BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

NASHVILLE, TENNESSEE

February 6, 2018

ORDER OPENING AN INVESTIGATION AND REQUIRING DEFERRED ACCOUNTING TREATMENT

This matter came before Chairman David F. Jones, Vice Chairman Robin Morrison, Commissioner Herbert H. Hilliard, Commissioner Kenneth C. Hill and Commissioner Keith Jordan of the Tennessee Public Utility Commission ("TPUC" or "Commission"), at a regularly scheduled Commission Conference held on January 16, 2018.

During the Conference, the Commissioners voted unanimously to require Atmos Energy Corporation ("Atmos Energy"), Chattanooga Gas Company ("Chattanooga Gas"), Kingsport Power Company d/b/a AEP Appalachian Power ("Kingsport Power"), Piedmont Natural Gas Company ("Piedmont Natural Gas"), and Tennessee American Water Company ("Tennessee American Water"), to immediately apply deferred accounting treatment, specifically described herein, with respect to the impact of the lowering of the federal corporate income tax rate and to require the named public utilities to provide to the Commission no later than March 31, 2018, the amounts deferred and a proposal to reduce rates or otherwise make adjustments to account for the tax benefits resulting from the 2017 Tax Cuts and Jobs Act, Pub. L. No. 115-97 ("2017 Tax Act").
BACKGROUND

Generally, the statutory rate for federal income tax expense is included as a component of the revenue requirement when utility rates are set by the Commission. On December 22, 2017, new federal tax reductions, including those for businesses, were signed into law. The primary business tax reduction impacting utilities and utility rates was the lowering of the corporate tax rate from 35% to 21%, which will significantly reduce income tax expenses that are currently recovered in utility service rates. The lower tax rates will also impact the future tax liability for utilities that have deferred income taxes because the tax deferrals were included in ratemaking calculations at 35% when in fact the rate is now 21%; this lower tax liability is not reflected in existing rates because future recovery in previous proceedings was based upon a 35% tax rate.

Income taxes and deferred tax liabilities are major components included in establishing rates for all corporate investor-owned utilities. Many public utility commissions, including Tennessee, require depreciation methods to recognize depreciation benefits over the life of the asset placed into service. The Internal Revenue Service ("IRS"), however, allows businesses, including utilities, to recover investment at a faster rate by utilizing accelerated depreciation methods. Accelerated depreciation lowers a utility's income for federal tax purposes in the early years when an asset is placed in service thereby reducing income taxes owed in those early years. These tax savings are then recorded as deferred income taxes and returned to ratepayers in future years to avoid utility windfall profits.

Absent an adjustment, utilities' service rates would be unreflective of a significantly lower cost. This Commission and other state commissions have in the past allowed for deferring expenses and/or revenues until such time as a final decision can be made as to (1) the proper amounts to be

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1 See In Re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges to Permit It To Earn A Fair And Reasonable Rate of Return, Docket No. 08-00039, Order, p. 32 (January 13, 2009).
recovered by the utility or returned to ratepayers and (2) the method by which amounts are recovered by utilities or returned to ratepayers.\(^2\)

The five largest public utilities under the Commission's jurisdiction, Tennessee American Water, Kingsport Power, Atmos Energy, Piedmont Natural Gas and Chattanooga Gas charge rates that were set by the Commission using the now superseded statutory rate of 35\% while utilizing accelerated depreciation for income tax purposes. However, most of the smaller utilities under the Commission's jurisdiction, either do not utilize accelerated depreciation methods or the amounts are not significant. A large number of the smaller utilities do not currently pay the 35\% tax rate, but rather pay lower tax rates due to lower earnings being taxed on the graduated business tax scale or because they do not generate significant positive net income. Several of the smaller utilities are established as Limited Liability Companies ("LLCs"), wherein income taxes are not included in the calculation of utility rates because the LLC members are personally responsible for paying income taxes on utility operations. Finally, telecommunication providers that have opted for market regulation are not subject to the Commission's rate-setting jurisdiction.\(^3\)

**FINDINGS AND CONCLUSIONS**

The tax benefits of the 2017 Tax Act have an immediate impact. Since the earnings of larger utilities under the Commission's jurisdiction are significantly impacted by the 2017 Tax Act due to the lowering of the corporate tax rate from 35\% to 21\%, Commission review and action is necessary in order to investigate to prevent utilities from receiving windfall profits. This review should take place in an efficient manner as possible.

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\(^3\) *Tenn. Code Ann. § 65-5-109(m).*
The 2017 Tax Act, which became effective January 1, 2018, significantly impacts earnings of investor-owned utilities in two significant areas. First, the corporate federal income tax rate is being reduced from 35% to 21%. As utility rates are based upon the 35% statutory tax rate, the new 21% tax rate will significantly reduce utilities’ federal income tax expense currently recovered in utility service rates. Second, the lower tax rate also creates excess deferred tax reserves due to the fact that taxes were deferred at a higher rate. This reduced tax liability also affects revenue requirements of utilities.

Since the 2017 Tax Act will result in increased earnings for utilities, the Commissioners found that it is necessary to investigate and make appropriate rate reductions or other ratemaking adjustments in order to avoid utilities from receiving windfall profits. Furthermore, since the tax benefits are immediate and to preserve the Commission’s options relative to this tax benefit, the Commissioners determined that utilities should use deferral accounting to capture the benefits of tax reform. Specifically, the Commissioners voted unanimously that the five largest utilities under the Commission’s jurisdiction – Tennessee American Water, Kingsport Power, Atmos Energy, Piedmont Natural Gas and Chattanooga Gas must:

1. Track and accumulate monthly in a deferred account the portion of its revenue representing the difference between the cost of service approved by the Commission in its most recent rate case and the cost of service that would have resulted had the provision for federal income taxes been based on 21% rather than 35%; and

2. Calculate the excess deferred tax reserve caused by the reduction in the corporate federal income tax rate and recognize as a deferred liability the estimated reduction of the utilities’ revenue requirement resulting from the 2017 Tax Act; and

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4 Local and long distance telecommunication providers that have elected to operate under market regulation pursuant to state law are exempt from the Commission’s regulation of retail rates.
3. Calculate and defer any other tax effects resulting from the 2017 Tax Act on revenue requirement that are not included in the preceding calculations.

Further, the Commissioners voted unanimously that these calculations, including all amounts deferred, shall be submitted to the Commission no later than March 31, 2018, along with proposals to reduce rates or make other ratemaking adjustments to account for the tax benefits resulting from the 2017 Tax Act. In addition, the Commissioners voted unanimously to create a separate docket for each individual utility's filing. The Commissioners directed the Commission Staff to work with and assist the remaining water, wastewater and natural gas utilities under the Commission's jurisdiction in calculating the tax impacts on their earnings resulting from the 2017 Tax Act and for the Staff to report the results to the Commission.

**IT IS THEREFORE ORDERED THAT:**

1. Atmos Energy Corporation, Chattanooga Gas Company, Kingsport Power Company d/b/a AEP Appalachian Power, Piedmont Natural Gas Company, and Tennessee American Water Company shall:

   a. Track and accumulate monthly in a deferred account the portion of its revenue representing the difference between the cost of service approved by the Tennessee Public Utility Commission in its most recent rate case and the cost of service that would have resulted had the provision for federal income taxes been based on 21% rather than 35%; and

   b. Calculate the excess deferred tax reserve caused by the reduction in the corporate federal income tax rate and recognize as a deferred liability the estimated reduction of the utilities' revenue requirement resulting from the 2017 Tax Cuts and Jobs Act; and
c. Calculate and defer any other tax effects resulting from the 2017 Tax Cuts and Jobs Act on revenue requirement that are not included in the preceding calculations.

2. The calculations made by Atmos Energy Corporation, Chattanooga Gas Company, Kingsport Power Company d/b/a AEP Appalachian Power, Piedmont Natural Gas Company, and Tennessee American Water Company in relation to the tax deferred accounting treatment ordered herein shall be submitted no later than March 31, 2018, including proposals to reduce rates or make other ratemaking adjustments to account for the tax benefits resulting from the 2017 Tax Cuts and Jobs Act.


4. The Staff of the Tennessee Public Utility Commission shall work with the remaining water, wastewater and natural gas utilities under the jurisdiction of the Tennessee Public Utility Commission to calculate the tax impacts on earnings resulting from the 2017 Tax Cuts and Jobs Act, and Staff shall report the results to the Commission.

Chairman David F. Jones, Vice Chairman Robin L. Morrison, Commissioner Herbert H. Hilliard, Commissioner Kenneth C. Hill, and Commissioner Keith Jordan concur.

ATTEST:

Earl R. Taylor, Executive Director