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 IMPLICATION UNDER PHASE 1 FOR SYCAMORE GAS COMPANY, INC.	)))))	**CAUSE NO. 45032 S3**

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

PUBLIC'S EXHIBIT NO. 1

TESTIMONY OF OUCC WITNESS MARK H. GROSSKOPF

June 14, 2018

Respectfully submitted,

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TESTIMONY OF OUCC WITNESS MARK H. GROSSKOPF
CAUSE NO. 45032 S-3
SYCAMORE GAS COMPANY

I. INTRODUCTION

Q: Please state your name and business address.

A: My name is Mark H. Grosskopf, and my business address is 115 W. Washington Street, Suite 1500 South, Indianapolis, Indiana 46204.

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

A: I am employed by the Indiana Office of Utility Consumer Counselor ("OUCC") as a Senior Utility Analyst. For a summary of my educational and professional experience and my preparation for this case, please see the Appendix attached to my testimony.

Q: What is the purpose of your testimony?

A: I explain the OUCC's response to Sycamore Gas Company's ("Sycamore" or "Respondent") Phase 1 subdocket proposal regarding regulatory treatment of federal income taxes necessitated by the Tax Cuts and Jobs Act of 2017 ("TCJA"). I discuss Sycamore's Phase 1 subdocket rate proposal to use this Cause as a substitute for its pending rate case, whereby the new 21% corporate income tax rate is incorporated into the revenue requirement Sycamore proposed in that case, Cause No. 45072. The OUCC recommends denial of Sycamore's proposal to increase its rates and recommends an immediate reduction in customer rates for the full amount of the excess income tax expense embedded in current rates and charges ($224,438), effective on the date a final order is issued in this subdocket.

II. COMMISSION INVESTIGATION OF IMPACTS OF TAX CUTS AND JOBS ACT OF 2017

Q: What are the main effects of the Tax Cuts and Jobs Act of 2017 ("TCJA") on regulated utilities?[1]

A: The main effects of the TCJA on regulated utilities are the reduction of the federal income tax rate to 21% and the elimination of bonus depreciation. Regulated utilities are still allowed to deduct all interest expense without limitation.

Q: What adjustments are necessary to reflect these effects in a regulated utility's rates and charges?

A: There are three major adjustments necessary to reflect the impact of the TCJA in a regulated utility's rates and charges: (1) reduction of federal income tax expense embedded in utility rates to reflect the new 21% corporate tax rate on a going-forward basis; (2) amortization of the federal income tax expense over-collected by the utility from January 1, 2018 until the federal income tax rate embedded in rates and charges is reduced to 21%;[2] and (3) reduction of federal income tax expense to reflect the return of excess accumulated deferred income taxes created when accumulated deferred income taxes ("ADIT") are revalued at the 21% rate.

Q: Which of the above adjustments did the Commission's February 16, 2018 Order include in Phase 1 of its investigation (Cause No. 45032) to be addressed in this subdocket?

A: According to the Commission's February 16, 2018 Order ("February 16 Order"), Phase 1 "is intended to ascertain the real time existing customer rate impact directly

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[1] The TCJA was passed by Congress on December 22, 2017.

[2] Per the Commission's order dated January 3, 2018 in Cause No. 45032, all Indiana investor-owned utilities are required to begin using regulatory accounting, such as the use of regulatory assets and liabilities, for all calculated differences resulting from the TCJA and what would have been recorded if the TCJA did not go into effect.

related to the change in the federal income tax rate on the ongoing revenue requirement for each Respondent and to foster an expedient process to reflect such impact in customer rates going forward." (February 16 Order, p. 2.)

In accordance with the Commission's Order, Sycamore was therefore required to complete a 30-day filing under Phase 1 showing the calculated base rate reduction due to the 21% federal tax rate. Respondent made the 30-day filing on March 26, 2018, but subsequently withdrew its 30-day filing. Per the Order, Sycamore was thereafter required to file a subdocket supporting a proposal for revised rates and charges to reflect the new tax rate. (February 16 Order, p. 2.) Sycamore's Phase 1 proposal is discussed in detail below.

Q: How will Sycamore's Phase 2 TCJA impacts be handled?

A: By order of the Presiding Officers on June 7, 2018, Sycamore's Phase 2 tax issues will be addressed in its pending rate case, Cause No. 45072.

III. PHASE 1 TAX PROPOSALS

Q: Did Respondent's testimony in this Cause show any calculation of the excess income tax expense amount embedded in Sycamore's current rates and charges?

A: No. Instead of filing schedules showing the reduction to its current rates and charges for the new 21% income tax rate, Sycamore filed proposed revenue requirement schedules in this subdocket that are nearly identical to the proposed revenue requirement schedules in Cause No. 45072 (Sycamore's pending rate case). These schedules include proposed expense adjustments for a test year ending September 30, 2017 and a proposed rate base as of March 31, 2018. Most importantly, these schedules show that Sycamore does not intend to revise its current rates and charges to only reflect the new 21% corporate income tax rate but instead seeks to incorporate that new tax rate along with alleged increased expenses and proposed rate base additions that are still subject to review in its pending rate case, Cause No. 45072.

Q: Is using the proposed revenue requirements from Sycamore's current rate case appropriate for this subdocket?

A: No. Sycamore's current rate case, Cause No. 45072, is in progress and no determination has been made on the merits of the proposed revenue requirements. The OUCC is still conducting a due diligence review of Sycamore's rate case testimony and exhibits to determine just and reasonable rates, and the case has yet to be litigated. Sycamore is attempting to treat this Phase 1 subdocket like its pending rate case, including current proposed expense adjustments and an updated rate base. The only rate case adjustment Respondent removed from its proposed Phase 1 subdocket revenue requirement was a proposed refund of excess ADIT, leaving the refund of ADIT as a Phase 2 tax issue to be handled in the rate case. Sycamore's proposed Phase 1 subdocket revenue requirement uses a cost of equity from Respondent's last rate case in Cause No. 43090, which is higher than that settled upon by the Parties in the current rate case, ignoring the only known element of the rate case to which the Parties agree.[3]

In effect, Sycamore is asking the Commission to approve an *increase* to its current rates and charges based on these schedules that is higher than is being

[3] In Cause No. 45072, Sycamore Gas Company and the OUCC entered into a Stipulation and Settlement as to Petitioner's Cost of Equity Capital on April 6, 2018, agreeing to a cost of equity capital rate of 10.05%.

requested in the pending rate case. Not only is using Respondent's revenue requirement schedules in this Phase 1 subdocket inappropriate, it would be inappropriate to award Sycamore with a higher, unsubstantiated rate increase through a process intended by the Commission to be a rate *decrease* reflective of a lower income tax rate.

Q: Please summarize Sycamore's proposal for Phase 1 of this subdocket proceeding.

A: Respondent's witness Cynthia Hughes proposes a rate increase higher than that proposed in Respondent's pending base rate case, and the testimony of Respondent's witness John Browner concludes that Sycamore's rates should not be reduced to reflect a lower federal income tax rate. Mr. Browner believes that increased expenses since Sycamore's last rate case more than offset the reduction in its federal tax liability. On page 4, lines 3 and 4 of his testimony, Mr. Browner states, "Sycamore's current rates are already insufficient to recover its costs and are confiscatory, and a rate reduction would only make them more so."

Q: Should the Commission take Sycamore's allegation of increased expenses into consideration when deciding how the benefit of the TCJA should be passed back to ratepayers in this Cause?

A: No. Sycamore's expenses will be factored into new rates when Cause No. 45072 is decided. Further, any increased expenses are deductions for tax purposes, which serve to lower Respondent's income tax liability. From January 1, 2018 until the date of the rate case decision, rates should only reflect, as a flow-through expense, the 21% federal income tax rate in effect when service is rendered.

Q: Does the OUCC accept Sycamore's Phase 1 proposal?

A: No. Sycamore has provided no compelling justification for not immediately adjusting its current rates and charges to reflect a reduction in income tax expense. In fact, Sycamore proposes to increase rates in advance of a fully vetted rate case proceeding, by an amount in excess of the requested increase in Cause No. 45072. The OUCC does not consider this to be a reasonable proposal nor does it comport with the Commission's desire to pass back TCJA benefits to customers in an expedited manner.

Q: Is Sycamore's proposed fiscal year ending April 30, 2018, rather than December 31, 2017, an obstacle to its ability to reduce its rates to reflect the 21% income tax rate?

A: No. Mr. Browner presents a blended tax rate, reflecting the tax rates effective from May 1, 2017 through April 30, 2018, as a problem. (Direct Testimony of Browner, Pet. Ex. JSB, p. 3, lines 10-19.) For the period ending December 31, 2017, Respondent's base rates were based on a 34% federal tax rate, and from January 1, 2018 through April 30, 2018, a 21% federal tax rate applies. Respondent will have a blended rate tax year, but only the refund of over-collection back to January 1, 2018 is necessary. Mr. Browner's testimony highlights the fact that the last four months of Respondent's tax year, January 1, 2018 through April 30, 2018, will be at a lower federal tax rate. The refund of the over-collection for this period will be addressed in Phase 2 of the tax investigation, along with the continuing over-collection until the new tax rate is reflected in base rates.

Q: What did the Commission state regarding the flow-through of tax expense in its 1987 tax investigation in Cause No. 38194?

A: In Cause No. 38194, the Commission discussed the reasonableness of adjusting a utility's rates and charges as a result of a change in only the federal income tax expense. In its deliberations, it stated:

> This Commission realizes that a change in the Federal Income Tax Rate should have no substantive bearing on whether a utility is or is not earning its authorized return. Federal Income Tax Expense, like many other utility expense items, is a pass through expense. In other words, the utility's Federal Income Tax obligation is passed-through as a cost of doing business to its ratepayers. <u>Because of the pass-through nature of this expense, a change in the Federal Income Tax rate should have no effect on a utility's net operating income and therefore its ability to earn its authorized return.</u> Further, this Commission has often stated that public utilities are in no fashion guaranteed to earn their authorized return, or any return at all, but, are only provided an opportunity to earn such return.

Cause No. 38194, Interim Order, June 1, 1987, page 27. (Emphasis added.)

Q: Did the OUCC calculate the amount of excess income tax expense embedded in Sycamore's current rates and charges?

A: Yes. Since Sycamore did not provide this calculation in this Phase 1 subdocket, I performed the calculation, which is provided in my Attachment MHG-1. I calculated the amount of excess income tax embedded in Sycamore's current rates to be $224,438. Column (a) of Attachment MHG-1 represents the revenue requirements approved in the last rate case, Cause No. 43090. The figures in column (b) were derived by running the new 21% federal tax rate through the revenue requirement schedules approved in Cause No. 43090. It is important to note that the updated Adjusted Net Operating Income of $1,504,019 represents an increase in revenue resulting from a decrease in tax expense. Then, the pro forma income tax expense is "grossed-down" much the same as a revenue increase would normally be "grossed-up". The result necessitates a revenue decrease of $224,438, to be allocated based on the cost of service approved in the last rate case.

Q: Does Sycamore's opposition to reducing its base rates to reflect the TCJA benefits to its ratepayers also affect Phase 2 of the tax investigation?

A: Yes. It lengthens the time the federal income tax expense is over-collected by the utility, from January 1, 2018 until the federal income tax rate embedded in base rates is reduced to 21%, thereby increasing the amount to be refunded to ratepayers from the regulatory liability as required per the Commission's order dated January 3, 2018 in Cause No. 45032. In this Cause, Sycamore did not provide the amount of the still accruing over-collection reflected in this regulatory liability. However, the timing and benefit to ratepayers as a result of this regulatory liability will be addressed as one of the Phase 2 issues in Respondent's pending base rate case.

Q: What does the OUCC propose?

A: The OUCC proposes Sycamore reduce its current rates and charges to reflect the 21% federal income tax rate and begin passing back the TCJA savings to its customers immediately, effective on the date a final order is issued in this subdocket. I have calculated the necessary base rate reduction of $224,438 on Attachment MHG-1, in agreement with Sycamore's rate reduction calculated in its withdrawn 30-Day Filing on March 26, 2018, correctly reflecting new rates at the lower federal income tax. It is undisputed that Sycamore's federal income tax rate was reduced effective January 1, 2018 to 21%. The Commission has previously recognized that taxes are a flow-through expense. Therefore, ratepayers should begin receiving the benefits intended by federal tax reform immediately. (*See*, Cause No. 38194, Interim Order, June 1, 1987, p. 27.)

Q: Does this conclude your testimony?

A: Yes.

AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.

Mark H. Grosskopf

Mark H. Grosskopf
Senior Utility Analyst
Indiana Office of Utility Consumer Counselor
Cause No. 45032 S3
Sycamore Gas Company/Commission
Investigation

June 14, 2018

Date

APPENDIX MHG-1 TO TESTIMONY OF
OUCC WITNESS MARK H. GROSSKOPF

Q: Please describe your educational background and experience.

A: I graduated from Indiana University in May 1980, receiving a Bachelor of Science degree in business with a major in accounting. I worked in auditing and accounting positions at various companies from 1980 to 1995. I joined the OUCC in April of 1995 and have worked as a member of the OUCC's Natural Gas Division since June of 1999. I became a Certified Public Accountant in November of 1998. I also completed both weeks of the National Association of Regulatory Utility Commissioners Annual Regulatory Studies program at Michigan State University. I completed an additional week of the Advanced Regulatory Studies Program hosted by the Institute of Public Utilities Regulatory Research and Education at Michigan State University.

Q: Have you previously testified before the Commission?

A: Yes, I have testified as an accounting witness in various causes involving water, wastewater, electric, and gas utilities, including but not limited to, rate cases, pipeline safety adjustment cases, 7-Year Plan, and Transmission, Distribution, and Storage System Improvement Charge ("TDSIC") Tracker cases.

Q: Please describe the review and analysis you conducted to prepare your testimony.

A: I reviewed the direct testimony and exhibits provided by Sycamore Gas Company to support Respondent's proposal related to Phase 1 of Cause No. 45032 S-3. I also reviewed Respondent's exhibits supporting the revenue requirements in Respondent's pending rate case, containing related and similar exhibits to the revenue requirements schedules in this subdocket. I have been involved with the

Commission's Investigation in Cause No. 45032 since its inception, conducting analysis of the Tax Cuts and Jobs Act of 2017 and the effect this Act has on the rates of the various utilities involved in the investigation, including Sycamore Gas Company.

Sycamore Gas
Cause No. 45032 S-3
Impact of Change in Federal Tax Rate (Phase 1)

Summary Information:

Most Recent Base Rate Case:	Cause No. 43090
Depreciation Study?	No
Cost of Service Study?	Yes

	(a) As Approved	(b) Updated	
Revenue Requirement:			
Original Cost Rate Base	$ 15,224,621	$ 15,224,621	
Times: Weighted Cost of Capital	8.84%	8.84%	
Net Operating Income Required	1,345,856	1,345,856	
Less: Adjusted Net Operating Income	562,624	1,504,019	
Net Revenue Increase/(Decrease) Required	783,232	(158,163)	
Gross Revenue Conversion Factor	1.6985	1.4190	
Recommended Revenue Increase/(Decrease)	$ 1,330,349	$ (224,438)	
Calculation of Income Tax Expense:			
Operating Revenues	$ 4,790,808	$ 4,790,808	$ -
Less: Operating expenses	(1,860,467)	(1,860,467)	-
Depreciation	(684,927)	(684,927)	-
Taxes Other Than Income	(367,186)	(367,186)	-
State Income Tax	(118,715)	(118,715)	-
Interest Expense	(542,875)	(542,875)	-
Federal Taxable Income	1,216,638	1,216,638	-
Times: Federal Tax Rate	34.00%	21.00%	-13.00%
Federal Income Tax Expense	$ 413,657	$ 255,494	$ (158,163)
			1.4190
			(224,438)
Revenue Conversion Factor:			
Gross Revenue Change	100.0000%	100.0000%	
Less: Bad Debt Adjustment	0.8835%	0.8835%	
Subtotal	100.0000%	100.0000%	
Less: IURC Fee	0.1100%	0.1100%	
Subtotal	99.1165%	99.1165%	
Less: URT	1.38763%	1.38763%	
Subtotal	99.0065%	99.0065%	
Less: State Income Tax	8.4156%	8.4156%	
Subtotal	89.2033%	89.2033%	
Less: Federal Income Tax	30.3291%	18.7327%	
Change in Net Operating Income	58.8742%	70.4706%	
Revenue Conversion Factor	1.6985	1.4190	

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing ***Indiana Office of Utility Consumer Counselor Public's Exhibit No. 1 Testimony of OUCC Witness Mark H. Grosskopf*** has been served upon the following counsel of record in the captioned proceeding by electronic service on June 14, 2018.

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