FILED
JUNE 19, 2018
INDIANA UTILITY
REGULATORY COMMISSION

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE INDIANA UTILITY REGULATORY COMMISSION'S INVESTIGATION INTO THE IMPACTS OF THE TAX CUTS AND JOBS ACT OF 2017 AND POSSIBLE RATE IMPLICATIONS	)	**CAUSE NO. 45032 S12**
RESPONDENTS: OHIO VALLEY GAS CORPORATION AND OHIO VALLEY GAS, INC.	)	

IURC
RESPONDENT'S
EXHIBIT NO. 1
11-29-18
DATE
REPORTER AL

RESPONDENTS' PHASE TWO DIRECT TESTIMONY

Respondents Ohio Valley Corporation and Ohio Valley Gas, Inc. submit the attached direct testimony and exhibits of its witness, Jerry A. Klinker addressing the Phase 2 issues identified by the Indiana Utility Regulatory Commission in this investigation.

Respectfully submitted,

/s/Clayton C. Miller
Clayton C. Miller, Att'y No. 17466-49
STOLL KEENON OGDEN PLLC
201 N. Illinois Street, Suite 1225
Indianapolis, IN 46204
(317) 822-6786
(317) 464-1592 (Facsimile)
Clayton.Miller@skofirm.com

ATTORNEY FOR RESPONDENTS OHIO VALLEY GAS CORPORATION AND OHIO VALLEY GAS, INC.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the Ohio Valley Gas' Phase 2 direct testimony and exhibits has been served this 19th day June, 2018, by email transmission to the following counsel of record:

Tiffany Murray
Randall Helmen
INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR
PNC Center
115 W. Washington Street
Suite 1500 South
Indianapolis, Indiana 46204
Email: TiMurray@oucc.IN.gov
rhelmen@oucc.IN.gov
infomgt@oucc.in.gov

/s/Clayton C. Miller
Clayton C. Miller

520123.444556/7716729.1

DIRECT TESTIMONY OF JERRY A. KLINKER

on behalf of

OHIO VALLEY GAS CORPORATION and OHIO VALLEY GAS, INC.

I.U.R.C. CAUSE NO. 45032 S12

1. **Q: Please state your name and business address.**
A: My name is Jerry A. Klinker, and my business address is 21256 Cunion Ct. Noblesville, IN 46062

2. **Q: Please describe your educational background and experience.**
A: I graduated from the School of Engineering at Purdue University with a Bachelor of Science Degree in Electrical Engineering in May 1991. In May 1997, I graduated from the University of Chicago Booth School of Business with a Master of Business Administration Degree in Finance and Strategic Management. I have over 20 years of financial experience focused in business project portfolio strategy and planning for a variety of corporations, such as FastParts.com, Inc., Transcap Trade Finance, Motorola, and KI Brands. I am directly employed by Klinker Consulting, LLC and I am the founder and managing member since 1996. In September 2017, I began my employment as Acting Finance Controller for Ohio Valley Gas Corporation and its wholly owned subsidiary, Ohio Valley Gas, Inc. (herein referred to collectively as "OVG").

3. **Q: In what capacity are you currently employed?**
A: As acting Finance Controller for OVG, I have been contracted for completion of financial planning efforts, including the impact of the Tax Cuts and Job Act of 2017 to OVG's rate structure, as well as the payback model for Accumulated Deferred Federal Income Taxes.

4. **Q. Have you previously testified in any Indiana Utility Regulatory Commission ("Commission") proceeding?**
A. No.

5. **Q: What is the purpose of your testimony?**
A: I have been asked by OVG to address the issues raised in Phase 2 of the Commission's underlying generic tax investigation. The purpose of my testimony in this subdocket specific to OVG is to identify the two sources and amounts of funds to be paid to OVG's ratepayers in this proceeding as well as propose a mechanism for making these payments to ratepayers. In doing so, I address the subjects set forth at sections 1a. through 1c. of the pleading filed by the Indiana Office of Utility Consumer Counselor on May 2, 2018 in the general docket as endorsed by the Commission's presiding officers in their May 14, 2018 docket entry establishing this subdocket and subdockets for other utilities. I describe the research, methodology, and results of my efforts to modify or establish regulatory accounts in response to recent changes in the federal corporate income tax rate, as well as develop the associated payback model to flow tax savings through to OVG's ratepayers.

1. 2018 Tax Savings

6. Q. When was OVG last general rate case?

A. OVG's most recent general rate case was IURC Cause No. 44891. OVG initiated that cause on December 15, 2016, and the evidence was based on an adjusted test year of the twelve months ended June 30, 2016. The Commission's order approving new rates in that cause was issued on October 17, 2017, and OVG filed revised tariffs implementing the new rates as approved in that order in late October, 2017.

7. Q. What was the federal income tax rate used to determine OVG's federal income tax expense that was included in its revenue requirement in Cause No. 44891 on which the utility rates approved in the Commission's October 17, 2017 order in that Cause were based?

A. The then prevailing federal income tax rate was 34%.

8. Q. Is OVG today subject to a federal income tax rate of 34%?

A. No. In late 2017, after the conclusion of Cause No. 44891, Congress enacted the federal Tax Cuts and Jobs Act of 2017 ("TCJA") which, among other things, lowered the applicable federal corporate income tax rate from 34% to 21%.

9. Q. Are OVG's current utility rates set at a level designed to allow it the opportunity to recover a tax expense based on the old 34% rate?

A. No, OVG is no longer charging the rates approved in its most recent general rate case, IURC Cause No. 44891. This current proceeding is a subdocket of a generic investigation initiated by the Indiana Utility Regulatory Commission in early 2018. As a part of that generic investigation, OVG and other respondent utilities were ordered to file revised tariffs on March 26, 2018 containing utility rates reflecting the reduced federal income taxes from the TCJA. OVG's revised tariffs were approved in late April 2018, and took effect as of May 1, 2018.

10. Q. As part of the order initiating the generic investigation of which this proceeding is a subdocket, the Commission also ordered jurisdictional utilities "to immediately begin using regulatory accounting" to record "as a deferred liability" the difference between utility rates then in effect and hypothetical rates based on the lower federal corporate income tax rates from the TCJA. Has OVG done so?

A. Yes. OVG has tracked the revenues it collected from customers since January 1, 2018 through April 30, 2018. This amount was compared to the revenues it would have collected from these same customers if the utility rates which took effect on May 1, 2018 had instead taken effect on January 1, 2018. The difference was $727,451.20. This total is the sum of amounts recorded on OVG's books as a deferred liability as part of its monthly accounting close.

11. Q. How was this amount calculated?

A. Beginning with January 2018, a closing journal entry was completed every month from January through April. This journal entry was a computation of the revenue impacts of the newly proposed rates that were submitted, approved, and implemented May 1, 2018. By taking the difference between the rates in effect and the newly approved rates, an amount was calculated for every rate combination that was billed during the month. In the case of OVG, this is a set of 600 different rate combinations including business division, town, and rate class. This amount was then multiplied by the therm usage in that rate combination. And finally, this was adjusted by the Normalized Temperature Adjustment that applied to each rate combination. All this information is utilized in computing customer bills, is readily available, and is accurate per confirmed measuring devices.

The results of the above created a new regulatory liability to be repaid to the customer base. This amount was $227,761.59 in January, $221,245.33 in February, $160,906.15 in March, and $117,538.13 in April for a total amount of $727,451.20. This amount is tracked in a separate account on OVG's financial books.

12. Q. What does OVG propose to do about this $727,451.20 deferred liability?

A. OVG is in this proceeding proposing to eliminate this liability by temporarily reducing OVG's distribution charge for the first four months of 2019. Since this change is directly created by individual customers' usage, the payback should try to mirror the consumption conditions giving rise to the liability. This is easier said than done given the impacts of weather as related to the volumetric therm usage of natural gas. The proposal is to pay this back to customers, via a lowering of the variable portion of approved rates during the same months as the liability was generated (January-April) as this will most closely match the individual customer's use. Then, in OVG's first GCA proceeding after the end of April 2019, IURC Cause No. 44147 GCA-26, OVG will include an additional variance to true-up any discrepancy in the total amount paid to customers. As noted above, the total amount to be paid to customers is $727,451.20. If the amounts paid via the lower distribution charge over the course of the first four months of 2019 turns out to be, for example, $700,000, then the contemplated GCA-26 variance would be designed to reduce customers' rates by an additional $27,451.20. Conversely, if the amounts paid via the lower distribution charge over the course of the first four months of 2019 turns out to be $750,000, then the contemplated GCA -26 variance would be designed to increase customers' rates by $22,548.80. The amount of the proposed temporary reduction in OVG's distribution charge will be the same as the amount by which OVG's distribution charge was reduced previously in this underlying tax investigation docket, as implemented effective May 1, 2018.

13. Q: Is the adjustment approach outlined for applying OVG's 2018 tax savings reasonable?

A: Yes. The entire Regulatory Liability defined in this case is a direct result of the necessary lag between the effective date of lower federal income tax rates and the approval of revised utility rates based on OVG's reduced federal income tax expense. This happened to occur during the time of year when OVG's customers are consuming the most gas. Using a payback period other than

January through April would be weighted incorrectly in the favor of businesses utilizing gas regardless of weather conditions. By aligning with this timeframe, OVG can as closely as possible align with the usage pattern that created the liability. And although the exact weather conditions will not exist next year at the same time, thus creating the likely need for a true-up, the GCA Variance process allows for the fairest correction of any such differences. It is not perfect, but it is in my view the most reasonable approach to take in this unusual circumstance.

14. Q. You stated that the purpose of your testimony includes identifying "the two sources and amounts of funds to be paid to OVG's ratepayers in this proceeding." If the revenues received for the first four months of 2018 constitute the source of the first amount, what is the second amount?

A. The second amount to be addressed in this subdocket concerns OVG's accumulated deferred income tax expense.

<u>2. Reduced Accumulated Deferred Income Tax</u>

15. Q. Why does OVG have any deferred income tax expense?

A. OVG's deferred income tax expense account is the result of tracked differences between the depreciable life of various capital investments made by OVG in its used and useful plant and equipment over the past 34 ¼ years and the accelerated depreciation it has been allowed to claim on those same assets for tax purposes. As of December 31, 2017, the federal tax portion of OVG's Accumulated Deferred Income Tax (ADIT) account was $10,621,120.

16. Q. Does it matter what the federal income tax rate was as OVG accumulated deferred income taxes in its ADIT account?

A. Yes.

17. Q. Please explain.

A. The prevailing tax rate is a multiplier used to calculate the amount of Accumulated Deferred Income Tax. By taking the difference between the book depreciation and the accelerated depreciation used for tax calculations, and then multiplying this difference by the tax rate, you are able to determine the Deferred Income Taxes for the period. Over the life of the asset, this amount will accumulate as each period is added to the balance of the respective Deferred Income Tax account.

18. Q. By what amount has OVG's ADIT account been reduced because of the reduction in the federal corporate income tax rate from 34% to 21%?

A. $4,061,016.

19. Q. For some utilities, ADIT accounts can contain both "protected" and "unprotected" amounts depending on whether they relate to accelerated tax depreciation or some other book-to-tax difference such as deductions for repairs. What percentage of OVG's ADIT is considered to be protected?

A. 100% of OVG's ADIT is protected.

20. Q. How much of the $4,061,016 reduction in OVG's ADIT account will be paid out to OVG's ratepayers?

A. Over time, all of it.

21. Q: How did you determine your proposed timetable for paying this amount to OVG's ratepayers?

A: My assessment built a knowledge base that was used to review the Reverse South Georgia Method, the Average Rate Assumption Method ("ARAM"), and review data available from the OVG records to determine the best approach for calculations. This was done through knowledge gained from a variety of sources, including guidance provided by the Internal Revenue Service, publications by the Michigan State University department of Public Utilities, and spending time developing an understanding of the OVG calculations for Deferred Federal Income Taxes and the related depreciation schedules for the assets associated with OVG's accelerated tax depreciation.

22. Q: What timetable are you proposing for paying OVG's protected excess ADIT to OVG's customers?

A: I utilized ARAM to determine an amortization period of 35 years for paying OVG's protected excess ADIT to its ratepayers.

23. Q. Please describe how you determined the amount OVG's ADIT should be reduced?

A. As noted above, the federal portion of OVG's ADIT accounts as of December 31, 2017, which was immediately prior to the enactment of the TCJA, totaled $10,621,120. The balances in these accounts are all in the "protected" area and were costs allocated to capital projects that were impacted by accelerated depreciation schedules including MACRS and bonus depreciation. Prior to 2018, OVG was consistently utilizing a 34% corporate federal income tax rate when computing its ADIT. With the new tax rate lowered to 21%, this difference of 13 percentage points represents a 38.24% reduction. Multiplying $10,621,120 by 0.3824 results in a dollar reduction to OVG's ADIT of $4,061,016. This amount was moved to a new account on the balance sheet as of December 31, 2017 called "Deferred Regulatory Liability". Full detail of the accounts and calculations can be found in Exhibit 1, titled "Calculation of Accumulated Deferred Income Tax to be returned based on Federal Income Tax Changes Effective January 1, 2018."

24. Q: How did you determine the ARAM for OVG?

A: After analyzing the asset records of OVG, I could find the full depreciable asset amount, the book depreciation method, and the tax depreciation method. Utilizing this information, I was able to find the most commonly used tax depreciation method by value of assets and the aligned corporate book depreciation method. Using these two variables, I could compute a Theoretical Payback Model. This model shows the expected payback of deferred tax liabilities that are created early in an asset's life, and the time to payback over the useful life of the asset as determined by its corporate book depreciation. This theoretical payback model can be seen in Exhibit 2, entitled "Deferred Tax Theoretical Payback Model – Model Asset Allocation." Since this is the most common payback timeframe, I utilized this timeframe for continued calculations and this theoretical timeframe is 34.25 years, which results in a real-world payback of 35 years.

I took all the different tax depreciation methods (3-year, 5-year, 7-year, 20-year, 20-year at 15-year rates, and all previous with bonus depreciation in some years), which all have their differing MACRS schedule defined rates (10 rates in all), and I assumed an average rate as necessary for the Average Rate Assumption Method. I then combined this with the total protected excess ADIT and created a payback model assuming 35 years from start to finish. By applying the average rate, with assumed payback period, and using the defined age of each asset class every year, a full payback model by year can be built. A summary of these results is included in Exhibit 3, entitled "Deferred Tax Theoretical Life Model Payback Timing Allocation of $4,061k". Using this chart to show how much, when, and how it lays out on top of the Theoretical Payback Model timing results in 5 payback periods lasting 7 years each.

Laying out this payback model in full detail, with individual payback amounts by year over the next 35 years, and then subdividing into 5 payback periods of 7 years each we can calculate an exact amount that needs to be returned and a rate during that payback period that will accomplish this with OVG Customers. This detail can be seen in Exhibit 4, entitled "Ohio Valley Gas ARAM Method for ADIT Payback".

25. Q. Having determined the amount and timetable for these excess ADIT payments, how do you propose OVG's customers should receive these payments?

A. From the above work, it was determined that the excess protected ADIT should be returned to customers using a modification to the fixed portion of the base rates charged to customers and defined in the most recent rate case. This is expected to happen with 5 different periods as defined, beginning in January 2019, continuing for 35 years, with a negative adjustment to the fixed portion of the base rates in the amount of $0.11, $0.28, $0.36, $0.45, $0.50 for each respective payback period. This amount is easily tracked. It is easy to ensure it is maintained over time. And if need be, will be easy to true up periodically if the customer base of OVG changes significantly.

26. Q: Why is your proposed schedule for paying OVG's excess ADIT to its customers reasonable?

A: Based on the longevity of gas distribution pipelines, a useful life of an asset being 35 years is within reason. Also, given OVG has invested significantly in the last 8 years, with projects much larger than historical, they have a relatively young Deferred Tax Liability balance that would not be paid back through Income Taxes for many years to come. So, by aligning the timing of the asset age, to the timing of the payback model, OVG will be returning funds to its customers at roughly the same rate at which it would have been paid back to the federal government through income taxes.

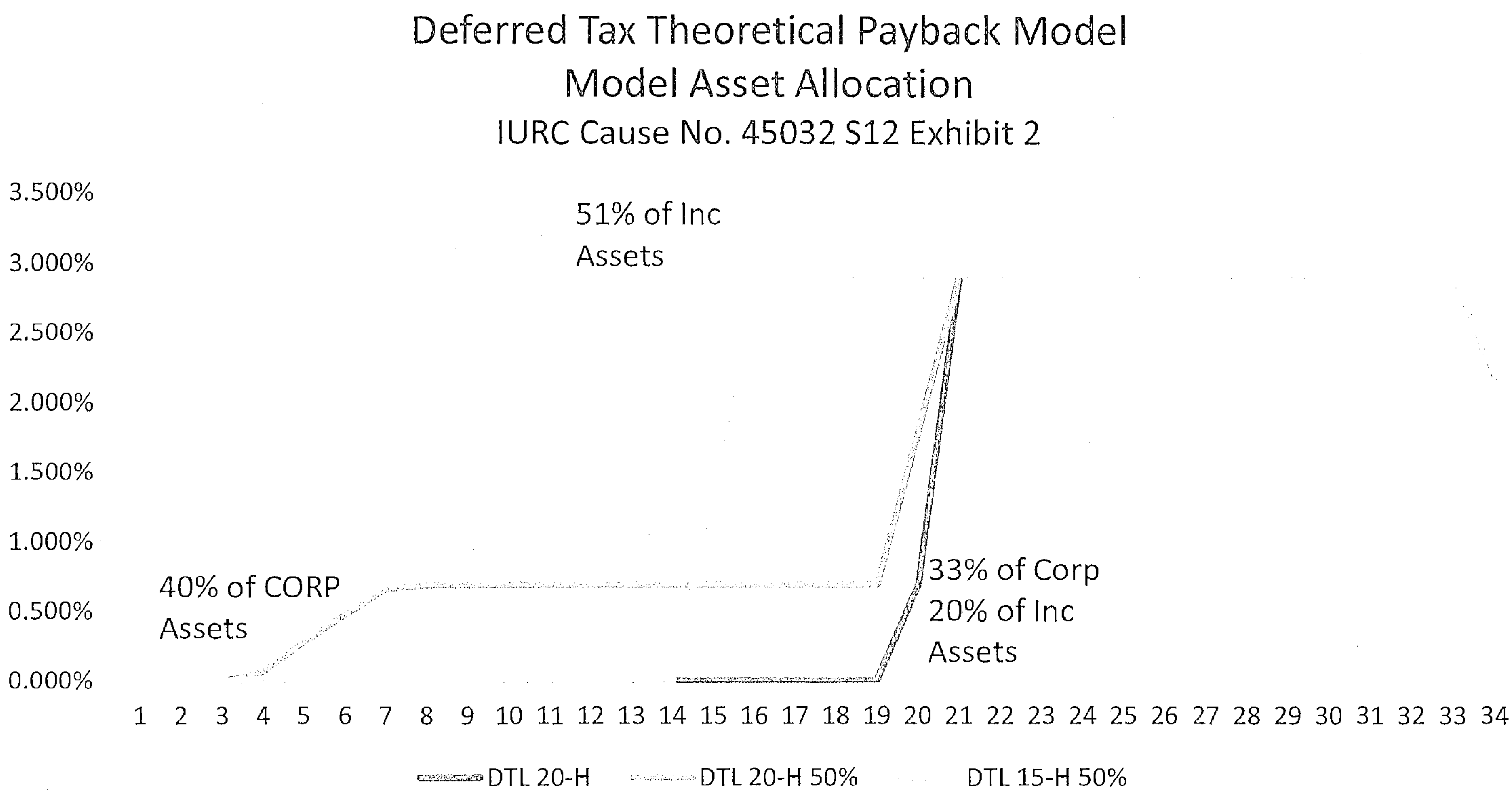
27. Q: Does this conclude your direct testimony.

A: Yes.

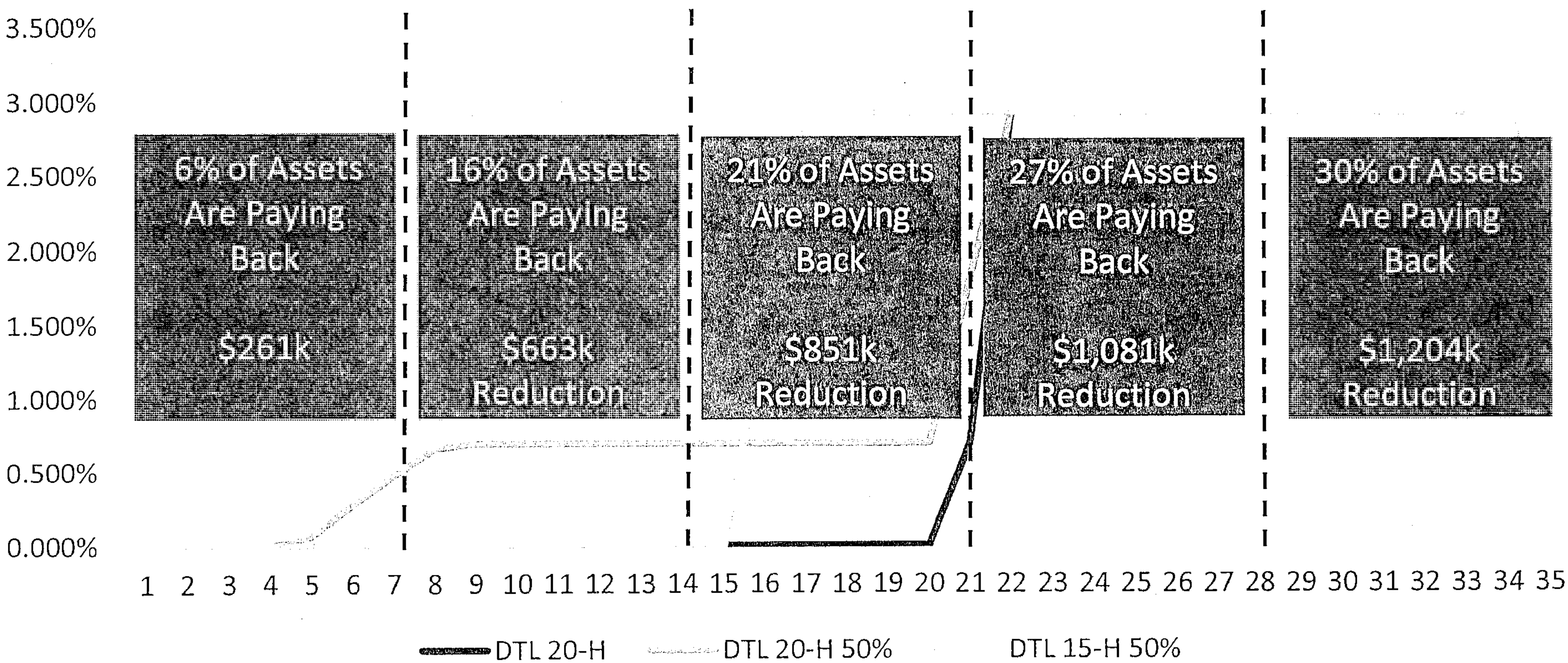
Calculation of Accumulated Deferred Income Tax to be returned based on Federal Income Tax Changes Effective January 1, 2018

IURC Cause No. 45032 S12 Exhibit 1

	As of December 30, 2017 - Just before final close					Credit is positive	Change	New Balance	
Corp	1	0	282	282.1	0	$ 9,420,566.08	$ (3,601,981.15)	$ 5,818,584.93	Balance of Deferred Income Tax
				282.11		$ (367,604.85)	$ 140,554.80	$ (227,050.05)	Accumulation of Deffered Federal Income Taxes - Liberalize Deprciation
				282.12		$ 1,026,887.16		$ 1,026,887.16	"" State
				282.21		$ (33,280.25)	$ 12,724.79	$ (20,555.46)	Accumulation of Deffered Federal Income Taxes - Bad Debts
				282.22		$ (7,751.75)		$ (7,751.75)	"" State
				282.31		$ (117,064.50)	$ 44,759.96	$ (72,304.54)	Accumulation of deferred Federal Income Taxes - Accrued Vacation
				282.32		$ (32,210.47)		$ (32,210.47)	"" State
				282.41		$ 127,826.49	$ (48,874.83)	$ 78,951.66	Accumulation of deferred Federal Income Taxes - NCB Stock Sales
				282.42		$ 4,407.81		$ 4,407.81	"" State
				282.51		$ 67,079.36	$ (25,647.99)	$ 41,431.37	Accumulation of deferred Federal Income Taxes - Prepayments
				282.52		$ 17,584.04		$ 17,584.04	"" State
Inc	2	0	282	282.1		$ 1,889,699.29	$ (722,532.08)	$ 1,167,167.21	Balance of Deferred Income Tax
				282.11		$ (350,668.39)	$ 134,079.09	$ (216,589.30)	Accumulation of Deffered Federal Income Taxes - Liberalize Deprciation
				282.12		$ 156,088.75		$ 156,088.75	"" State
				282.21		$ (1,057.33)	$ 404.27	$ (653.06)	Accumulation of Deffered Federal Income Taxes - Bad Debts
				282.22		$ (315.79)		$ (315.79)	"" State
				282.31		$ (14,375.66)	$ 5,496.58	$ (8,879.08)	Accumulation of deferred Federal Income Taxes - Accrued Vacation
				282.32		$ (4,000.72)		$ (4,000.72)	"" State
				282.41				$ -	Accumulation of deferred Federal Income Taxes - NCB Stock Sales
				282.42				$ -	"" State
				282.51				$ -	Accumulation of deferred Federal Income Taxes - Prepayments
				282.52				$ -	"" State
	1					$ 9,097,522.33			Sum of all Deferred Federal Tax accounts (original balance is all Federal)
	2					$ 1,523,597.91			Sum of all Deferred Federal Tax accounts (original balance is all Federal)
	Total					$ 10,621,120.24			
						34%			Historical tax rate used for Deferred Income Taxes
						21%			New rate beginning January 2018
						-38.24%			Relative change in rates (New-Old/Old)
	1					*$ (3,478,464.42)*	$ (3,478,464.42)		*CORP Change required to Deferred Federal Tax accounts*
	2					*$ (582,552.14)*	$ (582,552.14)		*INC Change required to Deferred Federal Tax accounts*
	Total					*$ (4,061,016.56)*			


Deferred Tax Theoretical Payback Model
Model Asset Allocation
IURC Cause No. 45032 S12 Exhibit 2
3.500%
3.000%
2.500%
2.000%
1.500%
1.000%
0.500%
0.000%
51% of Inc
Assets
40% of CORP
Assets
33% of Corp
20% of Inc
Assets
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34
DTL 20-H
DTL 20-H 50%
DTL 15-H 50%

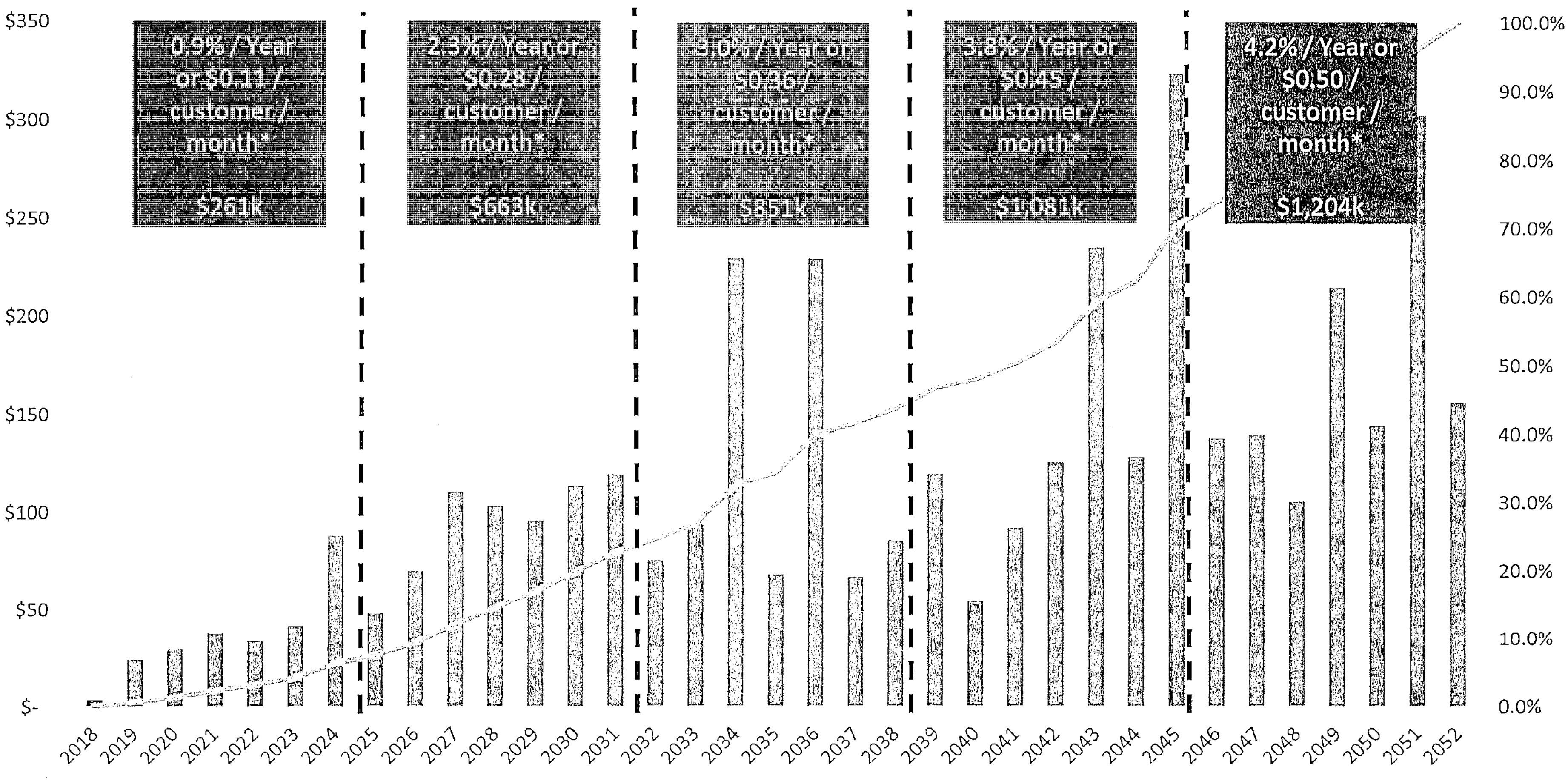
Deferred Tax Theoretical Life Model
Payback Timing Allocation of $4,061k
IURC Cause No. 45032 S12 Exhibit 3



Ohio Valley Gas

ARAM Method for ADIT Payback

IURC Cause No. 45032 S12 Exhibit 4



* Based on 28464 Customers as of 12/31/2017