Part 2

1810403

Morgan

PART B

Summary of the Testimony of Justin M. Morgan

My testimony discusses the listed issues before the Commission as follows:

1) Staff recommends the amortization of excess deferred income taxes ("EDIT") related to the Rider W deferral balance be included in Rider W's Projected Factor revenue requirement as a reduction to tax expense*

2) Staff recommends the unamortized portion of all accumulated deferred income taxes (which includes unamortized EDIT) be included in the rate base used to calculate the Projected Factor revenue requirement*

*These issues collectively decrease the Projected Factor revenue requirement in Rider W by approximately $2.88 million.

PRE-FILED TESTIMONY

OF

JUSTIN M. MORGAN

VIRGINIA ELECTRIC AND POWER COMPANY
FOR REVISION OF RATE ADJUSTMENT CLAUSE:
RIDER W
CASE NO. PUR-2018-00087

OCTOBER 12, 2018

CONFIDENTIAL VERSION

Q1. PLEASE STATE YOUR NAME AND THE POSITION YOU HOLD WITH THE STATE CORPORATION COMMISSION ("COMMISSION").

A1. My name is Justin Morgan. I am a Principal Utility Accountant with the Commission's Division of Utility Accounting and Finance.

Q2. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A2. My testimony addresses the impacts of the Tax Cuts and Jobs Act of 2017 ("TCJA") on the Rider W revenue requirement.

Q3. WHAT ARE STAFF'S RECOMMENDATIONS CONCERNING THE TCJA IN THIS CASE.

A3. Staff has the following recommendations:

(1) Amortization of excess deferred income taxes ("EDIT") related to the Rider W deferral balance should be included in Rider W's Projected Factor revenue requirement as a reduction to income tax expense.

(2) The unamortized portion of all accumulated deferred income taxes ("ADIT") (which includes unamortized EDIT) should be included in the rate base used to calculate the Projected Factor revenue requirement.[1]

(3) The Projected Factor revenue requirement should be calculated using the 21% corporate federal tax rate.

(4) Amortization of EDIT associated with plant should be included in Rider W's Projected Factor revenue requirement.[2]

Q4. PLEASE DESCRIBE THE TCJA AND HOW IT WILL IMPACT THE COMPANY'S COST OF SERVICE.

A4. On December 22, 2017, the TCJA was signed into law. Among other provisions, the TCJA reduces the federal corporate income tax rate from 35% to 21%, effective January 1, 2018. The lower tax rate will serve to significantly reduce current and deferred income tax expenses recognized in utility cost of service and will also generate significant amounts of EDIT that will be returned to customers through

[1] The Company has included the EDIT associated with plant in rate base, but has not included EDIT related to the Rider W deferral balance.
[2] Staff recommendations 1 and 2 are issues before the Commission for consideration. Staff recommendations 3 and 4 are consistent with the Company's revenue requirement methodology.

future deferred income tax reversals. In other words, tax expense charged to customers will be less due to the lower tax rates.

Q5. PLEASE EXPLAIN HOW THE COMPANY CHARGES TAX EXPENSE TO CUSTOMERS.

A5. Customer rates are set to recover tax expense based on the current tax rate. Prior to January 1, 2018, the corporate federal tax rate was 35%. Therefore, these rates included recovery of tax *expense* based on the 35% corporate tax rate. However, the Company is able to defer a portion of its tax *liability* to the Internal Revenue Service ("IRS") to a future period. The difference between the tax expense recovered based on the 35% tax rate and the actual amount the Company remits to the IRS is recorded as ADIT. This ADIT represents a future liability to the IRS.[3]

Q6. HOW DOES THE TCJA IMPACT THE COMPANY'S FUTURE LIABILITY TO THE IRS?

A6. Due to the reduction in the federal corporate income tax rate, the Company's future tax liability to the IRS has been reduced. In order to reflect this lower liability, the Company reclassified a portion of ADIT as EDIT.[4]

[3] Staff notes that while the Company has a net deferred tax liability balance in this instance, an ADIT balance can also represent a deferred tax asset to recognize the Company will realize a deduction in a future period.
[4] Staff notes that the Company has only reclassified the excess amount of plant-related ADIT in Rider W as a result of the TCJA rate reduction and this reclassification was to a regulatory liability account on its books.

Q7. DID THE COMPANY RECLASSIFY THE EXCESS AMOUNT OF ADIT RELATED TO THE RIDER W DEFERRAL TO A REGULATORY LIABILITY ON ITS BOOKS?

A7. No. The Company recorded an accounting entry in December 2017 that removed EDIT related to the Rider W deferral balance and recognized that amount as income.[5]

Q8. IS THIS ACCOUNTING TREATMENT CONSISTENT WITH THE COMMISSION'S ORDER IN CASE NO. PUR-2018-00005?

A8. No. In Case No. PUR-2018-00005, the Commission directed public utilities subject to the TCJA to accrue regulatory liabilities reflecting the Virginia Jurisdictional revenue requirement impacts of the reduced income tax rate. The Commission stated that this regulatory accounting recognition of cost savings would serve to protect the interests of customers until such time as the federal tax benefits could be appropriately reflected in customers rates. The Company's accounting and proposed ratemaking treatment of the TCJA impacts related to the Rider W deferral effectively allocates these federal tax benefits to the Company and not to customers.

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[5] *See* Attachment Staff 6-36.

Q9. PLEASE DISCUSS THE COMPANY'S COST RECOVERY FOR RIDER W PURSUANT TO § 56-585.1 A6 ("SUBSECTION A 6") OF THE CODE OF VIRGINIA ("CODE").

A9. Subsection A 6 states, in part:

> To ensure the generation and delivery of a reliable and adequate supply of electricity, to meet the utility's projected native load obligations and to promote economic development, a utility may at any time, after the expiration or termination of capped rates, petition the Commission for approval of a rate adjustment clause for recovery on a timely and current basis from customers of the costs of... (ii) one or more other generation facilities... A utility that constructs or makes modifications to any such facility... shall have the right to recover the costs of the facility, as accrued against income, through its rates, ...

In short, Subsection A 6 provides the Company the right to recover the costs of the facility on a timely and current basis.

Q10. BASED ON THE COMPANY'S PROJECTED FACTOR REVENUE REQUIREMENT, WILL THE COMPANY RECOVER MORE THAN ITS COSTS FOR RIDER W?

A10. Yes. In addition to recovery of Rider W's costs, as provided for in Subsection 6, the Company will retain taxes collected from customers in excess of the Company's future tax costs.

Q11. IS THERE A REQUIREMENT THAT EDIT RESULTING FROM THE TCJA BE RETURNED TO RATEPAYERS?

A11. Yes. During the 2018 Session, the Virginia General Assembly enacted Senate Bill 966 ("SB 966"). SB 966 was signed into law by the Governor of Virginia on March 9, 2018 and became effective July 1, 2018. Among its provisions, Enactment Clause No. 6 of SB 966 stated that "the State Corporation Commission shall implement adjustments in the rates for generation services of incumbent electric utilities, as defined in § 56-576 of the Code of Virginia, effective April 1, 2019, to reflect the actual annual reduction in the corporate income taxes to be paid by such utilities pursuant to the provisions of the federal Tax Cuts and Jobs Act of 2017 and as of the effective date of such act." Since the Enactment clause refers to generation services, the Rider W generation RAC should incorporate all impacts of the TCJA.

Q12. DOES STAFF TAKE ISSUE WITH THE COMPANY'S RATEMAKING TREATMENT OF PLANT-RELATED EDIT?

A12. No. Both the Company and Staff have (1) reduced rate base by the plant-related balance of ADIT (which includes unamortized EDIT) and (2) included the amortization of EDIT[6] as a reduction to tax expense.

Q13. DOES STAFF TAKE ISSUE WITH THE COMPANY'S RATEMAKING TREATMENT OF THE EDIT RELATED TO THE DEFERRAL BALANCE?

[6] The Company amortizes its plant-related EDIT using the Average Rate Assumption Method, that amortizes EDIT as the associated depreciation-related timing differences reverse.

A13. Yes. As discussed previously, the Company has not proposed to return to ratepayers the EDIT related to the Rider W deferral balance.

Q14. HOW DOES STAFF PROPOSE TO RETURN EDIT RELATED TO THE RIDER W DEFERRAL BALANCES TO CUSTOMERS IN THE PROJECTED FACTOR?

A14. Staff reduces tax expense to reflect the EDIT amortization related to the Company's recovery of its Rider W deferral balance. Furthermore, rate base is reduced by the 13-month average rate year unamortized EDIT balance. This balance should be included as a reduction to rate base to recognize that this ADIT (which includes unamortized EDIT) is a source of customer-supplied capital until returned to customers through rates. This ratemaking treatment reduces the Projected Factor revenue requirement by approximately $2.88 million.[7]

Q15. PLEASE SUMMARIZE STAFF'S RECOMMENDATIONS IN THIS PROCEEDING.

A15. Of the four recommendations discussed previously in Staff's testimony, the two issues of dispute before the Commission are as follows:

[7] This amount is the sum of the EDIT amortization of $2.78M shown in my Appendix A and the $0.10M impact of including the unamortized portion of the deferral related EDIT in the rate year rate base.

1) Staff recommends the amortization of EDIT related to the Rider W deferral balance be included in Rider W's Projected Factor revenue requirement as a reduction to tax expense.

2) Staff recommends the unamortized portion of all ADIT (which includes unamortized EDIT) be included in the rate base used to calculate the Projected Factor revenue requirement.

Q16. DOES THIS CONCLUDE YOUR TESTIMONY?

A16. Yes.

APPENDIX A

Virginia Electric and Power Company
Rider W

Adjustment to Reflect Tax Rate Change on Projected Factor
For the Rate Year April 01, 2019 to March 31, 2020
In Thousands (000's)

Line No.	Description	Amount	Total
1	Under (Over) Recovery of Actual Costs during 2017	$ 3,659	
2	Under (Over) Recovery of Actual Costs during 2016	$10,367	
3	Under (Over) Recovery of Actual Costs during 2015	$ 1,730	
4	Adjustment to 2014 True-up due to Micron	$ (44)	
5	Under (Over) Recovery of Actual Costs as of 12/31/17	$15,712	
6	Times: 2018 Effective Tax Rate	25.62%	
7	Deferral Related ADIT as of 12/31/17 at 2018 Effective Tax Rate		$ 4,026
8	Under (Over) Recovery of Actual Costs during 2017	$ 3,659	
9	Under (Over) Recovery of Actual Costs during 2016	$10,367	
10	Under (Over) Recovery of Actual Costs during 2015	$ 1,730	
11	Adjustment to 2014 True-up due to Micron	$ (44)	
12	Under (Over) Recovery of Actual Costs as of 12/31/17	$15,712	
13	Times: 2017 Effective Tax Rate	38.80%	
14	Less: Deferral Related ADIT as of 12/31/17 at 2017 Effective Tax Rate		$ 6,097
15	Deferral Related EDIT Amount		$ (2,071)
16	Divided by: 1-minus the 2018 Effective Tax Rate		74.38%
17	**Jurisdictional Rate Year EDIT Amortization Amount**		**$ (2,784)**