Liberty Utilities (Granite State Electric) Corp. d/b/a Liberty Utilities

Investigation to Determine Rate Effects of Federal and State Corporate Tax Reductions

Docket No. DE 18-050

Technical Statement of Steven E. Mullen

Purpose

This Technical Statement describes Liberty Utilities (Granite State Electric) Corp.'s ("Liberty") proposal to address the impacts of Tax Reform per the Commission's Order No. 26,096. In that order, the Commission directed utilities to determine a) the estimated reduction to federal and state income taxes due to reductions in federal and New Hampshire tax rates, and b) the excess deferred tax reserve caused by the reduction in tax rates.

Impact of Tax Reform/New Hampshire Tax Rate Changes

The calculated annual rate impact resulting from the reduction in tax rates totals $1,443,313 and is comprised of two pieces:

- The annualized change in the gross-up for the $3,750,000 permanent distribution rate increase that took effect on July 1, 2017 ($1,256,082) – See Attachment 2, line 15
- The annualized change in the gross-up for the step increase to distribution rates that also took effect on July 1, 2017 ($187,231) – See Attachment 2, line 31

The $1,256,082 impact associated with the July 1, 2017, permanent rate change was determined using Federal Energy Regulatory Commission ("FERC") methodology set forth in FERC's Order No. 475 (July 2, 1987), which was issued following the last major change to tax rates that resulted from the Tax Reform Act of 1986. However, since the $3.75 million permanent increase to distribution revenues approved in Docket No. DE 16-383 was a settled number without supporting schedules, the income tax expense implicit in that revenue shortfall is not explicitly stated. Thus, to perform the calculation, the estimated amount of income tax expense had to be derived using an extrapolation between amounts contained in the Company's pre-settlement rebuttal position and the Staff's pre-settlement testimony. Details of the calculation are included in Part 1 of Attachment 2, lines 1 - 20. Those calculations resulted in an estimated income tax expense of $2,959,555 being implicit in the revenue requirement associated with the $3.75 million revenue increase. Using the FERC methodology and applying the reduced tax rates effective beginning in 2018, the annual reduction to income tax expense, and therefore revenue, is $1,256,082.

With respect to the $2,473,723 step increase that took effect on July 1, 2017,[1] the calculation of that increase included a return calculated at a pre-tax rate of return (i.e., the return amount included income taxes). Recalculating the pre-tax rate of return at the lower tax rates results in a

[1] See Attachment 1 to the DE 16-383 Settlement Agreement.

reduction of $187,231 from the originally calculated return of $1,520,934. (See Attachment 2, Part 2, lines 23-31)[2]

Excess Accumulated Deferred Income Taxes

The Company has determined that its ADIT balance as of December 31, 2017, (the last date before the tax rate changes took effect) has decreased by approximately $3.9 million. In accordance with Tax Cuts and Jobs Act, that balance will be returned to customers, using the Average Rate Assumption Method, over the average remaining life of the underlying assets. See below for the proposed disposition of the $3.9 million.

Proposal

As stated above, the total of the two annualized reductions to income taxes is $1,443,313. In Order No. 26,096, the Commission directed that the reduction to income taxes "shall be entered as a deferred liability until final rates are established for the utility in a general rate case, or until otherwise ordered by the Commission." Considering that Liberty had other changes scheduled to take effect on May 1, 2018, through the operation of settlement agreements in prior dockets, rather than increase distribution rates now only to later reflect the reduction to income taxes in a rate case, Liberty proposes to partially offset the $1,443,748 by the following increases to distribution rates that otherwise would have taken effect:[3]

Docket No. DE 16-383, Distribution Rate Case (see March 16, 2018, filing in that docket)

- Recovery of revenue requirement associated with certain 2017 capital additions as allowed as a step adjustment per the DE 16-383 settlement agreement (increase of $289,348)[4] (See Attachment 2, Part 3, lines 38-40)
- Recovery of additional rate case expenses ($48,039 total to be recovered, annualized = $82,353) (See Attachment 2, Part 3, lines 42-43)

Docket No. DE 18-034, Reliability Enhancement Program/Vegetation Management Program (see March 16, 2018, filing in that docket)

- Recovery of the operation and maintenance expenses incurred for vegetation management activities conducted during calendar year 2017 (increase of $552,414) (See Attachment 2, Part 4, line 48)

---

[2] No changes to the deferred tax amounts included in the step adjustment calculation were made as part of this calculation to avoid a double-counting because the deferred income taxes were included in the December 31, 2017, balance of accumulated deferred income taxes used to calculate the $3.9 million of excess deferred income taxes described in the next section of this Technical Statement.

[3] The distribution rate changes were to have taken effect on May 1, 2018, but Liberty requested a delay of the effective date of the rate changes to June 1, 2018, to allow for simultaneous consideration of the impact of the reductions to federal and state tax rates.

[4] Similar to footnote 2, no changes to the deferred tax amounts were included because the deferred taxes would have been included in the December 31, 2017, balances.

- Recovery of the revenue requirement associated with capital investments made in 2017 in in accordance with Liberty's Reliability Enhancement Program/Vegetation Management Program ("REP/"VMP") (increase of $76,833)[5] (See Attachment 2, Part 4, lines 50-52)

Further information regarding the above amounts can be found on Attachment 2 to this Technical Statement. After taking those annualized amounts into account, a net reduction to income tax expenses of $442,365 remains. Liberty further proposes to reduce annual distribution revenues by that amount to reflect a net reduction to all distribution rates and charges of 1.06% ($442,365/$41,837,737[6]) effective June 1, 2018. (See Attachment 1).

Regarding the Excess Accumulated Deferred Income Taxes, the $3.9 million has been recorded as a regulatory liability and will remain as a reduction to rate base, consistent with the treatment of ADIT liabilities. The Company proposes that the treatment of this regulatory liability be deferred until the Company's next rate case which, consistent with the Settlement Agreement in its most recent distribution rate case, Docket No. DE 16-383, is required to have a test year of calendar year 2018. Liberty plans to file that case in late April 2019. As calendar year 2018 is also the initial year for the full impact of the lower tax rates to be in effect, having a full test year with the effect of the lower tax rates will provide a meaningful and appropriate opportunity to gauge the full impact of all changes of tax reform. For instance, the ability to take advantage of bonus depreciation for tax purposes has ceased. In addition, as deferred income taxes are part of the rate base calculation, it would be more appropriate and consistent to examine the impact to rate base related to deferred income taxes at the same time as other changes to rate base rather than only adjusting one component of the rate base calculation.

[5] Similar to footnote 2, no changes to the deferred tax amounts were included because the deferred taxes would have been included in the December 31, 2017, balances.

[6] $41,837,737 is the annual base distribution revenues using existing rates and forecasted billing determinants consistent with the methodology used in the REP/VMP filing. (See DE 18-034, Schedule DBS-2, page 2 of 4 (Bates 066), line 2.)