

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH
Docket No. M-100, Sub 148**

In the Matter of)	
)	
The Federal Tax Cuts and Jobs Act)	REPLY COMMENTS
)	OF THE
)	ATTORNEY GENERAL'S
)	OFFICE

The North Carolina Attorney General's Office (the "AGO") respectfully submits these reply comments about the effect of recent changes to federal corporate income tax rates on public utility rates in North Carolina. In their initial comments many of the utilities do acknowledge that ratepayers should benefit from the recent reductions in the federal income tax rate. However, the Commission should not adopt proposals put forth by utilities that would prevent consumers from receiving these benefits fully and immediately, as opposed to on a delayed basis.

As a matter of public policy, utility service should be economical, rates should be just and reasonable, and where a major change in federal taxes has had a substantial effect on the cost of public utility service – across all utilities – it is appropriate to flow through the benefit to North Carolina ratepayers. N.C.G.S. § 62-2(3); N.C.G.S. § 62-2(4); *State ex rel. Utilities Commission v. Nantahala*, 326 N.C. 190, 388 S.E.2d 118 (1990).

1. When Congress passed the Tax Reform Act of 1986, this Commission found that the significant reduction to the tax rate would "have an immediate and favorable impact on the cost of providing ... public utility services

to consumers in North Carolina,” and concluded that “[i]t is incumbent upon this Commission to take the appropriate action as required so as to preserve and flow through to ratepayers, as a reduction to public utility rates, any and all cost savings realized in this regard which would otherwise accrue solely to the benefit of the stockholders.” Order Initiating Investigation *In the Matter of The Tax Reform Act of 1986*, issued October 22, 1986 in Docket No. M-100, Sub 113, at 1. Affirming the Commission’s final decision in that proceeding, the North Carolina Supreme Court observed that the purpose of the Commission’s proceeding in 1986 was to “take the effect of the reduction in tax rates and flow it through to the ratepayers.” *State ex rel. Utilities Commission v. Nantahala*, 326 N.C. at 197, 388 S.E.2d at 122. By responding quickly through the rulemaking proceeding, significant over-collections by public utilities were avoided and customers benefitted from prompt rate reductions. See *id.* at 202, 388 S.E.2d at 125.

2. Undeniably, as the Commission indicated in its Order initiating this proceeding, the impact of the recent reduction in the federal corporate income tax rate from 35% to 21% has a substantial downward impact on the cost of service for utilities. Nevertheless, contrary to the long-standing North Carolina legal authorities and principles of sound ratemaking, many of the initial comments filed by investor-owned utilities indicate that they do not support promptly flowing through the full benefits of the December 22, 2017 enactment of the Federal Tax Cuts and Jobs Act in utility rate reductions to ratepayers. Instead, most propose to make accounting entries that defer part or all of the

over-collection of income taxes to be considered in future rate proceedings.

Those proposals are not acceptable.

3. In their initial comments, the investor-owned public utilities do acknowledge that utility ratepayers should benefit from the changes in the federal corporate income tax rate; however, by and large they want to (a) delay as long as possible returning money collected from ratepayers for past income tax over-collections, (b) continue to over-collect income taxes until their next rate cases, and (c) avoid telling ratepayers the magnitude of these past and continuing over-collections.

4. For example, Duke Energy Carolinas and Duke Energy Progress filed joint comments in this proceeding that state, “[i]t is the Companies’ intent that customers will receive the benefits of tax reform.” Duke Initial Comments at 2. However, despite the fact that both of the Duke Energy North Carolina subsidiaries have pending general rate cases, Duke has only supplied information in this proceeding from rate cases that used test years that are several years old,¹ and also has suggested using deferral accounting – instead of a prompt rate reduction – to address part of the adjustment to cost of service revenues. Duke Initial Comments at 8 and note 4. Further, Duke does not identify how much the companies hold in accounts for accumulated deferred income taxes (“ADIT”), does not report the excess ADIT amount (“excess ADIT,” known

¹ For example, Duke Energy Progress presents its estimated impacts of the December 22, 2017 enactment of the Federal Tax Cuts and Jobs Act in the context of its last rate case, which used an adjusted test year ending June 2012. See, Exhibit 1 filed with the Duke comments. Similarly, Duke Energy Progress presents the Tax Act impacts in the contents of an adjusted test year ending March 2012 used in its prior rate case. See, Exhibit 2 filed with the Duke comments.

as "EDIT") that it has accrued based on the reduction in federal income taxes, and does not propose to return any of the excess amounts (*i.e.*, the EDIT) to ratepayers until it files future general rate cases. Duke Initial Comments at 9. Instead it proposes "to hold" onto those excess funds, apparently for several years, as cost-free capital. *Id.*

5. Other utilities also suggest limiting or deferring the benefit of income tax reform rather than flowing it through to ratepayers promptly. Dominion Energy North Carolina proposes to defer the amount that is accounted for provisionally (relating to the impact of tax reform on cost of service) and to hold onto the excess amount that has accrued in deferred income taxes for consideration in its next general rate case. Carolina Water Service makes a similar proposal. Piedmont Natural Gas proposes to defer the benefits of tax reform for consideration in a future general rate case, other than with respect to revenues that are recovered in periodic surcharges for the Integrity Management Rider. Like Duke, Piedmont did not reveal the current balances of ADIT and EDIT deferred tax accounts.

6. Allowing utilities to hold onto the excess is particularly unreasonable if the utility has a pending general rate case or if rates were recently established. Duke has acknowledged that it is appropriate to address the effect of tax reform in the pending Duke Carolinas general rate case, but suggests that it is not appropriate to address tax reform in the pending Duke Progress case because the evidentiary hearing has already been held in that case. Duke Initial Comments at 10. However, the fact that the evidentiary

hearing has already occurred in the Duke Progress case should not postpone action until another rate case is filed years from now. The effects of the changes in the tax law are known and measureable, and may be addressed either in late-filed exhibits or by identifying the increment in rates relating to the 2017 federal tax legislation as provisional, pending further consideration and determination (similar to the provisional treatment ordered in this proceeding). Alternatively, the rates established in the general rate case may be adjusted subsequently by findings made in this rulemaking proceeding with reliance on factors determined in the rate proceeding.

7. The Commission should not be persuaded to delay rate reductions based on the justification offered by Duke for continuing to over-collect from ratepayers and to delay returning over-collections. Duke contends that prompt action to flow over-collected taxes back to customers will affect Duke's cash flow and may therefore harm ratepayers. It appears from Duke's comments that Duke and other utilities have experienced high cash flows in recent years in part because their rates are established based on the inclusion in their revenue requirements of the full federal corporate income tax rate, whereas income taxes actually incurred and paid may be significantly less than that due to bonus depreciation and other factors. Duke Initial Comments at 5. Duke's comments propose to continue over-collecting the known and measureable adjustment to its expense for income taxes because of a hypothetical impact that rate reductions and the return of excess funds would have on Duke's credit rating. The fact that Moody's has placed Duke Energy Corporation on a credit watch for possible

downgrade does not mean that the credit ratings of Duke Energy or its North Carolina subsidiaries will suffer. Far less does it provide evidence of the extent or effect of such a downgrade. Duke's credit rating is high relative to many of its peers, and the effect of a slight downgrade would be small relative to the benefit ratepayers receive from a rate reduction and the return of excess funds held by Duke. In short, Duke's argument unfairly seeks to maintain unreasonably high utility rates merely to prop up Duke's cash flow, without any attempt to weigh the relative benefits and harms that its proposal would have on ratepayers.

8. Duke suggests that the substantial beneficial impact of the federal corporate income tax rate reduction provides headroom for the Commission to allow rate increases that Duke supports but other parties have disputed, such as for high coal ash costs, storm costs, and accelerated depreciation of some meters. See Duke Initial Comments at 9. However, ratepayers will not benefit if income tax-related utility rate reductions are used to mask unreasonable cost recovery proposals.

9. As a result of the scant information provided by utilities in initial comments, the public and the Commission do not know how much excess deferred income taxes have been accrued. However, this information is known to the utilities—publicly-traded utilities must report this data in their annual reports to shareholders—and the information ought to be reported and considered in this docket as well. The amount of EDIT may be very large. According to an estimate provided in comments filed by the Carolina Utility Customers Association ("CUCA") based on FERC Form 1 filings, Duke Carolinas

has over \$1.6 billion of excess accrued deferred income taxes allocated to North Carolina retail customers, and Duke Progress has approximately \$875 million. CUCA Initial Comments at 4.

10. The utilities' proposals are unjust and unreasonable to ratepayers. To the extent that the cost-of-service effect associated with the lower corporate income tax rate is not flowed through in rates, utilities will continue to over-collect revenues, and customers will continue to be forced to pay excessive rates to build up utility accounts that essentially lend cost-free capital for utility operations. Similarly, if the utilities' proposals are accepted and they are allowed to retain the funds they are currently holding in EDIT accounts—i.e., excess deferred income taxes that were collected in earlier years when the federal income tax rate was higher than it is following the recent tax law—then the utilities would continue to maintain these excess funds as cost-free capital. Not returning dollars to consumers who struggle to pay their bills, or to consumers who would use their money for different purposes if given the opportunity, results in an undue burden on ratepayers and communities in North Carolina.

In conclusion, the AGO requests that the Commission take prompt action to require the utilities to provide a full accounting of the past and present extent of over-collection of taxes and then to order immediate utility rate reductions that reflect the full impact of the federal income tax reduction on cost of service and that return excess deferred income taxes that have accrued as soon as allowed under federal tax law.

Respectfully submitted, this the 20th day of February, 2018.

JOSHUA H. STEIN
Attorney General

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Margaret A. Force
Assistant Attorney General
N.C. Department of Justice
P.O. Box 629
Raleigh, NC 27602
(919) 716-6053
pforce@ncdoj.gov

CERTIFICATE OF SERVICE

The undersigned certifies that she has served a copy of the foregoing
ATTORNEY GENERAL'S REPLY COMMENTS upon the parties of record in this
proceeding and their attorneys by electronic mail.

This the 20th day of February, 2018.

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Margaret A. Force
Assistant Attorney General