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*Impacts of the Tax Cuts and
Jobs Act on Electric Utilities*

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June 24, 2019



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Overview

- The Tax Cuts & Jobs Act of 2017 (“TCJA”) generally
- Introduction of Panelists
- Agenda
 - Overview of the TCJA
 - Impact of TCJA on Electric Utilities
 - Accounting Issues Stemming from the TCJA
 - FERC’s Actions Stemming from the TCJA
 - Questions

Today's Presenters



Kimberly Johnston, a National Tax Partner in Ernst & Young's Power & Utilities tax practice, serves clients, industry groups, and regional teams throughout the United States, Canada, and Mexico to deliver sustainable value for tax operations, regulatory proceedings, and investment growth plans. Ms. Johnston has 25 years of energy sector experience in corporate tax, including experience leading tax efficient M&A strategies, legislative advocacy efforts, regulatory proceedings, audit settlement negotiations, tax operational effectiveness, and merger integration and divestiture plans. Her areas of focus include serving investor-owned utilities, independent power producers and midstream energy companies on regulatory strategy, rate case proceedings, tax planning strategies, due diligence on investment growth opportunities, and tax operations. Prior to rejoining Ernst & Young, Ms. Johnston served as the Vice President of Tax for CenterPoint Energy and the Tax Director of Spectra Energy.



David Davoren is the Corporate Tax Manager for Emera Maine, an electric utility company operating in eastern and northern Maine. At Emera Maine, Mr. Davoren is responsible for, among other things, the determination and financial disclosure of corporate income tax expense (federal and state) used in audited financials and regulatory reporting. Mr. Davoren has also assisted in developing filings with the Federal Energy Regulatory Commission related to the Tax Cuts and Jobs Act of 2017 and its effects on ADITs. Prior to joining Emera Maine in 2012, Mr. Davoren worked as a Corporate Tax Consultant for the Corporate Tax Group, a regional tax consulting firm specializing in corporate tax clients. Mr. Davoren is a Certified Public Accountant in the state of Maine and holds a Bachelor's of Science in Business Administration from Boston College.

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Jeffrey M. Jakubiak, a partner in Gibson Dunn's New York and Washington, D.C. offices and a member of the firm's Energy, Regulation and Litigation Practice Group, counsels clients regarding matters at the Federal Energy Regulatory Commission. Holding a bachelor's degree in quantitative economics, Mr. Jakubiak's practice focuses on matters at the crossroads of law and economics, particularly those involving electric company ratemaking, mergers, and power sales, as well as the workings of energy markets. Mr. Jakubiak also has developed proprietary quantitative analytical tools that he uses to advise clients on electric asset transactions, market-based rate authorizations, and litigation risk.



Moderator: Jennifer C. Mansh, a senior associate in Gibson Dunn's Washington, D.C. office and a member of the firm's Energy, Regulation and Litigation Practice Group, advises clients on a wide range of energy litigation, regulatory, and transactional matters before the Federal Energy Regulatory Commission, the Commodity Futures Trading Commission, the Department of Energy, and state public utility commissions. Ms. Mansh has represented a wide variety of electric utilities, merchant transmission companies, power marketers, and natural gas and oil pipeline companies in rate, licensing, and enforcement proceedings before FERC, CFTC, and state public utility Commissions. In addition to her litigation experience, Ms. Mansh assists clients on a variety of transactional matters and compliance issues.

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The Tax Cuts & Jobs Act and Impact on Electric Utility Companies

Key TCJA Provisions Impacting Utilities



Corporate tax rate and corporate AMT

- ▶ 21% tax rate, effective 1/1/18
- ▶ AMT repeal (AMT refunds not subject to sequestration)



Interest expense deduction

- ▶ Limit deduction to net interest expense that exceeds 30% of Adjusted Taxable Income (ATI)
- ▶ ATI through 2021 = EBITDA; Beginning in 2022 = EBIT



Expensing

- ▶ 100% immediate expensing deduction for qualified property placed in service after 9/27/17 for five years; phase-down starting in 2023



Net operating losses

- ▶ Indefinite carryforward and repeal carryback (subject to certain exceptions)
- ▶ Net operating loss carryforward utilization limited to 80% of taxable income after 2017



Regulated trade or business carve-out

- ▶ Regulated utilities and regulated gas pipelines not subject to interest limitation and not eligible for immediate expensing

Impact of TCJA on Utilities

- Lower tax rate
 - ASC980 regulatory liability for EADIT
 - Cost of service and rate mechanisms
- Normalization rules
 - What is normalization and safe harbor (Rev. Proc. 2017-47)
 - ARAM or Reverse South Georgia methods
 - Protected and unprotected classifications
 - Treasury normalization guidance (Notice 2019-33)
- Holding company interest limitation
 - Excepted and non-excepted trade or businesses
 - Modified adjusted tax basis

Common Issues/Advice Being Sought from E&Y

- Regulated utility carve-out and implications to growth strategic plans
- Investor-owned utility financing/tax strategies
- Treasury bonus transition rules (REG-104397-18)
- Treasury normalization guidance (Notice 2019-33)
- Normalization ARAM adoption and maintenance
- TCJA regulatory settlements

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Accounting Issues Stemming from the TCJA

ADITs Generally

- What are they?
 - Accumulated Deferred Income Tax Liabilities & Assets (ADITs) – Represent a business' future income tax obligations and/or refunds for the differences between Generally Accepted Accounting Principles (“GAAP”) and U.S. Income Tax laws and Regulations in recognition of income and expenses.
 - Example: Tax Accelerated Depreciation (e.g., Bonus Depreciation)
- How do they work in a Regulated Business, Utilities?
 - For Regulators, ADITs reflect “Loans” by the Govt. to a Utility which require an adjustment to Utility's Rate Base (Plant in Service less ADITs equals Rate Base)

Federal Rate Reduction from 35% to 21%

- Income Tax Rate Changes Require Adjustment to ADITs
- ADITs @ 12/31/2017 will now reflect the future income tax obligation at 21% Rate
 - Requires a reduction in the ADIT which generally is recognized through the income statement as a benefit (i.e., income tax windfall).
 - For Regulated Utilities, Regulators require this benefit be returned to Customers through Rates
- So, how is this accomplished?

Regulatory Liability – Determination & Return

- 2017 TCJA requires adjustment to ADITs
 - At 12/31/2017, Utilities were required to analyze their existing ADITs and re-value them based on the Federal Income Tax Rates.
 - Resulting change in ADITs recognized as a Regulatory Liability – Excess Deferred Income Tax Regulatory Liability
- 2017 TCJA requires compliance with IRS Normalization Rules
 - Normalization requires that in determining the Regulated Utility’s Cost of Service, that the benefit of the amortization of the regulatory liability into income tax expense not exceed the benefit of accelerated depreciation.
 - Determines Protected v Unprotected classes of Regulatory Liability
 - Protected Amortization – Regulator unable to adjust amortization
 - Unprotected Amortization – Regulator has discretion on amortization
 - IRS Regulations specify two prescribed methods of amortization
 - Average Rate Assumption Method (“ARAM”) – Required unless the Utility lacks “Sufficiency of Records”
 - Reverse South Georgia Method (“RSGM”) – used when records are insufficient

ARAM & RSGM

- ARAM requires Cost data...
 - By Vintage (Year Placed in Service)
 - By Asset Category
 - “Sufficiency of Records”
- Amortization will mimic timing differences for accelerated depreciation between book and tax
- Amortization commences when Book depreciation exceeds Tax Depreciation (by vintage, by asset category)
- RSGM used when Regulated Utility lacks Sufficiency of Records
- Based on a weighted average using cost basis and year placed in service
- Straight line amortization over the weighted average life of the assets
- Hybrid Approach can occur
 - Some Vintages meet record standard, but not all

Issues Arising from the TCJA

- Does the Utility have sufficient records? And, sufficient records doesn't mean that full agreement between GAAP and Tax records exists
 - Requires extensive analysis... what method do we use?
- Complex calculations can occur... does the Utility utilize sophisticated tax plant software to analyze data?
 - If not, Excel based solutions will add complexity and require more resources
- How are Protected and Unprotected amortized amounts returned to Customer when competing interests exist (Transmission and Distribution regulators and intervenors)?
 - Competing Interests
- Insufficient Guidance
 - Issues surrounding Cost of Removal, Retirements, Sufficiency of Records
 - IRS Guidance pending
 - FERC??

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FERC Actions Stemming from the TCJA

FERC's Responses to the TCJA

- **March 13 & 15, 2018: Issued Show Cause Orders to 48 Public Utilities**
[162 FERC ¶ 61,224 (2018) (stated rates); 162 FERC ¶ 61,225 (2018) (formula)]
 - Identified through tariff review
 - Utility required to propose transmission rate change to account for lower federal corporate income tax rate OR show cause why unnecessary
 - FERC concerned about overcharging under existing rate structures because:
 - Utilities pass income tax expense to customers through rates
 - Corporate income tax burden had decreased from 35% to 21%
 - Did not address ADIT
 - FERC satisfied with most responses and terminated many proceedings. *E.g.*:
 - *Alcoa et al.*, 165 FERC ¶ 61,094 (2018): utilities filed revised stated rates
 - *Trans Bay Cable, LLC*, 165 FERC ¶ 61,106 (2018): no rate changes required when a settlement bars rate changes, particularly when it is a black box settlement

FERC's Responses to the TCJA

- **March 15, 2018: Notice of Inquiry (RM18-12-000)**
 - Sought comments on the effect of the TCJA on FERC-jurisdictional rates, and whether and how FERC should address those effects
 - Received 40 sets of comments from various stakeholders
- **November 15, 2018: Notice of Proposed Rulemaking (RM19-5-000)**
 - Would require rate revision to deduct or add TCJA-related excess or deficient ADIT and adjust income tax allowances by amortized excess or deficient ADIT
 - No prescribed calculation method or refund/recovery time period
 - Utilities with formula rates to add permanent ADIT worksheet
 - All utilities to submit compliance filings within 90 days of final rule
 - Received 14 sets of comments. Themes:
 - Most support flexibility for calculation method and refund/recovery time
 - Most utilities oppose new worksheet as unnecessary; customers support it
 - Many seek to expand scope of rule (*e.g.*, to *all* impacts of TCJA on rates)

Utility Filings and Complaints at FERC

- Most stakeholders are waiting to act until FERC issues a final rule
- Some transmission customers filed Section 206 complaints seeking out-of-period rate adjustments to account for ADIT
- FERC has tended to deny. Examples:
 - *City of Alexandria, La. v. Cleco Power LLC*, 166 FERC ¶ 61,202 (2019): 35% rate for January-May 2018 charges ok, as that was correct rate at time of 2017 annual update and formula rate lacks true-up mechanism
 - *North Carolina Electric Membership Corp. v. Duke Energy Progress, LLC*, 166 FERC ¶ 61,026 (2019): formula rate applied properly, and failed to show formula rate unjust and unreasonable as to ADIT
- Utilities with ongoing rate cases are providing for the return of excess ADITs in rates, and/or proposing different amortization periods, particularly for unprotected ADIT

Issues Seen at FERC To Date

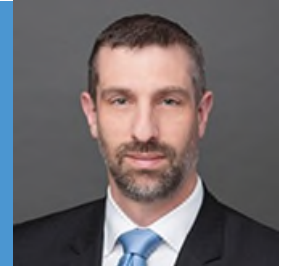
- Content and sufficiency of work papers
 - Detail filed with FERC and/or provided to intervenors
- Process used to determine Excess ADITs
 - ARAM leaves room for interpretation/application
- Allocation of Excess ADITs between functions
 - Fixed allocation at time Excess ADIT liability established or “floating”?
- Unprotected amortization schedule
 - How to determine
- When to start amortizing
 - January 1, 2018 or some other date
- Interpretation/application of formula rates
 - Changes will need to be made to most, if not all, formula rates

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QUESTIONS???

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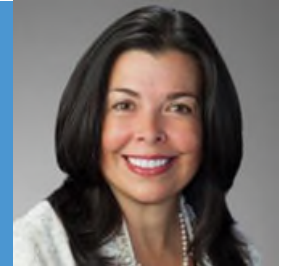


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