Agenda Date: 8/29/18
Agenda Item: 2J

STATE OF NEW JERSEY
Board of Public Utilities
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ENERGY

IN THE MATTER OF THE NEW JERSEY BOARD OF PUBLIC UTILITIES' CONSIDERATION OF THE TAX CUTS AND JOBS ACT OF 2017	)	ORDER DOCKET NO. AX18010001
IN THE MATTER OF THE PETITION OF ATLANTIC CITY ELECTRIC COMPANY FOR APPROVAL OF THE TREATMENT OF TAX IMPACTS ASSOCIATED WITH IMPLEMENTATION OF TAX CUTS AND JOBS ACT OF 2017 AND TO DETERMINE THE APPROPRIATE LEVEL AND MECHANISM BY WHICH RATES MUST BE ADJUSTED TO REFLECT THE BENEFITS OF THE ACT	)	AND DOCKET NO. ER18030241

Parties of Record:

Philip J. Passanante, Esq., for Atlantic City Electric Company
Stefanie A. Brand, Esq., Director, New Jersey Division of Rate Counsel

BY THE BOARD:[1]

BACKGROUND

By Order[2] ("Generic TCJA Order") dated January 31, 2018, the New Jersey Board of Public Utilities ("Board" or "BPU") directed affected utilities[3] to file petitions proposing new rates reflecting the impacts from the Federal Tax Cuts and Jobs Act (the "2017 Act") signed into law on December 22, 2017. The effective date of the 2017 Act was January 1, 2018. The 2017 Act sets forth changes to the Federal Internal Revenue Tax Code ("Tax Code"), including a reduction in the maximum corporate tax rate from thirty-five percent (35%) to twenty-one percent (21%). The Board is charged with the authority to ensure that the regulated utilities' rates charged to ratepayers are just and reasonable. When the Board sets rates in base rate cases and in certain annual/periodic clauses, utilities are permitted to gross up their revenue requirement as well as set other rate

[1] Commissioner Robert M. Gordon did not participate.
[2] See In re the New Jersey Board of Public Utilities Consideration of the Tax Cuts and Jobs Act of 2017, BPU Docket No. AX18010001 (January 31, 2018).
[3] The affected utilities are investor owned gas, electric, water and wastewater companies under the jurisdiction of the Board. In addition, affected utilities shall be those with 2017 revenues equal to or greater than $4.5 million.

factors, including, the accumulated deferred income tax, based on the then existing thirty-five percent (35%) corporate tax rate.

The Board issued the Generic TCJA Order which set all affected utility rates as interim and established a proceeding to consider the implications of the 2017 Act. Based upon the Board's review of the 2017 Act, the Board found in its Generic TCJA Order that the changes to the Tax Code would provide savings to the affected utilities and would result in an over-collection of tax revenue by the affected utilities that would not be paid in federal income taxes. The affected utilities were required to file amended tariffs reflecting a reduction in rates resulting from the reduction in the corporate tax rate effective April 1, 2018, as well as a plan to address other rate factors and to refund any over collection in rates.

ACE FILING

On March 2, 2018, Atlantic City Electric Company ("ACE" or "Company") filed its petition pursuant to the Generic TCJA Order, including proposed tariffs, as well as a proposed plan. Specifically, ACE proposed the annual revenue requirement for the April 1, 2018 interim rate to be $13,274,596 (excluding New Jersey Sales and Use Tax ("SUT")) and $14,154,038 (including SUT). The interim rate-related revenue requirement included the federal income tax rate change impact on revenues during the twelve (12) months ending July 31, 2017 test period used in ACE's most recent base rate case filing. ACE proposed filing final rates effective July 1, 2018. The Company calculated that the annual revenue requirement for the July 1, 2018 final rate reduction to be $22,706,885 (excluding SUT) and $24,221,217 (including SUT).

The Company stated that its Tax Cuts and Jobs Acts ("TCJA") regulatory balance at June 30, 2018 was anticipated to be $6,155,946. The Company indicated that it has not included the Weighted Average Cost of Capital ("WACC") in its TCJA regulatory liability balance, since it was addressed in the Company's last rate base case and the additional WACC on excess accumulated deferred balances would represent a duplicative accrual. The Company proposed to address the over- collection as part of its next base rate case, which the Company anticipated filing in mid-2018. However, ACE proposed to amortize the TCJA regulatory liability over a twelve (12) month period as a sur-credit that would automatically end once provided to customers if the Board directed the Company to address the matter in this proceeding. ACE also proposed that any over-refunding of the TCJA regulatory liability be deferred as a regulatory asset that would receive rate base treatment. The excess federal accumulated deferred income tax balances would be included as an overall reduction in the Company's rate base on a prospective basis.

According to the petition, the estimated excess deferred balance for property-protected is $102.55 million. The Company proposed a flow back of excess property-protected in accordance with the average rate assumption method ("ARAM"). ACE asserted that the estimated deferred balance for property non-protected is $100.03 million. The flow back method implemented is the average remaining life (weighted average of distribution and general plant). The non-property unprotected estimated deferred balance is $16.32 million, according to the petition. The method ACE proposed to flow back the non-property unprotected balance is a ten (10) year amortization given underlying items' tax versus book unwind period.

The tax impact on annual petitions will mainly be on the interest for any over/under recovered balance. Concerning the Market Transition Charge, the tax impact will be addressed with any necessary customer reduction in the true-up calculation in ACE's next compliance filing scheduled for August 31, 2018.

A residential customer utilizing Basic Generation Service and using 716 kWh per month would receive a bill reduction of $1.38 or approximately 1.0% for the interim rates effective April 1, 2018. ACE calculated that a typical residential customer utilizing 716 kWh would receive a bill reduction of approximately $2.37 or approximately 1.72% as a result of the final July 1, 2018 rates, which is a $0.99 further reduction from the April 1, 2018 interim rate reduction.

The Generic TCJA Order set the deadline for the filing of motions to intervene or participate on February 20, 2018. No motions seeking to intervene or participate were filed in this proceeding prior to the expiration of the February 20, 2018 deadline.

By Order dated March 26, 2018, ("March 2018 Order") the Board directed the Company to implement its proposed base rate reduction on an interim basis, effective April 1, 2018. As a result of the March 26, 2018 Order, an average residential customer using 716 kWh received a reduction of $1.38 or approximately 1.0% on their monthly bill. The March 2018 Order also directed that ACE's plan be addressed in this proceeding.

On June 19, 2018, ACE submitted a letter requesting an extension of the procedural schedule through August 31, 2018, to allow for continued discussions for a possible settlement on all open issues. By Order dated June 22, 2018 ("June 2018 Order"), the Board directed that the procedural schedule[4] in this matter be extended to provide the parties with additional time to complete their review of the petition. The June 2018 Order further directed the parties to submit all necessary information to the Board to allow the Board to consider final rates no later than the Board's August 2018 public agenda meeting, or as soon thereafter as the Board deemed appropriate.

COMMENTS FILED

On August 3, 2018, the New Jersey Division of Rate Counsel ("Rate Counsel") filed initial comments with the Board pursuant to the Generic TCJA Order and the June 2018 Order. In its comments, Rate Counsel requested that the Board modify the proposed tariffs and ACE's proposed plan. Rate Counsel provided comments on four (4) areas of tax change consequences as delineated in ACE's TCJA filing: (1) the impact of the 2017 Act on ACE's revenue requirement; (2) the tariff design for implementation of the proposed rate reduction; (3) the refund of over-collected income taxes during the "stub" period; and (4) the impact of the 2017 Act on the Company's accumulated deferred income taxes ("ADIT"). (Rate Counsel Comments at 3).

With respect to the impact of the 2017 Act on ACE's revenue requirement, Rate Counsel stated that it finds ACE's calculated revenue requirement reduction of $14,154,038, including SUT, to be reasonable and acceptable. (Ibid.)

Similarly, with respect to tariff design, Rate Counsel takes no exception to ACE's proposed methodology for implementing the appropriate rate reduction arising from the Act. Rate Counsel indicated that the Company's proposed tariff design results in all customers sharing fairly and proportionally in the cost reducing benefits of the 2017 Act and preserves the relative class revenue and rate responsibilities that were established in ACE's last base rate case. (Ibid.)

[4] A procedural order was issued by the Board in the Generic TCJA on January 31, 2018.

Rate Counsel argued that the Company should refund the over collection during the "stub period" as expeditiously as possible, instead of deferring the refund until the next base rate proceeding. Rate Counsel asserted that the $6.16 million, including interest at the short-term debt rates, should be refunded through a one-time bill credit to customers. Rate Counsel maintained that there is no justification for ACE to continue to withhold the ratepayer funds until the next base rate proceeding. Rate Counsel further asserted that continuing to withhold the funds from customers only adds to ACE's ultimate refund obligation through the accrual of interest. Rate Counsel noted that the short-term debt interest rates do not fully and adequately compensate utility customers for their financing costs, which supports an immediate refund of the stub period over-collections. (Id. at 4).

Regarding, the impact of the 2017 Act on the Company's ADIT, Rate Counsel agrees that Excess Deferred Income Taxes ("EDITs") can be broken down into three categories: (1) property-related protected; (2) property-related unprotected; and (3) non-property, unprotected. With respect to property-related protected EDITs, normalization requirements apply to accelerated federal tax method and life depreciation tax/book timing differences which require that these EDITs be used to reduce revenue requirements and revenue no sooner than would occur as the book/tax differences reverse. The 2017 Act requires, in most instances, the property-related protected EDITs be returned to ratepayers using ARAM, whereby the utility identifies the deferred tax reversal pattern and reverse the EDIT beginning when book depreciation exceeds tax depreciation and the deferred tax turnaround occurs. Rate Counsel stated that it did not object to ACE amortizing its property-related protected EDITs using ARAM. (Id. at 4 to 5).

The second category of EDITs (property-related unprotected) relates to other property-related tax/book timing differences for which deferred taxes were previously provided but which do not reflect tax method or life depreciation differences and is not related to accelerated depreciation. Unlike property-protected related EDITs, the property-related unprotected EDITs are not subject to normalization and the ARAM flow-back method. For these EDITs, ACE proposed to flow-back the $100.03 million over the average remaining book life of its plant, or 32.26 years. (Id. at 5). The third category (non-property EDITs) relate to deferred taxes collected for tax/book timing differences that are not related to property. Typical examples include pensions, other post-employment benefits, and regulatory assets. Non-property EDITs are unprotected in that the 2017 Act did not impose a normalization requirement. ACE proposed to amortize is $16.32 million of non-property unprotected EDITs over a ten (10) year period. (Ibid.)

With respect to property-related unprotected and non-property unprotected EDITs, Rate Counsel asserted that the EDITs are ratepayers funds have been collected and held by ACE in order to pay taxes in the future, but due to the reduction in the corporate tax rate, the EDITs are no longer needed to pay taxes. Rate Counsel argued that ratepayers have become involuntary investors in ACE, but unlike other investors, ratepayers are not compensated with dividend payments. (Ibid.) Rate Counsel argued that the Board should require ACE to return EDITs more rapidly than what ACE proposed. With respect to all unprotected EDITs, Rate Counsel proposed a three (3) year amortization to bring rates more closely aligned with costs. (Ibid.)

Rate Counsel further argued that the Board should not be overly concerned with rate instability once the three-year amortization period has expired. While Rate Counsel stated that rate stability can be a valid short-term ratemaking consideration under various scenarios where ratepayer protection is needed to avoid adverse rate impacts, Rate Counsel maintained that ratepayers do not need to be protected from a refund they are due. Rate Counsel further argued that it is not reasonable to string out the EDIT refund for thirty-two (32) or even ten (10) years to protect ACE's customers from unstable rates. (Id. at 6). Rate Counsel noted that ACE's filing does not express concern about the impact of a shorter EDIT amortization on its cash flow and that Rate Counsel is unaware that ACE has been placed on a credit watch by any of the major rating agencies because of any impact of the TCJA. Rate Counsel acknowledged that the Company's cash flow may be affected by the accelerated refund period, but argued that the impact on ratepayers would be more severe. (Ibid.) Rate Counsel asserted that EDITs are no longer a cost to ACE, and should be promptly returned to ratepayers. Rate Counsel asserted that intergenerational equity requires a swift refund of the EDITs, so that customers who receive refunds, more closely match the customers that contributed to ACE's EDITs. (Ibid.)

On August 10, 2018, ACE submitted its reply comments. As an initial matter, ACE reiterated its current financial position prior to the implementation of the 2017 Act. Accordingly, ACE stated that it could not agree to Rate Counsel's proposals without causing its credit metrics to deteriorate and its earned rate return on equity ("ROE") to decrease further. (ACE Reply Comments at 2).

In ACE's comments, the Company notes that Rate Counsel and the Company are in agreement on the total annualized revenue requirement reduction of $14,154,038 (including SUT), the tariff design, and the use of ARAM on property-protected EDITs. (Id. at 2-3, 5-6).

The Company proposed that the refund obligation related to the over-collection of federal income taxes during the January 1, 2018 and March 31, 2018 "stub period" be carried on the books as a deferred liability and addressed in the Company's next base rate case. The Company argued that it has realized lower equity returns on its distribution business as compared to the authorized return set by the Board over each of the last five (5) years. The Company further asserted that sales have declined by 7.6% over the period 2012-2018, and is forecasted to decline by an additional 1.3% over 2019-2022 period due to the promotion of energy efficiency, overall economic conditions, and the continued practice of setting rates using almost exclusively historic cost data. (Id. at 4). The Company argued that it has long been the Board's approach to consider *all* of the costs of providing service. ACE submitted that the Board should consider that ACE continues to under-earn its authorized ROE and it is not fully recovering its costs to provide service. (Id. at 4). ACE noted that the Board has expressed concern about the Company's struggle to earn its authorized ROE, as evidenced by the currently ongoing Management Audit of ACE, which includes a focus on the Company's chronic under-earning. (Ibid.)

ACE stated that Rate Counsel simply ignores the Company's well-documented financial circumstances. ACE asserted that Rate Counsel's argument for not including the stub period refund in the next base rate case is misleading and focuses solely on a single cost item and excludes all other cost factors. The Company argued that its prolonged under-earning should be considered in the context of the TCJA liability and its ultimate ratemaking treatment. (Id. at 5).

With respect to EDITs, ACE argued that customers share in the benefits received from the federal government in that the rate base is reduced in the amount of the EDITs. Customers, therefore, benefit from EDITs because rates are set utilizing a reduced rate base number and rates are lowered due to the rate base reduction.

For the non-protected EDIT liability, ACE asserted that the liability is $116 million and customers' rates are reduced by approximately $12 million because rate base is lowered by the EDIT liability. The Company argued that if the EDIT is distributed to customers, the benefit of the non-protected EDIT balance will no longer exist and the $12 million lower revenue requirement should be eliminated. ACE pointed out that while Rate Counsel is proposing that customers continue to receive the reduction in rate base associated with the prior tax law while also receiving the flow back of the non-protected EDIT under the TCJA over three (3) years, without any mention of an increase to rate base. The Company argued that Rate Counsel's proposal would result in a double counting of benefits to customers, which ACE claimed will require ACE to file more frequent rate cases in order to eliminate the double count of benefits to customers. (Id. at 6-7).

ACE further claimed that Rate Counsel's proposal will weaken the Company's credit metrics, and will require the Company to issue more long-term debt than previously planned to cover the accelerated flow back. The Company also argued that Rate Counsel's proposal will create a benefit for customers in years one (1) through three (3) as the EDIT is flowed back, but will cause rates in the beginning of year four (4) to be $43 million higher per year as the EDIT credit ends and the customers begin paying for the cost of accelerating the EDIT balance. (Id. at 7).

ACE added that passing the EDITs back to customers over a three (3) year period would require a large outlay of cash and puts pressure on the Company's credit metrics. In order to accelerate this payment, the Company claimed that it must raise money by issuing debt and requesting equity contributions from its parent company. According to the Company, the additional cash outflow results in the Funds From Operations ("FFO"), and increases the required inflow of cash from the issuance of debts. The lower FFO/debt ratio would put significant pressure on the Company's ratings, which will further deteriorate each year as the Company is required to issue more debt to fund the ongoing negative cash flow each year resulting from Rate Counsel's position. ACE further indicated that its Cash Flow from Operations-pre working capital ratios would drop significantly to 12.8%, in the range for possible negative credit action, if the Board adopts Rate Counsel's proposed EDIT flow back proposal. (Id. at 8).

ACE also stated that the Board should consider that the same non-protected EDIT flow back periods may not be appropriate for each utility, given each utility's unique set of facts such as credit metrics and magnitude of EDIT liability relative to its financial situation. (Id. at 9). The Company further asserted that Rate Counsel did not offer any principled reason or cite to any regulatory body to support its use of a three (3) year period. Citing decisions in other jurisdictions, ACE maintained that EDIT proposals similar to ACE's had been approved. Accordingly, ACE requested that the Board consider the Company's unique financial position. (Id. at 10).

ACE proposed that the Board authorize the Company to begin providing benefits to customers consistent with the Company's EDIT flow back proposals as filed in its March 2018 Petition, and if the Board believe it necessary, instruct the parties to reconsider the use of the amortization periods in ACE's next base rate case, which the Company expected to file in mid-August. (Id. at 11).[5]

DISCUSSION AND FINDINGS

The Board has reviewed the record in this proceeding, including the petition, discovery and comments filed by the parties. The parties are in agreement that the impact of the TCJA results an annualized revenue reduction of $14,154,038 (including SUT), and an over collection of

[5] ACE filed its base rate case on August 21, 2018.

$6.16 million for the stub period of January 1, 2018 to March 31, 2018. The parties are also in agreement with respect to the proposed tariff design methodology for implementing the rate reduction.

However, Rate Counsel and the Company are in disagreement on several issues, including: (1) refund of stub period over collection; and (2) refunding of EDITS, which are discussed below.

Refund of Stub Period Over-Collection

As to how the amount due to ratepayers for the stub period should be refunded, the Company proposed to defer the refund obligation until its next base rate case. Rate Counsel argued that the Company should be required to issue the refund for the stub period, including interest at the short-term debt rate, by way of a one (1) time bill credit.

The Board has reviewed the comments submitted by the parties with respect to this issue. The Board agrees with Rate Counsel that these are ratepayer funds that were paid between January 1, 2018 and April 30, 2018. These funds should be returned to customers as expeditiously as possible. There is no justifiable reason to withhold the funds from customers while ACE's next base rate case is pending. Accordingly, the Board **HEREBY ORDERS** ACE to refund to customers, with interest at the short-term debt rate, the estimated $6.16 million related to the stub period over collection. The Board **FURTHER ORDERS** that the refund be effectuated through a one-time bill credit to be posted to customer accounts within sixty (60) days of the effective date of this Order.

Refund of EDITs

With respect to EDIT, Rate Counsel and the Company are in agreement as to the deferred tax amounts--$102.55 million in property-related protected EDIT, $100.03 million in property-related non-protected EDIT, and $16.32 million in non-property related non-protected EDIT. The Company and Rate Counsel further agree that property-related protected EDIT is required to be amortized by utilizing ARAM.

However, Rate Counsel requested that the Company be required to refund its non-protected EDITs, both property and non-property related, over a three (3) year period. The Company argued that it should be permitted to flow-back its property-related non-protected EDIT over the average remaining book life of its plant, approximately 32.26 years, and amortize non-property non-protected EDIT over a ten (10) year period.

After reviewing and considering the parties' comments in this matter, the Board is persuaded that the most appropriate method takes into consideration the interests of ratepayers in receiving the refund as expeditiously as possible, while taking into account the Company's interest in earning an appropriate return on equity and level of cash flow. Accordingly, the Board **HEREBY ORDERS** that the refund related to the property related protected EDIT be appropriately refunded using ARAM. With respect to the non-protected EDITs (property and non-property), the Board is not persuaded that a more accelerated payback than what was proposed by the Company will further deteriorate the Company's credit metrics beyond other factors. To the extent ACE believes that it is not earning its appropriate rate of return, the Board notes that these issues should be raised by the Company in its pending base rate case. The Board agrees with Rate Counsel that there is a concern regarding inter-generational equity if the repayment period is longer than a few years. The customers receiving the refund should, as closely as possible, match the customers who contributed to the EDITs. Extending the payback period to thirty-two (32) or even ten (10) years for the non-protected EDITs does not ensure that. Accordingly, the Board **HEREBY ORDERS** ACE to refund the non-protected EDITs over a five (5) year amortization period. The Board **FURTHER ORDERS** that the refund related to the unprotected EDITs be effectuated through a per kWh credit to customer bills. Any change in this amount should be addressed in the Company's next base rate case. Additionally, any under- or over-credited amounts should be reconciled in the Company's base rate case filed after the expiration of the credit.

The Board **HEREBY APPROVES** the interim rates set forth in the Board's March 26, 2018 Order in this docket as final, effective October 1, 2018.

The Company is **HEREBY DIRECTED** to file the appropriate tariff sheets conforming to the terms and conditions of this Order prior to October 1, 2018.

The Company's costs remain subject to audit by the Board. This Decision and Order shall not preclude or prohibit the Board from taking any actions determined to be appropriate as a result of any such audit.

This Order shall be effective September 8, 2018.

DATED: 8/29/18

BOARD OF PUBLIC UTILITIES
BY:

JOSEPH L. FIORDALISO
PRESIDENT

Mary-Anna Holden
MARY-ANNA HOLDEN
COMMISSIONER

DIANNE SOLOMON
COMMISSIONER

UPENDRA J. CHIVUKULA
COMMISSIONER

ATTEST: Aida Camacho-Welch
AIDA CAMACHO-WELCH
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities.

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IN THE MATTER OF THE NEW JERSEY BOARD OF PUBLIC UTILILITES' CONSIDERATION OF THE TAX CUTS AND JOBS ACT OF 2017
DOCKET NO. AX18010001

IN THE MATTER OF ATLANTIC CITY ELECTRIC COPANY FOR APPROVAL OF REVISED RATES (EFFECTIVE ON AN INTERIM BASIS APRIL 1, 2018) TO REFLECT THE REDUCTION UNDER THE TAX CUTS AND JOBS ACT OF 2017
DOCKET NO. ER18030241

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