back tax impacts. Exhibit MJO-1, Page 1 provides the calculation of the Tax Savings in accordance with Exhibit 6 of the 2017 Settlement, Page 2 provides notes associated with Page 1, and Page 3 provides the total amount of tax flow back associated with the Tax Savings calculated on page 1 as well as the flow back of Excess ADIT.

Q. Please explain your calculation of the Tax Savings.

A. Exhibit 6 to the 2017 Settlement provides a template for calculating the Tax Savings. It is based on the 2018 forecasted earning surveillance report that DEF filed with the Commission on March 15, 2018. When populating that template, as shown in Exhibit MJO-1, the total revenue requirement impact of Tax Savings for 2018 is $134.1 million. Of that amount, $50 million is applied to the accelerated depreciation of the Crystal River Coal Units 4 and 5 ("CR4&5") pursuant to Paragraph 16b, which provides that "…each year throughout the term of the 2017 Second Revised and Restated Settlement Agreement 40% of such impacts, up to $50 million pre-tax, would be recorded as an acceleration of depreciation expense associated with Crystal River Units 4 and 5, thereby reducing the FPSC-adjusted net operating impact of Tax Reform by up to the after-tax impact of this accelerated depreciation." The remaining amount to flow back to customers, after accelerating the depreciation of CR4&5, is $84.1 million as shown in Exhibit MJO-1, Page 1, Line 55.

Q. Did you make any changes to the format of Exhibit 6 to the 2017 Settlement?

A. Yes, DEF makes a parent debt adjustment in its surveillance reports to reduce income tax expense to reflect the interest expense deduction associated with debt at its parent. This adjustment increases net operating income. As a result of the decrease in the federal corporate income tax rate, the parent debt adjustment was reduced from $15.7 million to $10.3 million. This change in the parent debt tax adjustment needs to be reflected in the calculation of the Tax Savings associated with the decrease in the federal corporate income tax rate. Therefore, rows 34a and 35a were added in Exhibit MJO-1, Page 1 to capture this change.

Q. Please explain the calculation of the flow back of Excess ADIT

A. The amount of Excess ADIT that was recorded as a regulatory liability as of December 2017 is presented and explained more fully in Matt Gordon's direct testimony, including the component that is protected by tax normalization rules ("Protected") and the component that is not protected by tax normalization rules ("Unprotected). Paragraph 16c of the 2017 Settlement provides that the Protected component must be flowed back over a term consistent with law. For the Unprotected component, notwithstanding the remaining provisions of Paragraph 16c, the flow back period is ten years if the amount is greater than $200 million and five years if the amount is less than $200 million. As shown in Exhibit MJO-1, page 3, DEF has calculated the Protected amount to be $560.5 million and the

Unprotected amount to be $248.5 million as of December 31, 2017. As further explained in Matt Gordon's direct testimony, the amortization percentage for the first year of the Protected amount is estimated to be 4.82%. Therefore, the estimated amortization of the Protected amount is $27.0 million. The Unprotected amount of $248.5 million will be amortized over ten years since the amount is greater than $200 million. Therefore, the estimated amortization of the Unprotected amount is $24.9 million. The total amortization of the Excess ADIT regulatory liability for 2018 is, therefore, $51.9 million. After removing the portion associated with wholesale Open Access Transmission Tariff ("OATT") customers, the remaining retail portion to be amortized is $49.9 million. Grossing this amount up by the new combined federal and state statutory tax rate results in a revenue requirement impact of $66.9 million.

Q. What is the total amount of the tax impact that will be flowed-back to customers and how will that amount flow back?

A. Adding the pretax effect of $84.1 million annual Tax Savings to the pretax effect of $66.9 million estimated amortization of the Excess ADIT regulatory liability results in a total estimated flow back of $150.9 million. Pursuant to the Implementation Stipulation, DEF will offset this total amount by recording a monthly storm reserve accrual beginning in January 2018 for one-twelfth of $150.9 million, or $12.6 million, until DEF has fully recovered the final storm recovery amount to be approved by the Commission in Docket No. 20170272. Also pursuant to the Implementation Stipulation, in the month following full recovery of the Commission-approved final storm recovery amount, DEF will cease recording the storm reserve accrual and will reduce base rates in the manner set forth in the 2017 Settlement by the final amount of flow-back approved by the commission in this proceeding. DEF will file tariff sheets for Staff's approval sixty days prior to that date.

Q. Since the Excess ADIT amounts reflected above are estimates, how will DEF true these amounts up?

A. While the annual Tax Savings calculated in Exhibit MJO-1, Page 1 are final (paragraph 16b of the 2017 Settlement provides for a one-time calculation based on the 2018 forecasted earnings surveillance report), the Excess ADIT amortization is not final. As further explained in Matt Gordon's testimony, DEF will not have the final December 2017 Excess ADIT balances and Average Rate Assumption Method ("ARAM") percentage until after it files its 2017 tax return in September. Since the Excess ADITs and amortization percentages are preliminary and subject to change, DEF will make a supplemental filing in the November/December timeframe based on DEF's 2017 tax return to adjust the Protected and Unprotected Excess ADIT balances, amortization amounts and the flow-back amounts applied to storm costs retroactive to January 2018. Although the amortization percentage will change each year according to ARAM, the flow-back of the Excess ADITs will be final, and not subject to any further adjustments after DEF's supplemental filing in November/December, with the exception of one potential adjustment related to cost of removal ("COR").

Q. Please explain the exception related to COR.

A. As further explained by Matt Gordon, the ADIT associated with COR is a deferred tax asset which DEF has recognized as Protected for the most part. Therefore, COR reduces the total Protected Excess ADIT balance. If the IRS rules that the COR Excess ADIT is Unprotected at any time during the period in which the storm costs are being recovered under the Implementation Stipulation, then DEF will make a filing to the Commission presenting the amount of COR Excess ADIT to be moved from Protected to Unprotected, and DEF will update the Excess ADIT amortization amount and flow-back amount applied to storm costs retroactive to January 2018.

Q. Does this conclude your testimony?

A. Yes, it does.

DIRECT TESTIMONY

OF

RALPH SMITH

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

20180047-EI

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 due to the Tax Cuts and Jobs Act of 2017 ("TCJA" or "2017 Tax Act"). My testimony addresses the impacts of the TCJA on Duke Energy Florida, LLC ("DEF," "Duke" 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. In this testimony, I address TCJA impacts on DEF.

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

A. I reviewed the Company's filing, including the direct testimony and exhibits. I also reviewed the Company's responses to OPC's formal and informal discovery and other materials pertaining to the TCJA and its impacts on the Company. On October 3, 2018, I met with DEF and representatives of the tax department to conduct informal discovery. In addition, I reviewed Rule 25-14.011, Florida Administrative Code ("F.A.C."), concerning procedures for processing requests rulings to be filed with the Internal Revenue Service ("IRS").

Q. PLEASE DESCRIBE HOW THE REMAINDER OF YOUR TESTIMONY IS ORGANIZED.

A. After this introduction (Section I), I address the TCJA impacts related to each of the following issues:

- In Section II, I address the amount and recommended treatment of "Protected" and "Unprotected" Excess Accumulated Deferred Income Taxes ("EADIT").
- In Section III, I address the amount of estimated 2018 income tax savings in base rates related to the reduction in the federal income tax rate to 21 percent.
- In Section IV, I discuss DEF's riders and surcharges that are impacted by the TCJA.
- In Section V, I address whether a Private Letter Ruling ("PLR") should be required for the Company, and issues related to a PLR request.
- Finally, in Section VI, I summarize my findings and recommendations.

II. QUANTIFICATION, CLASSIFICATION AND APPLICATION OF EXCESS ACCUMULATED DEFERRED INCOME TAXES

Q. WHAT ARE ACCUMULATED DEFERRED INCOME TAXES ("ADIT")?

A. ADIT is a source of cost-free capital to reflect that the utility collects money from ratepayers for Deferred Income Tax Expense and holds onto that money prior to eventually paying the income taxes to the government. ADIT results from differences between book and tax accounting. ADIT is referred to as Accumulated Deferred Income Taxes to recognize that these balances typically build up (or accumulate) over time, e.g., as tax deductions exceed corresponding book expense. One primary source of ADIT results from claiming accelerated tax deductions. The tax depreciation deductions on public utility property typically occur on an accelerated basis (i.e., method differences) and over a shorter period (i.e., life differences) than book depreciation accruals relating to the original cost of the public utility property. These types of differences between book and tax depreciation are referred to as “method/life” differences. Unlike many other types of book-tax differences, the tax depreciation “method/life” differences are subject to normalization requirements under Sections 167 and 168 of the Internal Revenue Code.

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

A. Regulated public utilities are required to identify the portions of their ADIT balances that represent "excess" ADIT based on recalculations using the difference between the old federal corporate income tax (“FIT”) rate (typically 35%) under which the ADIT was originally accumulated and the new FIT rate of 21% provided for in the TCJA.

Basically, the utility’s ADIT must be revalued at the new FIT rate (as if it had always been applicable) and the amounts that have been accumulated using the federal income tax rates that are higher than the current 21% rate will represent "excess" ADIT.

Q. WHAT AMOUNT OF EXCESS ACCUMULATED DEFERRED INCOME TAXES (“EADIT”) DOES DEF SHOW?

A. DEF shows a total EADIT net liability of approximately $809 million. A summary of this is presented on Company Exhibit No. __ (MG-1). The Company indicates it will true-up these estimates in December 2018 after filing its 2017 federal corporate income tax return in September 2018. The total EADIT net liability of $809 million consists of a property-related (account 282) EADIT liability of approximately $732 million and a non-property related net EADIT liability of approximately $77 million.

Q. HOW DO INTERNAL REVENUE CODE NORMALIZATION REQUIREMENTS AFFECT THE CATEGORIZATION OF ADIT AND EXCESS ADIT?

A. Internal Revenue Code ("IRC" or "Code") 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., related to the use of accelerated tax depreciation and subject to the normalization requirements) and (2) “unprotected” property and non-property related excess ADIT (which is not subject to normalization requirements and for which the amortization or application is up to the discretion of the Commission).

Q. HOW HAS DEF CLASSIFIED THE PROPERTY-RELATED EADIT BETWEEN "PROTECTED" AND "UNPROTECTED"?

A. On Company Exhibit No. __ (MG-1), page 1, DEF shows a “protected” EADIT liability for Property, Plant and Equipment ("PP&E") Method/Life differences of $617.75 million. On that exhibit, DEF also shows an “unprotected” EADIT liability of $114.25 million. The sum of those two amounts is the PP&E related EADIT liability of $732 million. The PP&E-related EADIT items listed on Company Exhibit No. __ (MG-1), page 1, are tracked in PowerTax (DEF’s computer tax program).

Q. HOW HAS DEF CLASSIFIED THE NON-PROPERTY-RELATED EADIT BETWEEN "PROTECTED" AND "UNPROTECTED"?

A. Company Exhibit No. __ (MG-1), page 2, shows non-PP&E related EADIT, classified between “protected” and “unprotected.” As shown there, DEF shows an EADIT net asset of $57.27 million for “protected” non-PP&E EADIT and an EADIT liability of $134.28 million for “unprotected” non-PP&E related EADIT. Those two amounts net to the $77 million net EADIT liability for non-PP&E related EADIT. During an on-site meeting on October 3, 2018, Company representatives indicated that none of the EADIT items on Company Exhibit No. __ (MG-1), page 2, are in PowerTax. DEF uses the PowerTax software to track its PP&E related ADIT in account 282 and the related EADIT balances. The other book-tax differences that comprise the ADIT in accounts 190 and 283 that are listed on Company Exhibit No. __ (MG-1), page 2 are tracked by the Company outside of PowerTax.

Q. WHAT NON-PP&E ITEMS OF EADIT HAS THE COMPANY CLASSIFIED AS "PROTECTED"?

A. As shown on Company Exhibit No. __ (MG-1), page 2, DEF has classified only two items as "protected," both of which relate to the Company's federal net operating loss ("NOL") carryforward.

Q. HOW DID DEF DETERMINE THE EADIT RELATED TO ITS FEDERAL NOL CARRYFOWARD WAS APPROPRIATELY CLASSIFIED AS "PROTECTED"?

A. The Company made a "with and without" calculation as the basis for that determination. Basically, the Company calculated its taxable income "with" accelerated and bonus tax depreciation and made another calculation of taxable income "without" the accelerated and bonus tax depreciation. Based on those calculations, which DEF provided to the OPC after the October 3, 2018 on-site interviews, the Company determined the EADIT related to its NOL carryforward was entirely related to accelerated and bonus tax depreciation, and thus should be classified as "protected" just as the method/life differences associated with accelerated and bonus tax depreciation which gave rise to that NOL carryforward are classified as "protected." The Company's response to OPC interrogatory 24, states that "DEF has recently determined that the excess deferred tax asset associated with the net operating loss is protected ..."

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

A. The 2017 Tax Act provides that the Average Rate Assumption Method ("ARAM") must be used for the "protected" portion of the EADIT. 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 as far as the Internal Revenue Service is concerned. "Unprotected" ADIT is not subject to normalization requirements. The "unprotected" ADIT 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 to be determined by the Commission (e.g., such as for the recovery of regulatory assets).

Q. DO YOU AGREE WITH DEF'S CLASSIFICATION OF THE EADIT BETWEEN THE "PROTECTED" AND "UNPROTECTED" CATEGORIES?

A. I have no disagreement with the DEF's classification of EADIT that has been presented on Company Exhibit No. __(MG-1). However, I note that the guidance provided in the TCJA and in previous IRS rulings presents 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.

Q. WHAT IS THE APPROPRIATE DISPOSITION OF THE "PROTECTED" EADIT?

A. The "protected" EADIT should be reversed using an ARAM if the utility has the available information to calculate the ARAM, or via another appropriate method that complies with normalization requirements, if the Company does not have the information to compute the ARAM. DEF has the information needed for the ARAM calculations, so it should use the ARAM for its "protected" EADIT.

Q. ARE YOU CONTESTING THE AMOUNTS ASSOCIATED WITH THE COMPANY'S PROPOSED EADIT?

A. No. The Company has indicated that its EADIT amounts are estimates and are subject to correction after it files its 2017 tax return, which, with a 6-month extension from March 15, 2018, should have been filed by September 17, 2018.[1] I have accepted the Company's amounts as reasonable estimates, subject to the later true up. DEF has indicated that in December 2018 it will calculate the actual amount of EADIT at December 31, 2017 based on its 2017 corporate income tax return that was filed in September 2018. DEF had indicated that it will submit the actual EADIT and amortization amounts in December 2018 and will true-up those amounts back to January 2018.

Q. WHAT AMORTIZATION DOES DEF PROPOSE FOR ITS PROPERTY-RELATED "PROTECTED" AND "UNPROTECTED" EADIT?

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[1] The OPC has not yet been provided with the Company's final as-filed 2017 federal corporate income tax return.

A. DEF is proposing to use ARAM for the “protected” EADIT and to apply a 10-year amortization to the “unprotected” property-related EADIT, as provided for in the 2017 settlement between the Company, the OPC and other intervenors.

Specifically, on Company Exhibit No.__(MJO-1), page 3, DEF shows net "protected" EADIT of $560.483 million. The $560.483 million of "protected" EADIT is also shown on Company Exhibit No.__(MG-1), page 1, line 6. on Company Exhibit No.__(MJO-1), page 3, DEF applied an ARAM-based amortization percentage of 4.82 percent to that $560.483 million "protected" EADIT amount, to derive the estimated “protected” EADIT amortization for 2018 of $27.015 million.

Q. DO YOU AGREE WITH DEF'S PROPOSAL TO APPLY THE ARAM FOR THE "PROTECTED" PORTION OF ITS PROPERTY-RELATED EADIT?

A. Yes, I do. Application of the ARAM for the "protected" EADIT is required by the Internal Revenue Code and TCJA. I agree with DEF's proposal to use the ARAM, but only for the "protected" EADIT.

Q. SHOULD THE ARAM FOR THE "UNPROTECTED" PORTION OF ITS PROPERTY-RELATED EADIT?

A. No. There is no Internal Revenue Code or TCJA requirement that the "unprotected" EADIT must be amortized using the ARAM. The amortization of a utility's "unprotected" EADIT is up to the discretion of the Commission and subject to any settlement approved by Commission order. Since this EADIT is by definition "excess" (meaning amounts that are in excess, or more than needed, based on the current federal corporate income tax rate of 21 percent) and the balance is a liability (meaning the amounts are being held by the Company and should be returned to ratepayers), a shorter amortization period should be considered. A straight-line amortization should be applied for the "unprotected" EADIT.

Q. WHAT HAS DEF PROPOSED FOR THE AMORTIZATION OF ITS "UNPROTECTED" EADIT BALANCE?

A. As explained on page 5 of the Direct Testimony of Company witness Olivier, DEF proposes to amortize the "unprotected" EADIT balance of $248.5 million over ten years since the amount is greater than $200 million. As explained by Ms. Olivier on pages 2-3 of her Direct Testimony, the Commission on November 20, 2017 approved DEF's 2017 Second Revised and Restated Settlement Agreement ("2017 Settlement") in Order No. PSC-2017-0451-AS-EU. Paragraph 16 of that 2017 Settlement sets forth the methodology for calculating the tax impacts and flow back associated with tax reform. Her Exhibit No.__(MJO-1), page 3, shows the amount of total flow back associated with the amortization of EADIT in addition to the flow back of annual tax savings. For the amortization of the "unprotected" EADIT, DEF proposes ten years, which appears to be consistent with DEF's 2017 Settlement.[2]

Q. DO YOU AGREE WITH APPLYING A STRAIGHT-LINE METHOD FOR AMORTIZING THE "UNPROTECTED" EADIT?

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[2] In re: Application for Limited Proceeding to Approve 2017 Second Revised and Restated Settlement Agreement, including Certain Rate Adjustments, by Duke Energy Florida, LLC., Order No. PSC-2017-0451-AS-EU, issued November 20, 2017, in Docket No. 20170183-EI, et. al., at p. 40.

A. Yes. Amortizing the “unprotected” EADIT using a straight-line method is a straightforward approach that is simple to administer.

Q. IS IT NECESSARY THAT THE “UNPROTECTED” EADIT BE FLOWED BACK OVER A PERIOD SIMILAR TO HOW THE ADIT WOULD HAVE FLOWED BACK IN THE ABSENCE OF THE TCJA?

A. No. The amortization of the “unprotected” EADIT is a matter within the Commission jurisdiction. There is no need to allow utilities to hold “unprotected” EADIT amounts for decades into the future. As described above, the EADIT amounts are "excess" and, if in a liability position (i.e., if they represent amounts owed to customers), these amounts should be flowed back over a quicker period. This quicker flow back reduces intergenerational inequity by returning the money to the customers who paid the higher tax rates rather than stretching the timeframe into the future for the benefit of customers who may never have paid for the “excess” ADIT. I am recommending an amortization period of ten years as the flow back period for DEF's “unprotected” EADIT balances. This is in agreement with DEF's proposal, which is in accord with the DEF 2017 Settlement.

Q. DO YOU HAVE A RECOMMENDATION FOR THE AMORTIZATION OF THE "UNPROTECTED" EADIT?

A. Yes. I recommend that DEF's proposal amortization of "unprotected" EADIT over ten years on a straight-line basis be accepted because it is reasonable and is consistent with the applicable provisions of the 2017 Settlement. I note that a ten-year straight-line amortization period for "unprotected" EADIT is being used by another Florida regulated utility, Tampa Electric Company[3] pursuant to a 2017 settlement with the OPC and other intervenors, and is a reasonable period for returning these excess amounts to customers. Moreover, Gulf Power Company agreed to return its entire "unprotected" property-related EADIT in 2018.[4] Thus, a ten-year flow back is reasonable for DEF to return this money to its ratepayers.

Q. WHAT ANNUAL AMORTIZATION OF THE "UNPROTECTED" PORTION OF DEF'S PROPERTY-RELATED EADIT IS PRODUCED BY A TEN-YEAR STRAIGHT-LINE AMORTIZATION?

A. Amortizing the "unprotected" property-related EADIT liability of $248.540 million over ten years produces an annual amortization amount of $24.854 million, as shown on DEF Exhibit No. ___(MJO-1), page 3, lines 5 through 7.

Q. WHAT IS DEF'S TOTAL ESTIMATED AMOUNT OF 2018 EADIT AMORTIZATION?

A. As shown on DEF Exhibit No. ___(MJO-1), page 3, the total amount of 2018 EADIT amortization estimated by DEF is $51.869 million, consisting of $27.015 million of "protected" EADIT amortization using the ARAM and $24.854 million of "unprotected" EADIT amortization using a ten-year straight-line amortization.

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[3] In re: Consideration of the Tax Impacts Associated with Tax Cuts and Jobs Act of 2017 for Tampa Electric Company, Order No. PSC-2018-0457-FOF-EI, issued September 10, 2018, in Docket No. 20180046-EI at p. 5.
[4] In re: Consideration of the Stipulation and Settlement Agreement Between Gulf Power Company, the Office of Public Counsel, Florida Industrial Power Users Group, and Southern Alliance for Clean Energy Regarding the Tax Cuts and Jobs Act of 2017, Order No. PSC-2018-0180-FOF-EI, issued April 12, 2018, in Docket No. 20180039-EI, at pp. 11-12.

Q. DID DEF ALLOCATE SOME OF THE EADIT AMORTIZATION TO ITS OPEN ACCESS TRANSMISSION TARIFF ("OATT")?

A. Yes. As shown on DEF Exhibit No. ___(MJO-1), page 3, lines 11 and 12, DEF allocated 3.73 percent of $1.935 million, of the 2018 EADIT amortization to its OATT. After making that OATT allocation, that left an amount of 2018 EADIT amortization of $49.935 million, as shown on DEF Exhibit No. ___(MJO-1), page 3, line 12.

Q. TO GET TO REVENUE REQUIREMENT AMOUNTS, DO THE EADIT AMOUNTS NEED TO INCLUDE A TAX "GROSS-UP"?

A. Yes. The amounts listed above do not appear to include the "gross up" amount. However, calculation presented by DEF on Company Exhibit No. __(MJO-1), page 3 of 3, to derive the total annual projected flow-back of EADIT, does include a "gross up" based on the reciprocal of the 25.345 percent combined state and federal income tax rate that uses the new 21 percent federal corporate income tax rate. The EADIT resulting from the tax rate change is increased or "grossed up" for the current income tax rate to derive the related revenue requirement impact. The "grossed up" amount of the EADIT regulatory liability (or asset) that is being amortized would be subject to income taxes at the current rate; therefore, it is necessary to apply a "gross up" factor at some point in the process. As explained above, DEF has first calculated the EADIT amortization on its Exhibit No.___(MJO-1), page 3 of 3, then applied a "gross up" to derive the revenue requirement impact of that EADIT amortization. The "grossed up" EADIT amortization amount is shown on line 14 of Exhibit No. ___(MJO-1), page 3.

Q. HOW HAS DEF CLASSIFIED THE EADIT RELATED TO REPAIRS DEDUCTIONS?

A. DEF has classified EADIT related to repairs deductions as "unprotected." On Company Exhibit No.___(MG-1), page 1, EADIT related to repairs deductions is shown on lines 42, 49 and 50. All of that EADIT has been classified by DEF as "unprotected." It should be noted that the "Tax Expensing" of repairs EADIT liability amount of $282.468 million shown on Exhibit No.___(MG-1), page 1, line 49, is the largest single "unprotected" EADIT component that DEF has. Properly classifying the EADIT for repairs deductions as "unprotected" and flowing it back over an appropriate period is thus very important. It appears that DEF has appropriately classified the EADIT related to repairs deductions as "unprotected." Moreover, as explained below in my testimony, DEF is proposing to amortize its net "unprotected" EADIT liability over a ten-year period on a straight-line basis.

Q. HOW HAS DEF CLASSIFIED THE EADIT RELATED TO COST OF REMOVAL/NEGATIVE NET SALVAGE?

A. DEF witness Matt Gordon's Direct Testimony at pages 7-8 contain the following description:

> "DEF treated the COR component of excess ADIT as both protected and unprotected with the majority being treated as protected. This approach is an effort to avoid any normalization violations. Some utilities are treating COR as a basis difference which would result in COR being classified as unprotected. DEF has reviewed the IRS rules extensively and believes the rules require utilities to use all of the book depreciation amounts included in its utility operations in the normalization ARAM calculations. The regulations require that “salvage” be taken into account when determining the depreciation amount. DEF’s book depreciation “salvage” amount is a “net salvage” amount which means

> that COR is a component of the depreciation rate. A portion of book depreciation gets assigned to book tax basis differences (portions of a book asset that is depreciated for book purposes but not for tax purposes). Examples of this would be AFUDC debt, tax repair projects, taxable contributions in aid of construction (taxable CIAC), etc. Therefore, some of the COR gets assigned to the method/life protected deferred taxes and some gets assigned to the basis differences unprotected amounts. DEF believes this method does not result in a normalization violation as we are proposing that COR be normalized along with the other components of book depreciation. COR results in a deferred tax asset and this method is to the benefit of customers as it slows down the recovery of the regulatory asset created from excess deferred taxes because the majority of the COR is showing up in protected deferred taxes which is recovered over a longer period of time than if deemed unprotected."

Additionally, DEF's response to OPC Interrogatories 14(c), (d) and (e) and 30 address how DEF accounts for cost of removal and negative net salvage. DEF's response to OPC Interrogatory No. 24 states, in part, that: "DEF has recently determined ... that the excess deferred tax liability on the Cost of Removal Regulatory Asset is not protected ..." DEF's response to OPC Interrogatory No. 26 and follow-up information obtained after the on-site meetings in St. Petersburg, FL with DEF on October 3, 2018 indicate that DEF had a Cost of Removal ("COR") regulatory asset of approximately $600 million, of which approximately $120 million had been applied in previous years, leaving approximately $480 million as of December 31, 2015, which had remained through December 31, 2017. The Cost of Removal Regulatory Asset refers to that balance, which had resulted from DEF's last rate case, in which DEF created a regulatory asset related to excess theoretical accumulated depreciation reserves related to cost of removal.

DEF's response to OPC Interrogatory No. 29(a) provides an additional explanation of DEF’s reasoning for classifying the EADIT for cost of removal as "unprotected." Specifically, in its response to OPC Interrogatory No. 29(a), DEF cites

Treasury Regulation Section 1.167(a)-1(c)(1) which DEF states generally allows taxpayers to use either gross salvage or net salvage (i.e., gross salvage less Cost of Removal) as the "salvage value" that is taken into account in determining depreciation deductions allowable under IRC Section 167. DEF quotes Internal Revenue Service Statements made in PLR 8616018, which addresses utility use of net salvage to compute its regulatory depreciation expense. DEF's annotated[5] quote from PLR 8616018 as stated in the Company's response to OPC Interrogatory No. 29(a) is reproduced below:

> "... it is clear that in calculating the amount to be normalized ... a taxpayer must use the same method of calculating salvage value in computing [protected ADIT] as it uses in computing its tax expense and depreciation expense for ratemaking purposes. Thus, if [a taxpayer] uses net salvage value to calculate its regulated tax expense and depreciation expense ... [the taxpayer] must use net salvage value ... to calculate [protected ADIT]. The use of any other method ... violates the consistency requirement of [the normalization rules] ...."[6]

DEF explains further that, similar to the taxpayer that requested PLR 8606018, DEF uses net salvage value to determine the rate of depreciation that it uses to calculate regulatory depreciation expense. As a result, to comply with the normalization requirements, DEF states that it must also use net salvage value to determine the Section 167 Regulatory Depreciation it uses to calculate “protected” ADIT and “protected” EADIT.

Further explanation provided by DEF in its response to OPC Interrogatory No. 29(a) indicates the Cost of Removal that is taken into account in the Company's

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[5] The bracketed items are per DEF's response to OPC Interrogatory No 29(a) as inserted into the PLR 86016018 quote by DEF for clarity.

[6] In footnote 4 to DEF's response, DEF notes that IRC Section 168(e)(3)(B)(ii) , as referenced in PLR 86016018, was re-designated to IRC Section 168(i)(9)(A)(ii) by Section 201(a) of the Tax Reform Act of 1986

calculation of “unprotected” EADIT is the portion attributable to book-tax basis differences. Thus, DEF has distinguished between (1) book-tax basis differences, which DEF has classified as being associated with “unprotected” EADIT) and (2) method/life differences (which DEF has classified as being associated with “unprotected” EADIT).

It should be noted that DEF's classification of EADIT for cost of removal as "unprotected" differs from certain other Florida utilities, such as Florida Power & Light Company, which classified its EADIT for cost of removal as "protected." Later in my testimony, I discuss the potential need to request a Private Letter Ruling from the IRS related to the cost of removal component of EADIT.

Q. HAVE YOU NOTED OTHER DIFFERENCES BETWEEN DEF'S CLASSIFICATION OF EADIT ITEMS VERSUS OTHER FLORIDA UTILITIES?

A. Yes. DEF has classified the EADIT related to the method/life state tax offset as "unprotected" as shown on Company Exhibit No. ___(MG-1), page 1, line 33. Additionally, the EADIT related to the Florida state income tax treatment of bonus depreciation has been classified by DEF as "unprotected" as shown on Company Exhibit No. ___(MG-1), page 1, lines 27, 28, and 29.

Some of the other Florida utilities, such as FPL, are treating their similar EADIT related to these Florida state income tax impacts as "protected."

Q. WHAT RATIONALE DID DEF PROVIDE FOR TREATING THOSE FLORIDA AND STATE EADIT ITEMS ASSOCIATED WITH PP&E AS "UNPROTECTED"?

A. DEF's rationale, which was explained during the October 3, 2018 onsite meeting in St. Petersburg, FL, was that the federal income tax normalization requirements only apply to federal income taxes. Florida state income tax impacts, including the Florida state income tax treatment of bonus depreciation (which is different than the federal bonus tax depreciation) as well as the method/life difference impact on Florida state income taxes (i.e., the "state offset") relate to state income taxes, not to federal income taxes, and thus the related EADIT for those items is not subject to federal income tax normalization requirements.

III. 2018 INCOME TAX SAVINGS IN BASE RATES RELATED TO THE REDUCTION IN THE FEDERAL INCOME TAX RATE TO 21 PERCENT.

Q. HOW MUCH 2018 INCOME TAX SAVINGS FROM BASE RATES HAS THE COMPANY IDENTIFIED?

A. Company witness Olivier's Direct Testimony at page 5, and her Exhibit No. __ (MJO-1) page 1, identify $134.060 million of income tax savings. DEF shows that $50 million of that was applied to the accelerated depreciation of Crystal River Coal Units 4 and 5 ("CR4&5") pursuant to Paragraph 16b of the DEF 2017 Settlement. As shown on Exhibit No. __ (MJO-1) page 1, line 55, and on page 3, line 15, an amount of $84.060 million of tax savings is available for flow back to customers.

Q. WHAT TREATMENT HAS THE COMPANY PROPOSED FOR THE 2018 BASE RATE INCOME TAX SAVINGS?

A. As described by Company witness Olivier at page 5 of her Direct Testimony:

> Adding the pretax effect of $84.1 million annual Tax Savings to the pretax effect of $66.9 million estimated amortization of the Excess ADIT regulatory liability results in a total estimated flow back of $150.9 million. Pursuant to the Implementation Stipulation, DEF will offset this total amount by recording a monthly storm reserve accrual beginning in January 2018 for one-twelfth of $150.9 million, or $12.6 million, until DEF has fully recovered the final storm recovery amount to be approved by the Commission in Docket No. 20170272. Also pursuant to the Implementation Stipulation, in the month following full recovery of the Commission-approved final storm recovery amount, DEF will cease recording the storm reserve accrual and will reduce base rates in the manner set forth in the 2017 Settlement by the final amount of flow-back approved by the commission in this proceeding. DEF will file tariff sheets for Staff's approval sixty days prior to that date.

Q. HOW DOES THE OPC PROPOSE TO APPLY THE TCJA SAVINGS FOR DEF'S BASE RATES?

A. Absent a different interpretation dictated by the Internal Revenue Service in a later pronouncement, I have no disagreement with DEF's proposed method of returning the total tax savings to DEF's customers.

IV. <u>DEF'S RIDERS AND SURCHARGES THAT ARE IMPACTED BY THE TCJA.</u>

Q. HAS DEF IDENTIFIED ITS RIDERS AND SURCHARGES THAT ARE IMPACTED BY THE TCJA?

A. Yes. The Company's response to OPC Interrogatory No. 22 listed the rider/surcharge filings that DEF will make in 2018. As clarified by DEF during the October 3, 2018 onsite discussions, the following rider/surcharge filings (i.e., all except the Fuel and

Capacity clause true-up and projection filings) have an investment component that is earning a return with income taxes:

- Nuclear Cost Recovery clause true-up and projection filings
- Environmental Cost Recovery clause true-up and projection filings
- Energy Conservation Cost Recovery clause true-up and projection filings
- Citrus Generation Base Rate Adjustment filing
- Actual Storm Cost Recovery filing
- Solar Base Rate Adjustment filing
- Asset Securitization Charge true-up filings

Q. HAS THE COMPANY INDICATED HOW THE TCJA IMPACT WILL BE ADDRESSED IN EACH OF THOSE RIDER/SURCHARGE FILINGS?

A. Yes. DEF's response to OPC Interrogatory No. 22 states the rate of return on rate base in every 2018 rider/surcharge filing will include a gross-up for income tax expense at the new combined statutory tax rate of 25.345 percent. DEF's response states further that: "Accumulated deferred income tax is a component of capital structure in the calculation of the rate of return on rate base." During the October 3, 2018 meeting, representatives for DEF clarified that all EADIT amortization would flow back to customers via base rates and would be accounted for in the Company's surveillance reports.

Q. DO YOU HAVE ANY CONCERNS REGARDING HOW TCJA IMPACTS ARE BEING ADDRESSED IN DEF'S 2018 RIDER/SURCHARGE FILINGS AT THIS TIME?

A. No. While I have not reviewed each of the DEF 2018 rider/surcharge filings for purposes of preparing this testimony, the explanations provided by the Company in its response to OPC Interrogatory No. 22 and the further clarifications obtained during the October 3, 2018 meeting, appear reasonable and do not raise any alarm bells or identify additional regulatory concerns regarding TCJA treatment in those DEF riders at this time. These amounts will be subject to true-up in the respective ongoing clause dockets.

V. <u>WHETHER A PRIVATE LETTER RULING ("PLR") SHOULD BE REQUIRED, AND ISSUES RELATED TO A PLR REQUEST.</u>

Q. DID THE COMPANY'S FILING CONTAIN A CLASSIFICATION OF EADIT RELATED TO COST-OF-REMOVAL?

A. Yes. As discussed above, DEF has treated the cost-of-removal component of EADIT as both “protected” and “unprotected” with the majority being treated as “protected”.

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 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 <u>not</u> 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 provided for under other sections of the Code are not subject to the normalization requirements associated with the Company'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 using specialized software, such as PowerPlan and PowerTax, and the proper application can require significant additional analytical work by the utility and the vendor. Since the comparison of book and tax depreciation involves complex calculations and utility book depreciation typically includes an element for negative net salvage, some jurisdictions (e.g., New York) have raised concerns about the cost of removal/negative net salvage component of book depreciation and the risks presented for potential normalization violations.

Q. HAVE THE FLORIDA UTILITIES REACHED DIFFERING INTERPRETATIONS OF WHETHER AND TO WHAT EXTENT THE EADIT RELATED TO COST OF REMOVAL IS "PROTECTED" OR "UNPROTECTED"?

A. Yes. For example, FPL appears to be taking a different position than Tampa Electric Company ("TECO") and Peoples' Gas System ("PGS") concerning the treatment of cost of removal/negative net salvage and has proposed to treat that item as "protected," pending receipt of additional guidance. DEF witness Gordon at pages 7-8 of his Direct Testimony explains DEF's classification and rationale, which appears to be different than FPL and also differs somewhat from TECO and PGS.

Q. SHOULD DEF SEEK A PRIVATE LETTER RULING FROM THE IRS REGARDING ITS CLASSIFICATION OF THE EXCESS ADIT RELATING TO COST OF REMOVAL/NEGATIVE NET SALVAGE AS "UNPROTECTED"?

A. Yes, I believe they should.

Q. IF DEF SEEKS A PRIVATE LETTER RULING AND THE IRS RULES THEREIN (OR IN ANOTHER PRIVATE LETTER RULING) THAT THE EADIT RELATING TO COST OF REMOVAL/NEGATIVE NET SALVAGE IS TO BE TREATED AS "PROTECTED," WHAT PROCESS SHOULD BE FOLLOWED FOR THE RECLASSIFICATION?

A. Pending clarification of the appropriate classification of EADIT for cost of removal/negative net salvage, DEF should amortize the related EADIT using the ARAM if the classification ruled by the IRS indicates this is "protected."

VI. 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 annual revenue requirement reduction and 2018 EADIT amortizations related to the TCJA.

Q. ARE YOU RECOMMENDING ANY DIFFERENT AMORTIZATION PERIODS FOR DEF'S EADIT?

A. No. I agree with DEF that the amortization of "protected" EADIT should use the ARAM and that a ten-year straight-line amortization should apply to DEF's "unprotected" EADIT. As noted above in my testimony, and in DEF's Direct Testimony, the application of a ten-year straight-line amortization to DEF's "unprotected" EADIT appears to be consistent with the 2017 Settlement. The application of the ARAM to "protected" EADIT is required by the TCJA.

Q. SHOULD DEF BE REQUIRED TO OBTAIN A PRIVATE LETTER RULING CONCERNING SOME OF ITS INTERPRETATIONS OF WHETHER CERTAIN COMPONENTS OF EADIT ARE "PROTECTED" OR "UNPROTECTED"?

A. Yes. As described in my testimony, DEF has reached interpretations that differ from some of the other Florida utilities concerning whether certain components of EADIT should be classified as "protected" or "unprotected." Moreover, DEF has offered an interpretation of the use of "net salvage" as the basis for its position, as described in the Company's responses to OPC Interrogatory Nos. 29 and 30, which appears to have merit, and which, if endorsed by the IRS in response to a DEF-submitted PLR request, could help provide useful guidance and clarity on the cost-of-removal/negative net salvage related EADIT. Thus, there could be benefit in having DEF submit its interpretations to the IRS in a PLR.

Q. DOES THIS COMPLETE YOUR PREFILED TESTIMONY?

A. Yes, it does.

MS. DuVAL: Moving on to exhibits, staff has compiled a stipulated comprehensive exhibit list, which includes the prefiled exhibits attached to the witnesses' 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 exhibits should be marked as set forth in this list.

CHAIRMAN GRAHAM: Okay. Let's start moving some of these exhibits into the record.

MS. DuVAL: At this time, staff requests that the comprehensive exhibit list, marked as Exhib- -- as Exhibit No. 1, be entered into the record.

CHAIRMAN GRAHAM: Seeing no objections, we'll enter Exhibit No. 1 into the record.

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

MS. DuVAL: And at this time, staff would move Exhibits 2 through 18 into the record as set forth in the comprehensive exhibit list.

CHAIRMAN GRAHAM: Is there any objections to entering 2 through 18 into the record? Seeing none, we'll enter those into the record as well.

(Whereupon, Exhibit Nos. 2 through 18 were marked for identification and admitted into the record.)

CHAIRMAN GRAHAM: Okay. Each party will be given five minutes to speak of the stipulation. We'll start with Duke.

MR. BERNIER: Thank you, Mr. Chairman. I won't take up all five minutes.

We are appreciative for intervenors and staff for working with us to get to what we think is a good resolution to this docket, and we ask the Commission to approve it. We're here to answer any questions, if you have any.

Thank you.

CHAIRMAN GRAHAM: OPC?

MR. REHWINKEL: Thank you, Mr. Chairman. I have a bit-longer remarks, but certainly not five minutes.

We support the stipulation and the resolution as being in the public interest. I want to thank your staff for working to facilitate the resolution of this matter through this stipulation, but also want to give a special thanks to Duke Energy Florida.

We're here today because Duke, in 2017, entered into a stipulation that was forwardlooking, and it agreed -- in it, they agreed to make a full pass-through of the tax savings, were there to be what became the Tax Cuts and Jobs Act of 2017.

They further entered into an implementation stipulation in January of 2018 where they agreed -- I think it was subsequently amended by an amendment -- but in 2018, they agreed not only to pass the tax savings through, but we agreed that we would -- the parties -- the customers agreed with Duke that we would use the tax savings to pay for the cost of Hurricane Irma and for -- once those costs had been paid, the next month, Duke's customers' rates would be permanently reduced. And that's reflected in the implementation stipulation as well as the stipulations that are included in what's before you today.

This simple stipulation belies a lot of hard work that was put into this matter by both Duke and the Public Counsel and our expert witness. Duke was very cooperative and sat down and answered all of our questions and facilitated this resolution by their open and transparent responsibility in making sure that a hundred percent of the tax savings were passed through to the customers in ways that the customers agreed to.

So, you have essentially $200 million of tax savings, $50 million of an early retirement-cost write-off, and $150 million to go to pay for the Irma storm, and then, once that storm is paid off, rates to be reduced.

So, once again, I just want to say that this is the right way to do it. Like Gulf Power and Tampa Electric Company, Duke has stepped up and is doing the right thing for the customers. And we appreciate it.

In the end, this agreement and this resolution is fully in the public interest, and we urge your adoption. Thank you.

CHAIRMAN GRAHAM: FIPUG?

MR. MOYLE: Thank you, Mr. Chairman. And, again, Jon Moyle on behalf of FIPUG. And it's a privilege to appear before you today, again, to talk about -- about tax reform. We have had this conversation a couple of times -- more than a couple of times since the United States Congress, in 2017, passed the tax reform act.

And I want to thank not only the parties and staff for their efforts, but recognize you -- you all opened dockets to deal with these tax issues.

We -- we're in a docket dealing with this tax issue today. You've opened them for a number of utilities.

And today, before you, is a conclusion that FIPUG supports and asks you to move forward with because it does the things that FIPUG has said are important. And No. 1 is it returns the tax savings -- it flows back the tax savings to the ratepayers, which we think is, first and foremost, what needs to be -- to be done.

And just -- as you all know, but I think the context helps -- I mean, the tax rate went from 35 percent to 21 percent. When you all set rates, you did it on the basis of a 35-percent rate. And the ratepayers -- that's a pass-through. It's a simple pass-through, whatever the tax rate is. My clients and others pay those rates.

Well, when Congress took it from 35 percent to 21 percent -- that's a significant reduction, and it's not fair for utilities to hang on to that money. And today, you're approving the flow-back of those dollars so the ratepayers will have additional monies in their -- in their pocket with a known time as to when that will happen and a known amount.

Now, there -- yes, there is going to be a retirement of hurricane, but that was something that made sense. Rather than to increase a hurricane charge and -- and flow the tax dollars back, we entered into discussions and struck a positive deal that makes sense.

But you know, the bottom line that FIPUG has -- has underscored and continues to suggest is the right way to handle these things is to get the tax money and the savings back to the ratepayers in a transparent way so you know when it's going to happen, how much it's going to be, and as soon as -- as soon as possible. And we appreciate Duke's efforts to do that.

We hope that you will adopt this stipulation, which will have the effect of, again, returning tax dollars to the ratepayers in a transparent and predictable way.

So, thank you. And I'm happy to answer any questions you might have.

CHAIRMAN GRAHAM: Retail Federation.

MR. WRIGHT: Thank you, Mr. Chairman. On behalf of the Retail Federation, thank you very much for the opportunity to address you.

I want to start by thanking Duke, in

particular, and Public Counsel and their witness, Mr. Smith, for taking the laboring war on the -- the deep analysis that was involved here.

Although we are not a direct signatory to the stipulation, we, the Retail Federation, and I, personally, were directly involved, personally, here and in St. Petersburg, and through the -- through the cyber space in negotiating these stipulations. And we fully support them.

I concur strongly with -- with the comments of all my colleagues here, Mr. Bernier, Mr. Rehwinkel, and Mr. Moyle, that this is a good deal for customers. It flows tax savings back to customers at the rate of $150 million per year directly, in a meaningful way, and another $50 million a year, writing off long-term coal-plant investment that will also benefit customers in the long run.

So, it gets -- as Mr. Moyle said, it gets money back to the customers promptly and transparently, which is a good thing for customers, and good public policy.

Thanks to the staff and thanks to you for making this happen so promptly. And we urge you to approve the stipulations. Thank you.

CHAIRMAN GRAHAM: Thank you, all. I --

MR. REHWINKEL: Mr. Chairman, can I say one thing? On behalf of Mr. Brew and PCS, I stated, and -- and Ms. Duval correctly noted, that they didn't take a position on the stipulation, but PCS supports the adoption of the stipulation as a resolution of this docket.

Thank you.

CHAIRMAN GRAHAM: Okay. I want to thank all of you for not taking your entire five minutes, but I did notice nobody thanked their prehearing officer. Did she not do a fantastic job? Was she an obstructionist? I mean, come on. Let's hear some dialogue.

MR. BERNIER: I'd like to amend my opening --

(Laughter.)

MR. REHWINKEL: I can say, in -- that the prehearing officer worked -- the staff worked with the prehearing officer to make this a possibility. And we appreciate it because it -- it obviated the need for the company to file responsive testimony and for us to just go and get this resolved here. So, we do appreciate it.

Thank you.

CHAIRMAN GRAHAM: Staff, any questions?

MS. DuVAL: We have no questions. Thank you.

CHAIRMAN GRAHAM: Commissioners, any questions? I already asked my question.

Okay. Staff, what now?

MS. DuVAL: If the Commission decides that a bench decision is appropriate, staff recommends that the proposed stipulations, as presented in Exhibit A of the November 2nd, 2018, joint motion, which addresses all of the issues, 1 through 11, be approved by the Commission.

CHAIRMAN GRAHAM: Okay. Commissioners?

Commissioner Brown.

COMMISSIONER BROWN: Well, I think the parties here today said it very eloquently about all of the benefits that are flowing back to customers. And I appreciate the parties doing it in a transparent and as soon as -- expedient way. Although I would have liked to have seen it done a little bit earlier, I'm glad that it's here before us today.

And with that, I would move approval of the stipulation as presented.

COMMISSIONER CLARK: Second, Mr. Chairman.

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 the motion.

Staff, any other matters?

MS. DuVAL: Since the Commission has made a bench decision, post-hearing filings are not necessary and have actually already been waived. And the final order will be issued by January 28th of 2019.

CHAIRMAN GRAHAM: Is there any other things that need to be addressed, spoke of, talked about?

I do thank you all for your patience today. I know that the agenda conference went a little long, but those things happen.

That all being said, thank you very much for your time and effort, and please travel safe.

MR. BERNIER: Thank you.

CHAIRMAN GRAHAM: We're adjourned.

MR. REHWINKEL: Thank you.

MR. MOYLE: Thanks.

(Whereupon, proceedings concluded at 12:12 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 16th day of January, 2019.

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