STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Docket No. DG 17-048

Liberty Utilities (EnergyNorth Natural Gas) Corp. d/b/a Liberty Utilities
Distribution Service Rate Case

TESTIMONY

OF

STEVEN E. MULLEN

August 9, 2018

THIS PAGE INTENTIONALLY LEFT BLANK

ATTACHMENTS

Attachment	Title
Attachment SEM-1	Schedules Demonstrating Updated Calculation of the Benefits of Reduced Federal and State Corporate Tax Rates

THIS PAGE INTENTIONALLY LEFT BLANK

I. INTRODUCTION AND BACKGROUND

Q. Please state your name and business address.

A. My name is Steven E. Mullen. My business address is 15 Buttrick Road, Londonderry, New Hampshire.

Q. By whom are you employed and in what capacity?

A. I am employed by Liberty Utilities Service Corp. ("Liberty") as Director, Rates and Regulatory Affairs. I am responsible for rates and regulatory affairs for Liberty Utilities (EnergyNorth Natural Gas) Corp. ("EnergyNorth" or "the Company") and for Liberty Utilities (Granite State Electric) Corp. ("Granite State").

Q. On whose behalf are you testifying today?

A. I am testifying on behalf of EnergyNorth.

Q. What is the purpose of your testimony?

A. My testimony responds to the July 31, 2018, secretarial letter issued in Docket Nos. DG 17-048 and IR 18-001 establishing a filing date of August 9, 2018, to submit a refined calculation of the impacts of reduced federal and state corporate tax rates. The revised calculation is necessary because the amount that was used in the Commission's Order No. 26,122 in DG 17-048 (April 27, 2018) was, for a number of reasons, agreed to be a placeholder amount that would be subject to later recalculation.

Q. What was the placeholder amount that was included in Order No. 26,122?

A. The amount used to represent the benefits of reduced federal and state corporate tax rates was $2,394,065.

Q. How was that amount determined?

A. The $2,394,065 originated in a Settlement Agreement between EnergyNorth and the Office of the Consumer Advocate ("OCA") (the "Liberty/OCA Settlement"). That amount consisted of two components:

- $1,694,407 related to the difference in the tax gross-up on the $10.3 million distribution revenue increase that was part of the Liberty/OCA Settlement; and
- $699,657 representing the annual amortization of the $27.3 million net amount of excess deferred income taxes ("DIT") amortized over 39.05 years.

The calculation of the $2,394,065 is provided in Attachment SEM-1, page 1 of 3, Section 1, column A. Section II of my testimony addresses the topic of excess DIT, and further refinements to the $2.4 million placeholder amount are discussed in Section III.

II. <u>EXCESS DEFERRED INCOME TAXES</u>

Q. What is meant by excess DIT?

A. Excess DIT is simply the difference between the accumulated deferred income taxes on the books, that were recorded at higher tax rates, and the amount of accumulated deferred income taxes recalculated at the lower tax rates remeasured on the effective date of the change in the federal income tax rate from 35% to 21%.

Q. Is the Company proposing different treatment of the $699,957 annual amortization of the excess DIT at this time?

A. Yes. EnergyNorth is proposing that the annual amortization of the excess DIT cease at this time. Liberty Utilities is currently undertaking a company-wide study of all its regulated utilities in the United States, using the services of PricewaterhouseCoopers, to determine whether its utilities have sufficient plant asset vintage information to be able to use the Average Rate Assumption Method ("ARAM") for the purpose of calculating the flow-back of excess DIT to customers. As part of that study, one utility in each of Liberty Utilities' West, Central, and East regions will be fully examined, with EnergyNorth being the utility in the East region. If EnergyNorth is determined to possess sufficient vintage data that would allow it to use the ARAM, then the flow-back to customers of the benefits of reduced corporate tax rates would occur over the same time that the book and tax timing differences would normally reverse.

Q. Is the use of ARAM optional?

A. No. In accordance with the tax reform law, public utilities that have sufficient vintage data are required to use ARAM. There is an alternative method available, referred to as the Reverse South Georgia Method, but that method is to be used only for those utilities who do not have a sufficient level of vintage account data that would allow them to use ARAM. The Reverse South Georgia Method cannot be used to determine the flow-back of the excess DIT if a utility has the records to calculate these amounts under ARAM. Both ARAM and the Reverse South Georgia Method would return the benefit of the excess DIT to customers over the remaining life of the underlying assets, but using the

Reverse South Georgia Method the benefit would be returned in a straight-line manner beginning immediately, whereas using ARAM the return of the benefit does not occur until the book/tax differences begin to reverse (when annual book depreciation exceeds tax depreciation).

Q. Is there a potential consequence of using a method other than ARAM if a utility has sufficient vintage data?

A. Yes. If a utility qualifies to use the ARAM but the excess DIT are used to reduce customer rates more rapidly than would otherwise occur using ARAM, then it would be considered to be a violation of the normalization rules. In such a situation,

- (i) the utility's tax for the taxable year is increased by the amount by which the utility reduced its excess tax reserve more rapidly than permitted; and
- (ii) the utility will be unable to claim accelerated depreciation for income tax purposes.

A normalization violation could also occur if the excess DIT is used to reduce rates more rapidly than would occur under either the ARAM or Reverse South Georgia approaches.

Q. Taking all of that into account, what does that mean with respect to the flow-back to customers of the benefits associated with the excess DIT for EnergyNorth?

A. The above discussion illustrates that it is very important to take a careful approach to ensure that the proper method of flow-back is used to avoid any potential unintended consequences, such as a normalization violation.

Q. What method was used to determine the $699,657?

A. That amount was determined using the Reverse South Georgia Method. At the time of entering into the Liberty/OCA Settlement, the Company's intention was to provide significant and immediate tax benefits to its customers, consistent with the directive in the Commission's Order No. 26,096 (January 3, 2018) in Docket No. IR 18-001 which stated, in part,

> Each utility shall file a proposal with the Commission no later than April 1, 2018, to address the effects of the changes in tax laws, including financial information that is sufficient to establish a revenue requirement that reflects prospectively the impacts of those changes. The filing shall include a calculation of any deferred liability accrued by report date and any liability projected to be accrued until the time when final rates are next issued in accordance with a general rate case. It shall also include a plan for providing periodic reports on the accrual and extinguishment of the deferred liability, including an outline of the financial information the utility would expect to file that would be sufficient to establish a revenue requirement that reflects the impact of the tax law changes.
>
> *Several utilities have rate cases being investigated by the Commission. Those utilities shall consider whether a rate reduction associated with the reduced tax obligations of the 2017 Tax Act, BET, and BPT, can be effected within the schedule for those rate cases and shall also comply with the filing requirements described herein*. (emphasis added)

At the time of that Order, the EnergyNorth rate case schedule included hearings at the end of February 2018. Thus, there was an effort to incorporate tax benefits to customers within the schedule for the rate case, which was on a quicker time frame than otherwise would have been involved with an April 1, 2018, proposal deadline if a rate case had not been underway. Now having had additional time to consider the various implications of the reduced corporate tax rates and the requirements with respect to ARAM, it is important that the flow-back of benefits related to the excess DIT be reassessed, and any post-May 1, 2018, amortization entries on the Company's books be reversed until such time as the ARAM study can be completed. Once that study is completed, EnergyNorth will be in a better position to know whether it is required to use the ARAM, or whether the Reverse South Georgia Method would be allowable.

Q. How long is the ARAM study expected to take, and what is involved in performing the study?

A. The study is expected to be a several-months process and will be very data and time intensive. As part of the study, the data for individual assets will need to be collected and analyzed.

Q. Given that time frame, what is the Company's proposal for dealing with the flow-back of the excess DIT in the future?

A. The current plan is for EnergyNorth to file its next rate case using a 2019 test year. EnergyNorth proposes, similar to what was approved for Granite State Electric and at least one other New Hampshire utility,[1] that the treatment of the excess DIT be deferred for consideration until that next rate case. In the interim, the full amount of excess DIT would remain as a reduction to rate base, so customers would not lose any of the related benefit.

[1] See DE 18-050 for Granite State Electric and DE 18-036 for Unitil Energy Systems, Inc.

III. FURTHER REFINEMENTS TO THE $2.4M PLACEHOLDER AMOUNT

Q. What other calculation refinements/additions are included in this filing?

A. In addition to the change related to excess DIT described above, there are five other components to the calculations included in my testimony, with details supporting those calculations provided in Attachment SEM-1:

- Update the state tax rate used in the original calculation. The 2017 rate of 8.2% was used in the original calculation and this adjustment updates the state tax rate to the 2018 rate of 7.9%. This results in an increase to the total amount by $28,084. (Attachment SEM-1, page 1, Section 1, column B, line 13)

- Revise the $10.3M distribution revenue increase downward to the $8,460,508 revenue increase allowed by the Commission. Note that this amount is prior to the revenue requirement reduction of $400,391 related to the iNATGAS investment because the taxes included in that amount were calculated separately (see next bullet). Calculating the impact on the reduced allowed revenue increase results in a decrease to the $2.4 placeholder amount of $307,622. (Attachment SEM-1, page 1, Section 1, column C, line 13)

- Recalculate the tax impact of the iNATGAS revenue requirement reduction to reflect the lower tax rates. The Commission's order calculated the reduction at the old tax rates, and, thus, the Commission's adjustment was overstated. This adjustment reduces the $2.4M amount by $36,111.[2] (Attachment SEM-1, page 2, line 44.1)

- Restate the test year income tax expense (calculated at the old tax rates) at the new, lower tax rates. The income tax expense included in the schedules attached to the Commission's order was $3,080,238. Restated, the lower tax expense is $1,773,126, representing an annual reduction to tax expense of $1,307,112, which is an increase to the $2.4M placeholder amount. (Attachment SEM-1, page 1, Section 2, line 21)

- Using the restated $1,307,112 annual reduction to tax expense, calculate the one-time impact of the tax benefit for the period of January 1 through April 30, 2018, the time prior to the May 1, 2018, change in rates. $1,307,112 x 4/12 = $435,704, which represents another increase to the tax benefits, although this is a one-time

[2] In the course of preparing Attachment SEM-1, page 2, it was discovered that the underlying formula in the "Actual" column, line 16 of the Order's Appendix 2 contained an error in that the cost of land was included in the calculation of book depreciation. That correction is included in Attachment SEM-1, page 2 and amounts to $6,052 of the total $36,111.

amount and not an annual amount. (Attachment SEM-1, page 1, Section 3, line 32)

Q. Regarding the second bullet above, did the Commission approve the Liberty/OCA Settlement and the $10.3 million distribution revenue increase that was used to determine a portion of the $2.4 million placeholder amount?

A. No. The Commission rejected the Liberty/OCA Settlement and approved a distribution revenue increase of $8,406,508, which was then subject to a further adjustment of $400,391 related to the Company's investment in the iNATGAS compressed natural gas facility, bringing the final amount of the annual distribution revenue increase to $8,060,117 million. Thus, the amount of the difference related to the tax-gross-up needed to be reduced to reflect the lower approved distribution revenue increase. As the iNATGAS revenue requirement adjustment was the result of separate calculations by the Commission, that adjustment was similarly handled separately for the purpose of my testimony.

Q. Please describe the refinements made to the calculation of the iNATGAS adjustment as detailed in Attachment SEM-1, page 2

A. Attachment SEM-1, page 2 replicates Appendix 2 to Order No. 26,122 and uses the same embedded formulas and line numbers for ease of reference and comparison. The changes made to what was the Order's Appendix 2 to reflect the lower corporate tax rate appear in the effective tax rate shown on line 20 and in the pre-tax rate of return shown on line 33. In addition, the correction noted in footnote 2 of this testimony has been included in the schedule. The impact of those changes resulted in a recalculated revenue requirement reduction of $364,280, as compared to the $400,391 calculated at the old tax rates, or a decrease of $36,111 (SEM-2, page 2, line 44.1) to the revenue requirement adjustment reflected in Order No. 26,122.

Q. Do you have any comments regarding the first, fourth, and fifth bullets listed above?

A. Those items should be fairly self-explanatory with the description of each bulleted item providing the necessary detail.

Q. What is provided on page 3 of Attachment SEM-1?

A. Page 3 contains calculations and comparisons of the effective tax rates/factors using old and new tax rates to aid in review of the other calculations.

Q. Please summarize the results of the various refinements and additions made to the calculation of the $2.4 million placeholder amount.

A. A summary of those results is shown in Section 3 on page 1 of Attachment SEM-1. As shown on lines 30–31, the net result of all the adjustments is recalculated annual tax benefit of $2,685,870, or an increase of $291,806 as compared to the $2,394,065 included in Order No, 26,122. In addition, there is a one-time tax benefit of $435,704 for the period of January 1 through April 30, 2018, as shown on line 32.

IV. PROPOSED TREATMENT OF THE TAX BENEFITS

Q. Has the Commission previously prescribed exactly how the benefits of reduced federal and state corporate tax rates should be provided to customers in all instances?

A. Generally speaking, the answer is "no." Although the Commission has issued rulings with respect to other New Hampshire utilities, its Order in IR 18-001 requested only the filing of a "proposal." During the DG 17-048 rate case hearing, the Chairman stated the following:

> CHAIRMAN HONIGBERG: No, but, you know, utilities are not just treating this as a pass-through. In most instances, they're identifying other things that can be done with money that comes into their hands that would be good and valuable things.
>
> And we heard from a different utility regarding their vegetation management. And one of the reasons why a rate increase isn't required is accounting for the changes in the tax laws. They're going to say, "well, we're going to have some more revenue. And, so, rather than return it, we're going to just apply that to the vegetation management." That was their proposal.
>
> I will -- I expect other utilities to make similar proposals. Returning some money to ratepayers and not returning other monies to ratepayers.[3]

Q. Recognizing that the $2.4 million amount was a placeholder, did the Commission provide any guidance with respect to how any adjustment to that amount should be treated?

A. Yes. On page 55 of Order No. 26,122, the Commission directed that "any adjustment to [the $2,394,065] be made through the LDAC."[4]

[3] DG 17-048, Hearing Day 3, Transcript at 14 – 15.
[4] "LDAC" stands for "Local Delivery Adjustment Charge."

Q. As the $2.4 million was an annual amount, does the Company interpret that language as applying only to any changes to the annual amount, or would it also apply to any one-time amounts ?

A. The language could really be interpreted either way. Certainly, with respect to changes to the annual amount of tax benefits, in this case the incremental $291,806,the answer is clear. Regarding the one-time amount of $435,704, the Chairman's statements during the hearing leave the disposition of that amount open to other opportunities.

Q. Given all of that, what is the Company's proposal?

A. Consistent with the Commission's order, the Company proposes to include the incremental annual tax benefit of $291,806 as a credit to customers and flowed back through the LDAC over the remainder of the original 20-month recoupment period which ends on December 31, 2019, and which as of September 1, 2018, would have 16 months remaining. Regarding the $435,704 one-time amount, the Company proposes a two-pronged disposition. First, the Company proposes to use $210,208 to recover an amount that has been on its books since 2016, representing the costs of an audit conducted by the Liberty Consulting Group. This deferred debit was not addressed as part of the DG 17-048 rate case. The Company proposes to include the remaining $225,496 as a credit through the LDAC through December 31, 2019.

Q. Have you included any bill impact information with this filing?

A. No. The main reason is that the topic of recoupment is still open in DG 17-048, and the Company expects that rate impacts of that issue, which also implicate the LDAC, will be dealt with at the same time as the rate impact of this filing.

Q. Does this conclude your testimony?

A. Yes, it does.