

**STAFF REPORT
REGARDING THE EFFECTS UPON MISSOURI UTILITIES
OF THE TAX CUTS AND JOBS ACT OF 2017
FILE NO AW-2018-0174**

I. Executive Summary

On December 22, 2017, Staff moved the Commission to open a working docket regarding the effects of the Tax Cuts and Jobs Act of 2017 (“TCJA”). Five days later, Staff moved the Commission to “allow interested stakeholders and Commission-regulated pass-through entities such as S Corporations, LLCs and partnerships to respond to certain questions as contained in this motion: direct all electric corporations, gas corporations and Missouri-American Water Company to respond, by January 12, 2018, to the questions outlined in this motion: and direct Staff to file, by January 12, 2018, a report summarizing stakeholder input and providing recommendations for the development of a prompt plan of response designed to ensure that Missouri public utility rates are just and reasonable.” On January 3, 2018, the Commission issued its *Order Opening a Working Proceeding Regarding the Effects upon Missouri Utilities of the Tax Cuts of 2017 and Directing Response*. The Commission’s order included the questions proposed by Staff and required all electric utilities, gas utilities, and the largest water and sewer utility, to respond by January 31, 2018. It further directed the Staff to submit a report by February 15, 2018, “summarizing stakeholder input and providing recommendations for the development of a prompt plan of response designed to ensure that Missouri public utility rates are just and reasonable.”

Staff submits this report summarizing the stakeholder input, providing Staff’s legal analysis of the TCJA and Commission authority and recommending the Commission close this working docket and address the TCJA in separate dockets for each utility. More specifically, Staff recommends the Commission open utility specific “R” dockets issuing “show cause” orders as to why the Commission should not issue an order reducing its rates across the board by the percentage estimated by the utility, or take some other action deemed necessary to effectuate the applicable provisions of the TCJA. Staff further recommends the Commission open a “WW” docket to further explore issues related to small water and sewer companies. Finally, Staff recommends the Commission open “HR” dockets with specific questions for steam heat utilities. See Section VI of this report for utility-specific recommendations.

II. Summary of TCJA Relevant Factors

The TCJA will affect the financial results of Missouri utilities in a variety of ways that will almost certainly result in an overall material revenue requirement reduction for large utilities.

Staff compared the estimated TCJA revenue requirement impacts (in all cases, decreases) provided in the January 31, 2018, filings in this case to the annual revenue amounts for each utility provided in the 2017 Missouri Public Service Commission Annual Report. This comparison allows for a “ballpark” estimate of the overall cost of service decreases associated with the TCJA, all other things being equal.

The “ballpark” estimates indicate estimated rate percentage decreases as follows¹:

Ameren Missouri (electric) – **	**
Kansas City Power & Light – 4.2%	
KCP&L Greater Missouri Operations – 3.8%	
The Empire District Electric Company – **	**
Laclede Gas – **	**
Missouri Gas Energy – **	**
Ameren Missouri (gas) – **	**
Liberty Utilities – **	**
Empire District Gas – **	**
Summit Natural Gas – **	**
Missouri-American Water Company – 7.1%	²

The following sections discuss some of the known or possible major financial impacts on Missouri utilities which are identified at this time:

Federal Income Tax Rate Reduction

The TCJA reduces the federal corporate income tax rate from its current 35% to 21%. In rate cases, a composite federal-state effective tax rate is used in calculating current and deferred income tax expense. The impact of the TCJA on the composite effective tax rate is a reduction from 38.39% to 25.45%. Incorporation of the federal corporate tax rate reduction in utility cost of service will result in material revenue requirement reductions for large Missouri utilities.

Excess Accumulated Deferred Income Tax Flow Back

For many years, ratepayers have provided deferred tax expense recovery to Missouri utilities in rates. Deferred taxes are amounts paid in by customers for income taxes that will not be paid to taxing authorities by the utilities until later periods. Because of this delayed payment, deferred taxes are a source of capital to the utilities, and rate base is reduced by the amount of net ADIT collected from customers in order to provide ratepayers a return on the monies provided.

Due to the TCJA, deferred taxes that were collected in years past from customers assuming a 38.39% composite effective tax rate will now actually be paid to the taxing authorities by utilities in the future at a 25.45% rate. This means that the current ADIT reserve balance recorded by utilities on their balance sheets and reflected in utility rate base is overstated, and that unless some action is taken by the Commission to flow back excess ADIT to customers the utilities will

¹ Note: All of the estimated percentages shown above reflect the lower federal corporate tax rate. Some, but not all, of the rate decrease percentages reflect an additional assumption regarding flow back of excess accumulated deferred taxes (discussed below).

² No annual revenue amounts were presented in the 2017 MPSC Annual Report for water and sewer utilities. Staff used the 2016 calendar test year amount for total company revenues for Missouri-American Water taken from Staff’s Accounting Schedules in Case No. WR-2017-0285 (filed November 30, 2017) to determine this percentage.

permanently retain this customer provided capital. For this reason, it would also be appropriate for the Commission to include an amortization of the excess portion of ADIT back to customers when setting rates.

The ADIT balance on the utilities' books at this time can be divided into two categories: protected ADIT and unprotected ADIT. Protected ADIT is the portion associated with accelerated depreciation tax timing differences that must be "normalized" for ratemaking purposes. "Tax normalization" effectively means the utility receives an immediate benefit from the accelerated depreciation tax timing difference, with that benefit then being gradually passed on to customers over the estimated life of the utility asset giving rise to the accelerated depreciation deduction. Under the TCJA, Staff's understanding is that the Commission is restricted from flowing back protected excess ADIT to customers in rates any more quickly than over the estimated average remaining life of the assets that gave rise to the ADIT. This amortization period is expected to be quite lengthy, with approximately 20 years being a reasonable estimate for most utilities.

Unprotected excess ADIT is the portion of the utility's deferred tax reserve that resulted from normalization treatment of tax timing differences other than accelerated depreciation deductions. Staff understands that unprotected excess ADIT can be flowed back to customers through an amortization period of the Commission's choosing.

Based upon Staff's preliminary analysis of potential excess ADIT flow back, Staff believes this component of tax reform will also have a material revenue requirement impact on Missouri utilities.

Bonus Depreciation

Since the financial crisis that occurred in the 2008 – 2009 timeframe, utilities have been able to take advantage of "bonus depreciation" tax deductions for new asset investment. Bonus depreciation provides companies with the ability to immediately deduct all or a large portion of the entity's plant investment in the first year the asset is placed in-service, as opposed to recovering the asset for tax purposes over a longer period of time. The availability of bonus depreciation to utilities allowed the companies to collect in rates a larger amount of capital from customers in the form of deferred taxes, and thus resulted in a lower rate base for the utilities than would exist absent bonus depreciation benefits.

For utilities, the TCJA results in a loss of all or almost all bonus depreciation deductions after September 30, 2017. Loss of bonus depreciation should have little or no short-term impact on utility revenue requirements, as essentially this will result in the same amount of increase to current income tax expense as the resulting decrease to deferred income tax expense. In the longer term, loss of bonus depreciation will mean the utilities will have to rely on external financing from debt and equity sources to a somewhat greater degree as ratepayers will be paying in less customer-provided capital in the form of deferred taxes. This will lead to higher

rate base levels in the future than would otherwise exist and may have cash flow impacts on the utilities as well.

Other Potential Impacts

The possible financial impacts of other provisions of the TCJA are not known at this time and will need to be researched further. These areas include prospective tax treatment of existing net operating losses, the ability of utilities to continue to receive full deductibility of interest expense, and loss of certain minor tax deductions for miscellaneous items.

As federal income taxes are currently deductible for purposes of calculating state tax liabilities, the reduction in the federal corporate tax rate will lead to increased payments to utilities for state income taxes, all other things being equal. It is possible that the Missouri government may take actions to change its corporate tax rate (currently 6.25%) and rules in response to the TCJA.

III. Staff Legal Analysis

Two well-established principles of law establish the parameters within which the Commission's response to the TCJA must operate. First, "[d]ue process prevents any court or legislative body from taking the property of a public utility where that property consists of money collected from ratepayers pursuant to lawful rates." *Lightfoot v. City of Springfield*, 236 S.W.2d 348, 354 (Mo. 1951). Second, the Public Service Commission is an administrative body, and not a court, and hence the commission has no power to exercise or perform a judicial function, or to promulgate an order requiring a pecuniary reparation or refund. *Lusk v. Atkinson*, 268 Mo. 109, ___, 116, 186 S.W. 703, 704-705 (banc 1916); *State ex rel. and to Use of Mo. Pac. Rwy. v. Public Service Commission*, 303 Mo. 212, 218-20, 259 S.W. 445, 447-48 (1923); *State ex rel. Jenkins v. Brown*, 323 Mo. 382, 386-87, 19 S.W.2d 484, 486 (1929); *American Petroleum Exchange v. Public Service Commission*, 172 S.W.2d 952, 955 (Mo. 1943) ("The Commission is without authority to award money"). There can be no refunds of revenue received by a public utility pursuant to an approved tariff and the P.S.C. cannot order them.

The Missouri Supreme Court has explained that refunds of excess utility profits are forbidden by the rule against retroactive ratemaking:

The commission has the authority to determine the rate to be charged, § 393.270. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery, see *State ex rel. General Telephone Co. of the Midwest v. Public Service Comm'n*, 537 S.W.2d 655 (Mo. App.1976). It may not, however, redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process. "The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match

expenses plus rate-of-return with the rate actually established, *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. at 31, 46 S.Ct. 363; *Lightfoot v. Springfield*, 361 Mo. 659, 669, 236 S.W.2d 348, 353 (Mo. 1951). Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, §§ 393.270(3) and 393.140(5), they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses. *State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 58-59 (Mo. banc 1979) (“*UCCM*”).

What the Commission can do is, after consideration of all relevant factors, set the prospective rate to be charged for utility service.

Perhaps, the consideration of all relevant factors is unnecessary. The Commission is authorized to treat an item of operating expense differently where it is just and reasonable to do so. *State ex rel. Midwest Gas Users' Association v. Public Service Commission*, 976 S.W.2d 470, 478 (Mo. App., W.D. 1998), citing *UCCM* and *State ex rel. Hotel Continental v. Burton*, 334 S.W.2d 75 (Mo. 1960). In *Hotel Continental*, the Court upheld the Commission's determination that the gross receipts taxes collected by a utility and paid over to taxing authorities was different in nature from other operating expenses such that it was permissible to establish a Tax Adjustment Clause (“TAC”) that provided for the automatic adjustment of rates between rate cases to reflect intervening changes in the rate of the gross receipts tax. *Hotel Continental*, 334 S.W.2d at 79. In *UCCM*, the Court distinguished *Hotel Continental*, and held that the fuel costs incurred by electric utilities were not different in nature from other operating expenses and that a Fuel Adjustment Clause (“FAC”) that provided for the automatic adjustment of rates between rate cases to reflect changes in the cost of fuel was therefore not permissible. *UCCM*, at 51. Finally, in *Midwest Gas Users' Association*, *supra*, the Western District of the Missouri Court of Appeals revisited *Hotel Continental* and *UCCM*'s review and analysis of that case and upheld the Commission's use of the “Purchased Gas Adjustment (PGA)/Actual Cost Adjustment (ACA)” system for natural gas costs.

It may be that the impact of the TCJA is like the gross receipts tax analyzed in *Hotel Continental* and the natural gas commodity costs considered in *Midwest Gas Users' Association* and that the Commission may order a reduction in utility rates without the necessity of considering all relevant factors in an extended general rate case. In *Midwest Gas Users' Association*, the Court applied the principles gleaned from *Hotel Continental* and *UCCM* to the PGA/ACA and determined that it was permissible: it was not single-issue ratemaking because the commodity price of natural gas does not include labor or other components subject to management economizing, so that savings in one area can offset cost increases in another. Much of the commodity price of gas is set by the FERC and simply passed on to customers much like the gross receipts tax considered in *Hotel Continental*. It was not retroactive ratemaking because the price already charged and paid was not changed and any shortfall was collected prospectively from future customers. It did not violate the filed-rate doctrine because the utility was required to put an actual rate in the tariff, not merely a formula as was the case with the FAC in *UCCM*. Any customer could examine the tariff and see how much she would have to pay for gas service. Finally, it was not an abdication of the Commission's regulatory duties because, in the

ACA phase, the amounts paid for gas and charged to customers were subject to audit, prudence review and true-up by the Commission. For these reasons, the PGA/ACA was approved. *Midwest Gas Users' Association*, 479-483.

Section 393.260.1, RSMo., authorizes the initiation of ratemaking by complaint, commonly referred to as an "overearnings complaint," by the filing of tariffs by the utility or by the Commission on its own motion:

Pursuant to § 393.150, a utility may file a schedule stating a new rate or charge, rule or regulation, which shall become valid unless suspended by the commission, on its own motion or upon complaint of interested parties as authorized by the statute. If suspended, the commission must within a specified period hold a hearing concerning the propriety of the new rate, charge, rule or regulation. A hearing may also be had without the filing of a new rate, if a complaint is filed, or on motion of the commission, §§ 393.260, 386.390. The commission may investigate any matter as to which a complaint may be filed, or in order to enable it to ascertain facts requisite to the exercise of any powers conferred upon it. At the conclusion of any hearing and investigation, the commission shall set the maximum price to be charged for the electricity, §§ 392.270(2), 393.270(3). * * * *UCCM*, 585 S.W.2d at 48 (emphasis added; internal citations omitted).

The Commission has periodically authorized trackers or accounting authority orders for unique, unusual or non-recurring events. For instance, the Commission promulgated a tree-trimming process in response to repeated outages. Since the cost of implementing the process was unknown, the Commission authorized trackers to track the costs. Similarly, the Commission has authorized riders for such things as recovery related to the MEEIA surcharge and the Renewable Energy Standard Rate Adjustment Mechanism ("RESRAM"). Staff considers the TCJA a unique, unusual and non-recurring event. Therefore, it may be necessary to consider such treatment in this case for certain unknown factors.

In summary, given that the TCJA will likely result in windfall profits for all Missouri regulated public utilities and in view of the legal constraints outlined above, the only response available to the Commission is to redetermine rates for each regulated public utility as promptly as possible. It may be that this rate reduction need not include the consideration of all relevant factors in a lengthy general rate case. In 1986-87, the Commission's response took the form of negotiated rate reductions under the threat of a Staff overearnings complaint. That approach resulted in prompt rate reductions.

Each of Missouri's major regulated public utilities has already provided an estimate of the impact of the TCJA expressed as a percentage. Staff recommends that the Commission on its own motion initiate a rate case for each of these regulated public utilities by issuing a show cause order to each of them, directing it to show cause, if any it has, why the Commission should not issue an order reducing its rates across the board by the percentage estimated by the utility, or take some other action deemed necessary to effectuate the applicable provisions of the TCJA.

IV. Summary of Utility Responses

Staff posed five questions in its December 27, 2017, Motion to Solicit Input:

- a. What is the appropriate avenue for effectuating change to utility rates as a result of the federal income tax reduction?
- b. Is a different avenue appropriate for regulated corporations and Commission-regulated pass-through entities such as S Corporations, LLCs, and Partnerships?
- c. What is the appropriate mechanism(s) for effectuating change to utility rates as a result of the federal income tax reductions?
- d. How does the change to the federal income tax affect pending rate cases? Can the change be considered in the pending rate cases?
- e. Please calculate the first-year approximate annual Missouri jurisdictional change in cost of service for your utility that is projected to result from implementation of the Tax Cuts and Jobs Acts of 2017 (all other things being equal) and provide supporting workpapers for this calculation.

Utility's Responses to Questions

The following is a summary of each utility's response to the five questions in the December 27, 2017 Motion to Solicit Input.

Ameren Missouri

- a. What is the appropriate avenue for effectuating change to utility rates as a result of the federal income tax reduction?
The appropriate avenue for effectuating any change in rates is through a general rate proceeding where all relevant factors are considered.
- b. Is a different avenue appropriate for regulated corporations and Commission-regulated pass-through entities such as S Corporations, LLCs, and Partnerships?
Not applicable to Ameren Missouri
- c. What is the appropriate mechanism(s) for effectuating change to utility rates as a result of the federal income tax reductions?
As outlined in response to Question a. the appropriate mechanism to effect a change to utility rates in response to the Act is through a Report and Order resolving a general rate proceeding in which new rates are determined based on all relevant factors which would include, but cannot be limited to, consideration of the impact of the Act on the utility's rates.
- d. How does the change to the federal income tax affect pending rate cases? Can the change be considered in the pending rate cases?
Utilities with pending rate cases are in a different position than those, like Ameren Missouri, which do not have a pending rate case.

- e. Please calculate the first-year approximate annual Missouri jurisdictional change in cost of service for your utility that is projected to result from implementation of the Tax Cuts and Jobs Acts of 2017 (all other things being equal) and provide supporting workpapers for this calculation.

Ameren Missouri can calculate an estimate of its 2018 cost of service with and without this tax change. However, Ameren Missouri cannot determine the difference between the income tax expense reflected in an estimated 2018 revenue requirement and the income tax expense reflected in its current rates. Ameren Missouri does estimate that the Preliminary Retail Revenue Requirement for 2018 for its electric operations will be approximately ** lower with the implementation of the TCJA of 2017. Ameren Missouri further estimates an annual revenue requirement reduction for its gas operations of approximately ** .**

Empire District/Liberty

The Empire District Electric Company (“EDE”), The Empire District Gas Company (“EDG”), Liberty Utilities (Missouri Water) LLC (“Liberty Water”), and Liberty Utilities (Midstates Natural Gas) Corp. (“Liberty Midstates”) (“collectively Empire/Liberty”) Response to the Commission Order.

- a. What is the appropriate avenue for effectuating change to utility rates as a result of the federal income tax reduction?
The only methods of effectuating a change to utility rates in Missouri are a rate case and a complaint case.
- b. Is a different avenue appropriate for regulated corporations and Commission-regulated pass-through entities such as S Corporations, LLCs, and Partnerships?
No, Empire/Liberty believe the avenue discussed in (a) above should be followed for Commission-regulated limited liability companies (LLC) pass-through entities. Empire/Liberty has no other pass-through entities (such as S Corporations and Partnerships) and, therefore, takes no position on this issue.
- c. What is the appropriate mechanism(s) for effectuating change to utility rates as a result of the federal income tax reductions?
See Empire/Liberty’s response to (a) above.
- d. How does the change to the federal income tax affect pending rate cases? Can the change be considered in the pending rate cases?

In respect to pending rate cases, Empire/Liberty would defer the decision to the Commission based on the circumstances (such as test year, update period, and true-up period) in each case.

- e. Please calculate the first-year approximate annual Missouri jurisdictional change in cost of service for your utility that is projected to result from implementation of the Tax Cuts and Jobs Acts of 2017 (all other things being equal) and provide supporting workpapers for this calculation.

The approximate decrease in Revenue Requirement is ** for EDE, ** for EDG, and ** for Midstates Natural Gas for an approximate ** decrease in Revenue Required for Empire/Liberty.

KCP&L/GMO

Kansas City Power & Light Company (“KCP&L”) and KCP&L Greater Missouri Operations Company (GMO) Response to the Commission Order.

- a. What is the appropriate avenue for effectuating change to utility rates as a result of the federal income tax reduction?

A change in a utility’s general rates can only be accomplished in a rate case filed by the utility or in a complaint case. Both of these avenues fully examine the utility’s cost of service in setting rates.

- b. Is a different avenue appropriate for regulated corporations and Commission-regulated pass-through entities such as S Corporations, LLCs, and Partnerships?

KCP&L/GMO does not a position on this issue.

- c. What is the appropriate mechanism(s) for effectuating change to utility rates as a result of the federal income tax reductions?

See response to question (a) above.

- d. How does the change to the federal income tax affect pending rate cases? Can the change be considered in the pending rate cases?

For KCP&L and GMO, the Commission can make its determination of the impact of the new tax rates in a pending rate case. KCP&L/GMO assumes that the issue will be addressed in the KCP&L and GMO rate cases (ER-2018-0145/0146) filed on January 30, 2018.

- e. Please calculate the first-year approximate annual Missouri jurisdictional change in cost of service for your utility that is projected to result from implementation of the Tax Cuts

and Jobs Acts of 2017 (all other things being equal) and provide supporting workpapers for this calculation.

KCP&L estimates a decrease in Revenue Requirement of approximately \$38.4 million.

GMO estimates a decrease in Revenue Requirement of approximately \$29.1 million.

Spire Missouri Inc. d/b/a Spire

- a. What is the appropriate avenue for effectuating change to utility rates as a result of the federal income tax reduction?

The appropriate venue for effectuating changes to utility rates as a result of reductions in federal income tax expense would be to consider them within the context of a rate proceeding, where all relevant factors may be considered.

- b. Is a different avenue appropriate for regulated corporations and Commission-regulated pass-through entities such as S Corporations, LLCs, and Partnerships?

Spire is not an S Corporation, an LLC or a partnership, it has no comment on this question at this time.

- c. What is the appropriate mechanism(s) for effectuating change to utility rates as a result of the federal income tax reductions?

See response to question (a) above.

- d. How does the change to the federal income tax affect pending rate cases? Can the change be considered in the pending rate cases?

The President signed the TCJA December 22, 2017, effective January 1, 2018. With respect to Spire Missouri, the TCJA was passed into law well after the end of the true-up period in the Spire's rate cases, Case Nos. GR-2017-0215 and GR-2017-0216 (the "Rate Cases"). In addition, the TCJA is complex enough that the changes cannot be accurately known and measured at this time even if the TCJA had been passed during the true-up period. As such, consideration of the effects of the TCJA in the Rate Cases would violate the "matching" principle, a principle that Staff, the Commission and other parties have relied upon, both in the Rate Cases and in other proceedings.

- e. Please calculate the first-year approximate annual Missouri jurisdictional change in cost of service for your utility that is projected to result from implementation of the Tax Cuts and Jobs Acts of 2017 (all other things being equal) and provide supporting workpapers for this calculation.

Spire estimated the change in cost of service resulting from the TCJA in the Rate Cases responses filed on January 22, 2018. Timothy W. Krick estimated Spire's Net Tax Benefit to Customers of the TCJA to be approximately ** **.

- d. How does the change to the federal income tax affect pending rate cases? Can the change be considered in the pending rate cases?

See the rebuttal testimony of MAWC witnesses James M. Jenkins and John R. Wilde filed on January 17, 2018, in Commission Case No. WR-2017-0285.

- e. Please calculate the first-year approximate annual Missouri jurisdictional change in cost of service for your utility that is projected to result from implementation of the Tax Cuts and Jobs Act of 2017 (all other things being equal) and provide supporting workpapers for this calculation.

See the rebuttal testimony of MAWC witnesses James M. Jenkins and John R. Wilde filed on January 17, 2018, in Commission Case No. WR-2017-0285. MAWC estimated the revenue requirement reduction associated with lowering of the federal corporate tax rate to be approximately \$20.3, based upon its requested future test year cost of service calculation.

ITC Midwest LLC and Ameren Transmission Company of Illinois (“ATXI”):

ITC Midwest and ATXI responded that they are transmission only utilities with no direct-connected load or generation. ITC Midwest and ATXI are currently working with the Midcontinent Independent System Operator, Inc, (“MISO”) to develop a path to reflect the impact of the TCJA on their formula rates.

V. 1986 Tax Reform

Since tax reform arises infrequently, there is interest in reviewing the Commission’s response in 1986, the last time that all Missouri utilities and ratepayers were affected by a broad reform of the federal Income Tax Code, including a significant tax reduction.

Summary

In general, the proceedings in response to the Tax Reform Act of 1986 occurred in three phases:

1. Phase One – the Commission opened a generic docket, made all of Missouri’s regulated public utilities with annual revenues of \$2,000,000 or more parties, and directed them to file certain information with the Commission and to provide procedural suggestions;

2. Phase Two – the Commission directed each utility to negotiate independently with Staff, OPC, and any interested intervenors, and reach agreement on a voluntary rate reduction. Where agreement on voluntary rate reductions could not be reached, Staff was directed to file overearning complaints.

3. Phase Three – As agreements on voluntary rate reductions were negotiated and embodied in *Stipulations and Agreements*, these were filed in the generic docket, as well as in a “spin-off” docket for each individual Company and approved by the

Commission. Upon approval of the stipulation and the implementing compliance tariffs, the spin-off docket was closed, and the Company was dismissed from the generic docket. No overearnings complaints were ultimately required in 1987.

Proceedings in 1986

In response to the Tax Reform Act of 1986, the Commission proceeded much as it has thus far proceeded in response to the TRJA. In November 1986, the Commission established a “generic docket,” Case No. AO-87-48, and made all public utilities with Missouri jurisdictional revenues of at least \$2,000,000 for 1985 to “report to the Commission the revenue requirement impact of the federal tax changes as applied to either the 1985 Missouri jurisdictional operations or more current historical test year data if such data was presented during a rate case recently pending before this Commission.” As it has in Case No. AW-2018-0174, the Commission required the participating utilities to file written answers to a series of questions:

1. Based on the tax law in effect in 1986, calculate a revenue requirement showing the operating results of unadjusted calendar year 1985 (or more recent unadjusted historical test year) and unadjusted calendar year 1986. The revenue requirement calculation must be consistent with the Company's last Missouri Commission rate order. Workpapers supporting the revenue requirement shall contain: a year-end rate base determined in a manner comparable to the last rate order; rate of return using authorized return on equity resulting from the last rate order or stipulation (if desired, a Company can provide a current estimate of the return on equity in addition to the authorized return on equity); an income statement unadjusted for any changes other than those required to calculate income tax expense; and tax workpapers showing the computation of current and deferred income tax expense. The tax workpapers shall show the necessary additions to and/or deductions from book income in arriving at taxable income and the computation of any deferred tax expense provisions/amortizations.

2. Based on the new tax law using the tax rate(s) and other known tax changes applicable to calendar year 1987 taxable income (e.g. a 40% phased tax rate for 1987), calculate a revenue requirement for each of the calendar years set forth in 1. above. Except for the tax change, assume the same conditions and provide supporting workpapers as delineated in 1. above. The tax workpapers should clearly note the adjustments required to fully reflect the impact of the new tax law.

3. Based on the new tax law using the tax rate(s) and other known tax changes applicable to tax years subsequent to calendar year 1987, calculate a revenue requirement for each of the calendar years set forth in 1. above. Except for the tax change, assume the same conditions and provide any supporting workpapers as delineated in 1. above. The tax workpapers should clearly note the adjustments required to fully reflect the impact of the new tax law.

4. If not previously provided herein, provide the workpapers supporting the amount of excess deferred tax reserves attributable to the turnaround of tax/book timing differences at a tax rate lower than the rate(s) at which the reserve has thus far been established. The workpapers should also contain the method and calculation of the amortization or return of such excess reserves as a reduction to tax expense in compliance with the new tax law.

5. All deferred tax expense and reserve information shall be presented in a fashion which will allow a ready disaggregation between the types of tax/book timing differences which gave rise to the deferred tax expense or reserve (e.g. accelerated depreciation, ITC, Schedule M items normalized, phase-in plans, etc.).

6. The Company may provide further information which it deems may be advantageous in examining the revenue requirement impact of the tax law change; however, such information shall be clearly identified and not provided in lieu of, but rather in addition to, the information requested in items 1. through 5. above.

The Commission went on to direct the parties:

On or before December 15, 1986, each company shall also explain any plans or proposals it may have for reflecting the impact of the change in the tax law upon its Missouri jurisdictional operations. If a company believes that rate adjustments are not appropriate to reflect the full revenue requirement impact of the change in the tax law, it should explain in detail all reasons in support of its position.

The Commission is considering various procedural alternatives for recognizing the effects of the change in the tax law in the ratemaking or regulatory process. Any company or other interested party may file comments suggesting appropriate procedures designed to recognize the revenue effect of such tax change on or before December 15, 1986. The Staff and the Public Counsel may file comments on or before January 5, 1987.”

On January 30, 1987, the Commission issued an order acknowledging the responses and comments received and adopting Staff’s proposal for the next phase of the proceeding:

The Staff contends that the appropriate vehicle to recognize the effects of the TRA is through voluntary tariff filings by the companies or through complaint proceedings against each company. Staff recommends that it conduct informal meetings with each company who has filed comments in this docket in order to discuss the possibility of voluntary rate decreases reflecting the revenue requirement effects of the TRA. Staff proposes that if an agreement cannot be reached, it would then file a complaint against the company.

In the event numerous complaint cases are filed and rate decreases are ultimately found reasonable, Staff suggests two alternatives to address the delay of rate decreases pending the disposition of these cases: (1) the Commission could require all companies within its jurisdiction to file tariffs, superseding all other filed tariffs and schedules, which would indicate that all tariffs, rates and charges in effect as of July 1, 1987 are interim, subject to refund; or (2) all such tariffs could be subject to refund only to the extent that there has been a reduction in revenue requirement due to the TRA. Staff requests that the Commission order the companies to file comments addressing these alternatives.

In addition, Staff requests the Commission to order the companies to file comments detailing the reason the companies believe their rates are not excessive in spite of the TRA.

Public Counsel and industrial intervenors also propose informal meetings to determine whether the issues can be resolved through negotiated settlement.

Having reviewed the companies' filings and the comments in response thereto, the Commission determines that the informal meeting approach is appropriate. Accordingly, the Commission determines that Staff shall establish a schedule of meetings between Staff, the Public Counsel, the individual companies and interested intervenors to discuss the possibility of voluntary rate decreases reflecting the revenue requirement effects of the TRA.

VI. Staff Recommendation

In general, Staff recommends that the Commission take the opportunity to reflect the revenue requirement impact of the TCJA in customer rates through general rate cases, considering "all relevant factors." If that course of action is not possible or feasible, then Staff recommends that actions be taken to ensure that utilities defer the financial impact of the TCJA on their books for potential rate treatment at a future time.

A number of major Missouri utilities are currently before the Commission in general rate case proceedings, and the cases are in varying stages of completion. Staff recommends that the utilities' rates be adjusted in these proceedings for the effect of the TCJA if the financial effects of the new law are reasonably known and measurable. At this time, Staff considers the financial impact of the reduction in the corporate income tax rate to be known and measurable. In addition, depending upon the information available from individual utilities, a reasonable quantification of the protected and unprotected excess ADIT flow back to customers may be possible as well. Staff does not consider other possible financial impacts of the TCJA to be known and measurable at this time, and the actual financial impact of those changes should be subject to deferral treatment.

If a utility is not currently seeking a change in its base rates, a Commission order to defer all TCJA impacts would be a reasonable alternative. "Deferral" is an accounting term for capturing

a cost on a company's balance sheet instead of expensing the cost. If the impacts associated with the TCJA are deferred, then the utility would not receive a higher earnings windfall from the new law. Instead, those benefits would be preserved on the utility's balance sheet as a regulatory liability, which could then be amortized as a reduction to cost of service in the utility's next general rate case.

Authorization for cost deferrals by the Commission are generally related to costs associated with extraordinary events, such as natural disasters. Staff views the passage of the TCJA as a unique, unusual and non-recurring event, and thus eligible for deferral treatment as an extraordinary event under traditional Commission criteria. Deferral of the financial impact of the new tax law would remove the earnings incentive for utilities to attempt to retain the tax law savings for an extended period of time.

Senate Substitute for Senate Bill 564 (SB 564) was perfected on February 8, 2018. SB 564 applies to electrical corporations that do not have a rate case pending as of February 1, 2018, or the effective date of the legislation, whichever is later. SB 564 provides the Commission with one-time authority (to exercise within 90 days of effective date of the legislation) to adjust rates prospectively to reflect, in rates or through deferral, changes in the income tax component of federal tax act without having to consider any other factor as currently required by Section 393.270 RSMo. The Commission shall require the electrical corporation to defer to a regulatory asset the financial impact of federal tax act from January 1, 2018, through effective date of rates under one-time adjustment. For good cause shown, the Commission may allow a deferral in whole or in part of financial impacts starting January 1, 2018, through effective date of rates in next general rate proceeding. The TCJA portion of SB 564 has an emergency clause, making it effective upon its passage and approval.

Staff recommends that rate case dockets be opened for all major utilities that are currently not before the Commission with general rate cases so that all options for reasonably quick incorporation of tax law impacts in customer rates by those utilities can be explored.

Within the rate case dockets, Staff will seek agreement on deferral of TCJA financial impacts pending further rate action. Further, Staff will explore with each utility their current earnings situation, and whether some or all of the financial benefits of the TCJA can be passed on to customers through voluntary utility action while preserving the utility's opportunity to earn a reasonable rate of return. In the context of the Tax Reform Act of 1986, many utilities agreed to voluntary rate reductions at that time to pass on the benefits of that legislation to customers.

Utility/Case Specific Recommendations

Staff recommends the Commission close File No. AW-2018-0174 and take utility-specific action.

The following provides the current rate case status of each major Missouri electric, gas and water utility, and Staff's recommendation on how to proceed in consideration of the TCJA:

Ameren Missouri (electric) – No rate case filed. Open an “ER” docket and issue a “show cause” order to either review the effect of the TCJA on Ameren Missouri or implement the provisions of SB 564, as applicable.

Ameren Missouri (gas)- No rate case filed. Open a “GR” docket and issue a “show cause” order to review the effect of the TCJA on Ameren Missouri Gas.

KCP&L – Rate case filed January 2018 (Case No. ER-2018-0145). Handle in rate case. On February 9, KCP&L filed a notice in the rate case stating:

In its revenue requirement filing, the Company has reflected its estimate of the tax savings that customers will experience beginning with the rates effective date of this case. The reduction of the federal tax rate in 2018 to 21% and an estimate of the annual amount of amortization related to excess ADIT (included in certain other amortizations) created as a result of the legislation is included in the income tax expense calculation. In addition, KCP&L will work with parties of this case to determine the actual impact of the tax cuts beginning January 1, 2018 and reflect these changes in the final true-up of this case based on a review of all costs to serve customers.

(Direct Testimony of Darrin Ives, p. 14, lines 1-10)

The purpose of this letter is to affirm to the Commission, the presiding officer and the parties that the foregoing position will remain KCP&L’s position throughout the course of this proceeding.

GMO – rate case filed January 2018 (Case No. ER-2018-0146). Handle in rate case. On February 9, 2018, GMO filed a notice in the rate case stating:

In its revenue requirement filing, the Company has reflected its estimate of the tax savings that customers will experience beginning with the rates effective date of this case. The reduction of the federal tax rate in 2018 to 21% and an estimate of the annual amount of amortization related to excess ADIT (included in certain other amortizations) created as a result of the legislation is included in the income tax expense calculation. In addition, KCP&L will work with parties of this case to determine the actual impact of the tax cuts beginning January 1, 2018 and reflect these changes in the final true-up of this case based on a review of all costs to serve customers.

(Direct Testimony of Darrin Ives, p. 15, lines 10-19)

The purpose of this letter is to affirm to the Commission, the presiding officer and the parties that the foregoing position will remain GMO’s position throughout the course of this proceeding.

GMO (steam heat) – No rate case filed. Open a “HR” docket and issue an order directing GMO to respond to the questions in the Commission’s January 3, 2018 Order Opening a Working Proceeding Regarding the Effects Upon Missouri Utilities of the Tax Cuts of 2017 and Directing Response.

Empire Electric – No rate case filed. Open an “ER” docket and issue a “show cause” order to either review the effect of the TCJA on Empire or implement the provisions of SB 564, as applicable.

Empire Gas – No rate case filed. Open a “GR” docket and issue a “show cause” order.

Liberty Utilities Midstates (gas) – Rate case filed September 2017 (Case No. GR-2018-0013). Handle in rate case.

Spire (Laclede Gas) – Rate cases filed April 2017 (Case No. GR-2017-0215). Hearing on effect of TCJA held February 5, 2018.

Spire (Missouri Gas Energy) – Rate case filed April 2017 (Case No. GR-2017-0216). Hearing on effect of TCJA held February 5, 2018.

Summit – No rate case filed. Open a “GR” docket and issue a “show cause” order.

Missouri-American Water – Rate case filed June 2017 (Case No. WR-2017-0285). Testimony has been filed on the TCJA. Handle in rate case.

Veolia – No rate case filed. Open a “HR” docket and issue an order directing Veolia to respond to the questions in the Commission’s January 3, 2018 Order Opening a Working Proceeding Regarding the Effects Upon Missouri Utilities of the Tax Cuts of 2017 and Directing Response.

Small Utilities- Water and Sewer

So far, Staff has discussed the impact of the TCJA on major electric, gas and water utilities in Missouri. However, there are many smaller utilities which also operate in this jurisdiction under a somewhat different regulatory framework. Most of the smaller utilities are water and sewer operations, but utilities with steam heat operations may also fit into this category. The impacts of the TCJA should not be expected to be the same for smaller utilities as for the larger ones.

Though a few small utilities are “C Corporations” (pay the corporate tax rate), many of them are either “Subchapter S” companies, Limited Liability Corporations (LLCs), or partnerships. Essentially, these tax structure result in the utility’s owner or owners paying a personal income tax rate on their proportionate share of utility profits. Accordingly, for Subchapter S and LLCs, the effect of the TCJA on personal income tax rates and rules is relevant, not the changes to the corporate tax rates and rules.

For those small Missouri utilities with a C corporation structure, prior to 2018, income taxes were levied using tiered tax rates, starting at 15% for taxable income amounts less than \$50,000

and escalating up to the flat 35% rate. Under the TCJA, Staff's understanding is that all corporate income will be taxed at a flat 21% rate.³ This means for some smaller utilities whose current rates, under the tiered structure, reflect income taxes paid at a rate lower than 21%, the impact of the TCJA will be to increase the cost of service.

Regarding Subchapter S and LLC utilities, in many or most cases these companies may not currently have any income tax allowance reflected in their customer rates. This is because the general ratemaking practice for these types of utilities has been not to incorporate in rates amounts associated with personal income tax returns. For these companies, the TCJA will have no immediate rate impact, and any reflection of income tax expense in their cost of service in the future will mean higher revenue requirements.

At this time, Staff lacks information as to the current tax status of most small water and sewer utilities, some of which have not filed a rate case in years. For this reason, and to allow for a more thorough examination of how the TCJA may change the tax liabilities for small utilities, Staff proposes to open a generic investigatory docket to examine TCJA issues specifically applicable to the small water and sewer companies. Within this docket, Staff plans to ask the small utilities several questions regarding income tax expense. These questions may include, but not be limited to, the following:

- 1) For purposes payment of income taxes, is your company: (a) C Corporation, (b) Subchapter S Corporation, (c) a Limited Liability Corporation, (d) a partnership, or (e) other?
- 2) If you know, does your company currently collect income tax expense in customer rates? If so, how much?
- 3) Have you or your financial advisors/consultants performed any analysis of the likely impact of the TCJA on your customer rates? If so, please provide such analysis.
- 4) Generally speaking, when do you expect your company to seek a change in customer rates from the Commission?

Based upon the responses to these questions, and in addition its own research, Staff will compile information for each company regarding its current tax structure, and (if possible) whether and how much is currently included in their rates for income tax expense. This data base will allow Staff to determine priorities as to what small utilities might be considered for further action regarding TCJA impacts.

³ The TCJA also changes the method by which these types of taxable entities can calculate business deductions to offset against business income.