

**BEFORE THE  
PUBLIC UTILITY COMMISSION OF OREGON  
UG 344**

In the Matter of )  
 )  
NORTHWEST NATURAL GAS )  
COMPANY, dba NW NATURAL, )  
 )  
Request for a General Rate Revision. )  
\_\_\_\_\_ )

**REBUTTAL AND CROSS-ANSWERING TESTIMONY  
OF BRADLEY G. MULLINS  
ON BEHALF OF  
ALLIANCE OF WESTERN ENERGY CONSUMERS**

**June 20, 2018**

**I. INTRODUCTION**

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**Q. ARE YOU THE SAME BRADLEY G. MULLINS THAT PROVIDED OPENING TESTIMONY IN THIS MATTER?**

A. Yes.

**Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL AND CROSS ANSWERING TESTIMONY?**

A. On June 12, 2018 parties engaged in continued settlement discussions and reached a settlement in principle with respect to all issues in this case with three exceptions. My testimony discusses these three remaining issues. In the event the parties are unable to reduce the settlement in principle to writing, Alliance of Western Energy Consumers (“AWEC”) reserves the right to address the issues addressed in the settlement in later rounds of testimony.

In this testimony, I first discuss the issues identified by witnesses Jenks and Gherke on behalf of the Citizen’s Utility Board (“CUB”) and by witness Fox on behalf of Staff regarding the problems with NW Natural’s Pension Balancing Account. Second, I respond to NW Natural’s testimony regarding the treatment of Excess Deferred Federal Income Taxes (“EDFIT”) associated with tax reform legislation H.R. 1 of the 115<sup>th</sup> Congress. Third, I respond to NW Natural’s testimony regarding the treatment of the “Interim Period” tax savings associated with the tax reform legislation.

**Q. HAVE YOU MODIFIED YOUR REVENUE REQUIREMENT RECOMMENDATION WITH RESPECT TO THESE THREE ISSUES?**

A. I have updated my revenue requirement analysis to reflect the use of Statement of Financial Accounting Standards (“SFAS”) 87 for pension expense. My recommendations with respect to EDFIT and the Interim Period Deferral remain unchanged. Thus, the revenue requirement

1 impacts of my recommendations, based on the parameters used in my revenue requirement  
2 model, are as follows:

**TABLE 1**  
Impact of Remaining Revenue Requirement Issues (\$000)

Transition to SFAS 87 Pension Expense	8,370
Excess Deferred Taxes	(13,498)
Interim Period Deferral	<u>(7,917)</u>
Total Impact of Outstanding Issues	(13,044)

**II. PENSION BALANCING ACCOUNT**

4 **Q. PLEASE SUMMARIZE THE CONCERNS STAFF AND CUB HAVE RAISED WITH**  
5 **RESPECT TO THE PENSION BALANCING ACCOUNT.**

6 A. Both Staff and CUB filed Opening Testimony identifying several issues related to NW  
7 Natural’s Pension Balancing Account, which parties stipulated to, and the Commission  
8 approved, in Docket UM 1475. Both Staff and CUB note that there is an increasing disparity  
9 between the long-term pension expense amount of \$3.8 million per year included in rates  
10 pursuant to the stipulation in Docket UM 1475 and NW Natural’s actual SFAS 87 pension  
11 expense. In contrast to the stipulated \$3,800,000 of pension expense expected in the long-run,  
12 actual SFAS 87 pension expenses are forecast to be \$11,937,012 in 2019.<sup>1</sup>

13 **Q. WAS THE DISPARITY BETWEEN THE STIPULATED PENSION EXPENSE AND**  
14 **ACTUAL SFAS 87 EXPECTED WHEN THE PENSION BALANCING ACCOUNT**  
15 **WAS CREATED?**

16 A. No. When parties agreed to the Pension Balancing Account, the expectation was that actual  
17 pension expenses would decline below the long-term \$3.8 million ratemaking value.

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<sup>1</sup> See Exhibit AWEC/501, NW Natural’s Supplemental Response to CUB Data Request 47.

1 Accordingly, the balances in the Pension Balancing Account were supposed to reverse  
2 naturally, without producing any incremental revenue requirement impact on ratepayers. By  
3 the end of 2017, the Pension Balancing Account balance grew approximately \$60.4 million.  
4 Based on this balance it is apparent that the balance is unlikely to reverse as intended, and  
5 absent some change, the mechanism will effectively self-destruct, as interest on the remaining  
6 balance will exceed the annual collections through rates.

7 **Q. DO YOU AGREE WITH THE CONCERNS OF STAFF AND CUB WITH RESPECT**  
8 **TO THE PENSION BALANCING ACCOUNT?**

9 A. Generally, yes. I generally agree with the observations of Staff and CUB that the balancing  
10 account is not functioning as intended. The balancing account that parties agreed to in Docket  
11 UM 1475 was intended to be a long-term ratemaking mechanism, but the balances are not  
12 reversing in the manner in which the mechanism was designed. Absent some change, there is  
13 no way for the Pension Balancing Account to ever be resolved as intended through the  
14 stipulation.

15 **Q. HOW DO YOU RECOMMEND THE COMMISSION HANDLE THE PENSION**  
16 **BALANCING ACCOUNT?**

17 A. Based on the concerns identified by Staff and CUB, I recommend that the Commission  
18 eliminate the Pension Balancing Account altogether. In its place, I recommend transitioning to  
19 a ratemaking method of relying on SFAS 87 pension expense. This recommendation is  
20 consistent with that provided by CUB.

21 To make this transition to SFAS 87 pension expense, however, it is important to note  
22 that unwinding a long-term mechanism such as this half-way through its intended life presents  
23 a number of challenges. Since the mechanism would be unwound mid-stream, for example, it

1 is not appropriate to presume that all of the Pension Balancing Account balances, which were  
2 intended to naturally reverse over time, are automatically recoverable from ratepayers.

3 **Q. WHY IS IT CHALLENGING TO CHANGE RATEMAKING METHODOLOGIES**  
4 **FOR PENSION EXPENSES?**

5 A. It is relatively straightforward to determine the revenue requirement impact of transitioning to  
6 SFAS 87 expense. This change will represent a significant rate increase for ratepayers relative  
7 to the amounts to which parties stipulated in Docket UM 1475.

8 Notwithstanding, as CUB notes, the primary challenge with changing methodologies is  
9 how the balances are to be handled. It is important to recognize that SFAS 87 is itself a long-  
10 term methodology. Had the stipulation not been in place and rates originally set on the basis of  
11 SFAS 87 pension expenses, NW Natural would not have been provided with recovery equal to  
12 the amounts that have accrued to the pension balancing account. If SFAS 87 had been used  
13 from the beginning, Pension recovery would have been set at a static level in the rate case and  
14 would not have been tracked on a year-to-year basis.

15 Further, SFAS 87 pension expenses are based on historical contributions, interest rates  
16 and other actuarial assumptions. Therefore, to consider these balances, it is necessary to  
17 perform an analysis for each year to analyze the prudence of historical pension contribution  
18 levels, and interest rate assumptions, and other actuarial assumptions, which gave rise to the  
19 year-to-year balances. Since the balances were originally expected to reverse naturally,  
20 without intervention by the Commission, the prudence surrounding contribution assumptions  
21 was not significant in the original design of the Pension Balancing Accounts. The effects of  
22 those assumptions were expected to wash out based on the way the Pension Balancing Account  
23 was designed. If the account is being unwound, however, those assumptions now carry greater

1 significance. If, for example, the higher than expected pension expenses were caused by an  
2 imprudent pattern of contributions, then it would not be appropriate for the NW Natural to be  
3 provided with any recovery of the associated amounts. Further, if the interest rate assumptions  
4 have declined based on actions taken by the Company to reduce the risk of its pension  
5 portfolio, that might also be an indication of imprudence.

6 Finally, under the stipulation the balances must be subject to an earnings test. NW  
7 Natural has not presented an earnings test in this docket, which is another factor complicating  
8 the treatment of the account balances.

9 **Q. HOW DO YOU PROPOSE HANDLING THE PENSION BALANCING ACCOUNT**  
10 **BALANCES?**

11 A. If the Commission agrees that the balancing account has not functioned as intended, and should  
12 be terminated in the middle of the mechanism's life, I recommend that it also open an  
13 investigation regarding the ratemaking treatment of the remaining balances in the pension  
14 balancing account. Since NW Natural disagrees that there should be any changes with respect  
15 to the pension balancing account, and is not requesting recovery of the balances, there is not  
16 sufficient information to properly assess the extent to which ratepayers should be responsible  
17 for the remaining balances. Even if NW Natural were to provide this additional information in  
18 its Sur-rebuttal Testimony surrounding the Pension Balancing Account Balances, there would  
19 be no way for parties to meaningfully respond to the new information.

20 **Q. HOW DID NW NATURAL RESPOND TO THE CONCERNS OF CUB AND STAFF**  
21 **WITH RESPECT TO THE PENSION BALANCING ACCOUNT?**

22 A. NW Natural finds that CUB's recommendation to eliminate the pension balancing account is  
23 premature. Rather than eliminating the mechanism, NW Natural recommends that the  
24 mechanism be modified by agreement amongst the settling parties. Specifically, NW Natural

1 identifies a “unique circumstance” related to tax reform legislation to the balance accrued to  
2 the pension balancing account. While NW Natural does not provide any concrete details  
3 surrounding its proposal to change the balancing account mechanism, it identifies a straw  
4 proposal, which it might recommend to the parties in settlement discussions, of using  
5 amortization of excess deferred federal income taxes (“EDFIT”) to pay down the pension  
6 balancing account balance.

7 **Q. HAS AWEC CONSIDERED NW NATURAL’S SETTLEMENT PROPOSAL TO**  
8 **APPLY EDFIT TO THE PENSION BALANCING ACCOUNT BALANCE?**

9 A. Yes. AWEC has considered NW Natural’s settlement proposal and is not willing to agree to a  
10 settlement which would use EDFIT to pay the Pension Balancing Account balance.

11 Amortization of EDFIT and treatment of the pension balancing account are two distinct issues  
12 that must be considered on their own merits. As noted above, it is premature to assume that the  
13 balances in the pension balancing account are recoverable from ratepayers, given that the  
14 mechanism has failed mid-way through its intended life. To apply EDFIT amortization to the  
15 account balance would improperly presume that amounts accrued to the pension balancing  
16 account are recoverable from ratepayers. To conclude that the amounts accrued to the Pension  
17 Balancing Account are recoverable from ratepayers more information is necessary, including  
18 an earnings test and consideration of the prudence of past pension contributions and actuarial  
19 assumptions.

20 Further, the amortization parameters associated with EDFIT is a separate point of  
21 controversy in this docket. The amount of EDFIT and the period over which that amount is  
22 amortized must be considered on their own merits, irrespective of how the Commission  
23 decides to handle the balances associated with the Pension Balancing Account. It may be that

1 the amortization of those amounts will help to offset the revenue requirement impact of  
2 transitioning to SFAS 87 expense. The fact that the two adjustments might be offsetting,  
3 however, should have no bearing on the amount of EDFIT that ultimately gets returned to  
4 ratepayers.

5 **Q. WHAT IS THE REVENUE REQUIREMENT IMPACT OF TRANSITIONING TO**  
6 **SFAS 87 EXPENSE?**

7 A. Based on the forecast for 2019, transitioning to SFAS 87 pension expense will result in an  
8 \$8,370,050 increase to revenue requirement.

9 **III. EXCESS DEFERRED FEDERAL INCOME TAXES**

10 **Q. WHAT IS NW NATURAL'S POSITION ON EXCESS DEFERRED FEDERAL**  
11 **INCOME TAXES?**

12 A. NW Natural proposes to exclude EDFIT from revenue requirement in this matter. Instead NW  
13 Natural proposes to handle the return of EDFIT in Dockets UM 1919 and UM 1924.

14 **Q. DO YOU AGREE WITH NW NATURAL'S PROPOSAL?**

15 A. No. With respect to EDFIT amortization, NW Natural has been acting in a careless manner.  
16 NW Natural has failed to present any calculation of the supporting EDFIT amortization in this  
17 docket, which is an outcome that is extraordinarily unfair to ratepayers. Ratepayers deserve to  
18 receive all of the benefits from tax reform in a timely manner, and NW Natural's reluctance to  
19 even consider any of the EDFIT benefits in rates is wholly inappropriate.

20 In fact, not only is it inappropriate to exclude EDFIT benefits from rates in this matter,  
21 it would also violate the normalization requirements to not ignore EDFIT, contrary to NW  
22 Natural's recommendation. The normalization rules have the effect of prohibiting a state  
23 commission from establishing cost of service rates that do not take excess tax reserves into  
24 consideration. Accordingly, NW Natural's recommendation for the Commission to ignore



1 EDFIT when establishing cost of service rates in this docket would plainly be in violation of  
2 the normalization requirements.

3 **Q. ARE THE DEFERRAL DOCKETS THE APPROPRIATE VENUE TO CONSIDER**  
4 **EDFIT REVERSAL?**

5 A. No. Dockets UM 1919 and UM 1924 were established only to deal with the Interim Period tax  
6 savings that NW Natural will recognize prior to the establishment of new rates on November 1,  
7 2018. Those dockets are not the appropriate venue to consider the ongoing impact of EDFIT  
8 on base rates following establishment of new rates in this docket.

9 The EDFIT amortization accrued over the period January 1, 2018 through October 31,  
10 2018 are appropriately considered in the Interim Period deferral, and thus, have some nexus to  
11 the deferral dockets. The ongoing EDFIT amortization after October 31, 2018, however, falls  
12 outside of the scope of the Interim Period deferral considered in those dockets. Therefore, in  
13 order to be in compliance with IRS normalization requirements, the test period EDFIT  
14 amortization captured in my adjustment must be considered when establishing rates in this  
15 docket.

16 **Q. DO YOU AGREE WITH NW NATURAL THAT THE EDFIT CALCULATION IS TOO**  
17 **COMPLICATED TO BE REVIEWED IN THIS DOCKET?**

18 A. No. Using the Average Rate Assumption Method (“ARAM”) requires a large amount of data.  
19 Provided that the underlying vintage data necessary to use the ARAM is available, however,  
20 the calculation is relatively straightforward and not complicated to implement.

21 AWEC has requested the underlying vintage data necessary to use the ARAM  
22 methodology, and NW Natural has been unable to provide it.<sup>2</sup> The reason NW Natural has

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<sup>2</sup> See, e.g., NW Natural’s response to NWIGU Data Request 42, Sub-part e.

1 been unable to provide the ARAM data is that the underlying data does not exist. NW Natural  
2 does not track book-tax differences associated with depreciation by vintage. The reason NW  
3 Natural might view the ARAM to be overly complicated is due to the fact that NW Natural  
4 would have to manufacture the vintage data necessary to perform ARAM.

5 **Q. WHAT DATA ARE NECESSARY TO USE THE ARAM METHODOLOGY?**

6 A. To use the ARAM methodology, it is necessary to have vintage level account data for each  
7 depreciation related book-tax difference. This means that, in order to calculate the reversal of  
8 the book-tax differences by vintage under the ARAM, the utility must possess vintage data  
9 both for accumulated tax depreciation and for accumulated book depreciation.

10 **Q. DOES NW NATURAL TRACK BOTH TAX AND BOOK DEPRECIATION BY**  
11 **VINTAGE?**

12 A. No. However, most utilities have property records that track tax depreciation by property  
13 vintage. Tax depreciation is calculated using a unit system of depreciation accounting and the  
14 vintage level plant data are necessary to compute tax depreciation expense each year. Thus,  
15 NW Natural likely has the vintage level data underlying accumulated tax depreciation,  
16 although it has not been able to produce that data in discovery.

17 On the other hand, book depreciation is calculated differently than tax depreciation  
18 using a group system of depreciation accounting, which cannot be tied to specific vintages.  
19 Based on the way NW Natural's depreciation study is performed, depreciation expense is  
20 calculated in groups, based on the property classes generally corresponding to FERC accounts.  
21 The vintage of the property in any particular FERC account informs the depreciation rate  
22 assumed for the FERC account, but the depreciation expenses accumulated amount are not  
23 tracked by vintage.

1           To compute the book tax difference by vintage under the ARAM, it is necessary to  
2 compare the accumulated tax depreciation to the accumulated book depreciation for each  
3 vintage. Since the book depreciation is not tracked by vintage, NW Natural does not have the  
4 data necessary to perform the ARAM calculation.

5 **Q.   SINCE NW NATURAL DOES NOT HAVE THE DATA NECESSARY TO PERFORM**  
6 **THE ARAM, WHAT DO YOU RECOMMEND?**

7 A.   I continue to recommend using the simplified method and tie the EDFIT reversal to NW  
8 Natural's composite depreciation rate, as discussed in my Opening Testimony. The IRS has  
9 long recognized that, in instances where the data necessary to use the ARAM is unavailable, a  
10 utility will still comply with the IRS normalization requirements if it uses the composite  
11 depreciation rate method that I identified in my Opening Testimony. In the past the IRS has  
12 referred to the simplified method identified in my Opening Testimony as the Reverse South  
13 Georgia method.<sup>3</sup>

14 **Q.   DO YOU AGREE WITH NW NATURAL THAT AMORTIZATION OF EDFIT, MUST**  
15 **ALSO BE APPLIED AS AN OFFSET TO ADFIT?**

16 A.   Yes. As can be noted on Page 2 of AWEC/203, I applied \$6,196,179 as a reduction to ADFIT  
17 to account for the rate base impacts of EDFIT amortization over the period January 1, 2018  
18 through October 31, 2018. The accumulated EDFIT amortization, however, must be returned  
19 to ratepayers through the Interim Period deferral if it is to be applied as an offset to ADIFT.

20 **Q.   PLEASE SUMMARIZE YOUR RECOMMENDATION.**

21 A.   It is wholly inappropriate for NW Natural to delay returning the base rate impacts of EDFIT to  
22 ratepayers in this case. Ignoring those benefits when establishing rates in this case will run

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<sup>3</sup> See, e.g., I.R.S. Priv. Ltr. Rul. 200743030 (Oct. 26, 2007).

1 counter to the IRS normalization requirements. Further, NW Natural’s allegation that the  
2 calculation is too complicated to be considered in this matter is without merit, since it is only  
3 complicated because NW Natural lacks the underlying data necessary to perform the ARAM.  
4 I continue to recommend that the EDFIT amounts be returned to ratepayers through base rates  
5 based on the calculation identified in my Opening Testimony, resulting in a \$13,497,794  
6 reduction to revenue requirement.

7 **IV. INTERIM PERIOD DEFERRAL**

8 **Q. HOW DID NW NATURAL RESPOND TO YOUR RECOMMENDATION**  
9 **REGARDING THE INTERIM PERIOD DEFERRAL?**

10 A. For the most part, NW Natural failed to meaningfully respond to the issues surrounding the  
11 Interim Period Tax savings that it is currently recognizing over the period January 1, 2018  
12 through October 31, 2018. NW Natural objects to the Interim Period deferral by making  
13 blanket statements, such as “amortization of deferrals are not accomplished through reductions  
14 in base rates.” Further, NW Natural believes that amortization of the Interim Period deferral is  
15 not appropriately handled in this docket, but rather should be considered in dockets UM 1919  
16 or UM 1924.

17 **Q. DO YOU AGREE THAT AMORTIZATION OF DEFERRALS ARE NOT**  
18 **ACCOMPLISHED THROUGH REDUCTIONS IN BASE RATES?**

19 A. No. There are a whole host of deferrals that the Commission has approved which are amortized  
20 in base rates. I am aware that PGE, for example, amortizes deferred maintenance costs in base  
21 rates and that other utilities have similar deferrals that amortize to base rates.

1 **Q. DOES AWEC OBJECT TO RETURNING THE INTERIM PERIOD DEFERRED**  
2 **AMOUNTS THROUGH A SUPPLEMENTAL SCHEDULE?**

3 A. No. Further, it is not necessary for the deferral to be included in base rates. It is, however,  
4 imperative that the amounts begin to be returned to ratepayers as soon as possible,  
5 corresponding to the final rate change in this docket. If a supplemental schedule is used it  
6 needs to go into effect at the same time as the rate effective date in this matter. If it is delayed a  
7 month or two, it will result in rate instability, since ratepayers might see a rate increase in one  
8 month followed by a rate reduction in the subsequent month. That sort of month to month  
9 variation should be avoided.

10 **Q. ARE THE DEFERRAL DOCKETS THE APPROPRIATE VENUE TO CONSIDER**  
11 **THE AMORTIZATION OF THE INTERIM PERIOD DEFERRAL?**

12 A. While the Commission may appropriately decide whether to approve a deferral in a deferral  
13 docket, the amount of the deferral and amortization schedule is a matter that is commonly  
14 reserved for a rate case. For example, when PacifiCorp requested to defer costs associated  
15 with the closure of the Deer Creek mine, the commission approved the deferral but required  
16 that the amount and amortization of the major portion of the deferral be established in  
17 PacifiCorp's next general rate case. Accordingly, it is wholly appropriate to consider the  
18 amortization of the interim period tax savings in this docket and it is unnecessary for NW  
19 Natural to delay returning the Interim Period Tax savings amounts to ratepayers by seeking to  
20 consider those amounts outside of the general rate case. A general rate case is a venue in  
21 which all issues are subject to review. Accordingly, NW Natural's proposal to exclude  
22 consideration of the Interim Period tax savings in this docket is entirely misplaced. The mere  
23 fact that NW Natural has failed to provide any meaningful response to my recommendations

1 regarding the Interim Period Deferral is not a valid reason not to consider that issue in this  
2 docket.

3 **Q. DID NW NATURAL OBJECT TO YOUR RECOMMENDATION TO USE A TWO-**  
4 **YEAR AMORTIZATION PERIOD?**

5 A. No.

6 **Q. DID NW NATURAL OBJECT TO INTEREST ACCRUING ON THE INTERIM**  
7 **PERIOD DEFERRED BALANCE AT ITS PRE-TAX COST OF CAPITAL?**

8 A. No.

9 **Q. DID NW NATURAL OBJECT TO YOUR METHODOLOGY FOR CALCULATING**  
10 **THE INTERIM PERIOD TAX SAVINGS?**

11 A. No.

12 **Q. DID NW NATURAL OBJECT TO USING YOUR SINKING FUND METHOD FOR**  
13 **AMORTIZING THE INTERIM PERIOD TAX SAVINGS?**

14 A. No.

15 **Q. HAS THE IMPACT OF YOUR RECOMMENDATION REGARDING THE INTERIM**  
16 **PERIOD DEFERRAL CHANGED RELATIVE TO YOUR OPENING TESTIMONY?**

17 A. No. I continue to recommend a revenue requirement reduction of \$7,916,553 with respect to  
18 the Interim Period tax savings. Although, as mentioned above, AWEC would not object to  
19 returning those revenues through a supplemental schedule.

20 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

21 A. Yes.

**BEFORE THE  
PUBLIC UTILITY COMMISSION OF OREGON**

**UG 344**

In the Matter of )

NORTHWEST NATURAL GAS )  
COMPANY, dba NW NATURAL, )

Request for a General Rate Revision. )  
\_\_\_\_\_ )

**EXHIBIT 501  
TO THE  
REBUTTAL AND CROSS-ANSWERING TESTIMONY  
OF BRADLEY G. MULLINS  
ON BEHALF OF  
ALLIANCE OF WESTERN ENERGY CONSUMERS**

**JUNE 20, 2018**



**Rates & Regulatory Affairs**  
UG 344  
2017 General Rate Revision  
**Supplemental Data Request Response**

**Request No.:** UG 344 CUB DR 47

47. Please complete the attached spreadsheet. Attach any necessary workpapers and additional spreadsheets with your response. Please complete based on the history from the last four years.

**Response:**

Please refer to “**UG 344 CUB DR 47 Attachment 1.xlsx**” for the Company’s data. Below are clarifying explanations for certain lines and columns in the spreadsheet.

**“N/A” Responses:** Unless otherwise indicated below, years for which “N/A” is shown indicates that the information is unavailable.

**Line A:** The actuaries calculate the pension benefit obligation each year using several assumptions including (this is not an exhaustive list):

- Discount rate used to present value the future pension obligation
- Retirement age, life expectancy, and turnover
- Expected wage increases and final average pay
- Expected percentage of employees that will take a lump-sum payment at retirement

**Line B:** Amounts shown represent the cumulative contributions in excess of cumulative FAS 87 expense.

**Line C:** The amounts shown on Line C are the fair value (i.e. market value) of the plan assets for each year reported.

**Line E:** Represents the funded status of the plan at year-end. It is calculated as the fair value of plan assets less the pension benefit obligation (Line C less Line A).



Line G: Represents the minimum funding requirement at the beginning of the year.

Line H: We are unsure what information is being requested in this line. The pension benefit obligation less the prepaid pension asset does not result in a “credit balance”. If by “credit balance” CUB is asking whether the plan is overfunded (i.e. plan assets are greater than the obligation), this information is provided on Lines J1 through J3. If, instead, CUB means whether the prepaid pension asset is actually a liability (i.e. cumulative contributions is less than cumulative expense), this information is provided in Line B.

Line I3: Represents the Commission-authorized return on equity.

Line I4: Represents the Commission-authorized cost of long-term debt.

Line J4: We are unsure what information is being requested in this line. The pension benefit obligation divided by the prepaid pension asset does not result in the level of funding target the Company achieved. To calculate funding target attainment, value of plan assets for funding target purposes is divided by funding target amount. NW Natural has added a line, line J3.1, to disclose actuarially-determined value of plan assets for funding target purposes. Line J3.1 divided by line D represents attainment percentage. Note that percentage calculated on unrounded dollars (i.e., not to nearest \$M) is disclosed on this line.

Line L: We are unsure what information is being requested in this line. If “post tax” means what customers pay assuming the franchise tax is included, the Company does not calculate this because franchise taxes are remitted to the specific jurisdictions and not retained. If “post tax” means the amount collected multiplied by the Company’s combined state and federal tax rate, the Company does not calculate this as the tax rate is only applied after including total revenues and expenses.

Line L1: The amounts shown represent the actual total FAS 87 expense incurred (both O&M and capital).

Lines O1 and O2: The interest rate on the benefit cost lags one year behind the rate used for determining the pension benefit obligation. The interest rate is actuarially-determined using benchmark rates from market indices.

Line Q: A simple average of the BU and NBU wage escalation assumptions (3.25% and 3.5%, respectively) is disclosed here.

Line U: Tax deductions are allowed for cash contributions (up to an annual limit allowed). Please note that the amounts shown are the deferred taxes calculated using a 39.5037% effective tax rate on tax-basis contributions less FAS 87 expense.

Line V: In no year did the Company have cash flow benefits from pension plan contributions.

**Supplemental Response – June 12, 2018**

In response to a discussion with representatives from CUB, NW Natural agreed to provide additional information associated with recent FAS 87 expenses. This supplement provides that response, as follows:

The Oregon-allocated FAS 87 expense for NW Natural is forecasted to be \$15,041,439 and \$11,937,012, for calendar year 2018 and the Test Year, respectively.

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**UG 344**

In the Matter of )

NORTHWEST NATURAL GAS )  
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**EXHIBIT 502  
TO THE  
REBUTTAL AND CROSS-ANSWERING TESTIMONY  
OF BRADLEY G. MULLINS  
ON BEHALF OF  
ALLIANCE OF WESTERN ENERGY CONSUMERS**

**JUNE 20, 2018**



**Rates & Regulatory Affairs**  
UG 344  
2017 General Rate Revision  
**Data Request Response**

**Request No.:** UG 344 NWIGU DR 42

42. Reference NW Natural 1200, Page 2: NW Natural states “There are two elements of the revenue requirements model that are affected by tax reform. The first impact is the direct change in income tax expenses based on the reduction of the federal income tax rate from 35% to 21%. The second occurs in the accumulated deferred tax component of rate base, which reflects the loss of the higher “bonus” depreciation that had previously been available on a phase-out basis through the test year.”

a. Is it NW Natural’s proposal to exclude the impacts of Excess Tax Reserves (i.e. Excess Deferred Federal Income Taxes) as defined in § 13001(d) of the TCJA.

b. Does NW Natural agree that it will violate the IRS normalization requirements if, in computing its cost of service in this matter, NW Natural does not account for Excess Tax Reserves in the manner described § 13001(d) of the TCJA. Please explain.

c. Is it NW Natural’s proposal to exclude the impact of deferring the revenue requirement benefits associated with the TCJA realized between January 1, 2018 and the rate effective date in this proceeding. Please explain.

d. Please provide all presentations and documents that the Company has received from its auditors or tax advisors discussing the implementation of the Tax Cuts and Jobs Act, since the Tax Cuts and Jobs Act was enacted into law.

e. Please provide NW Natural’s best estimate of the impact of Excess Deferred Federal Income Taxes on test period revenue requirement. Please provide all workpapers, with all links and formulas intact, supporting the calculation. To the extent that the document includes hard-coded numbers, please identify and provide the source of the hardcoded number.

f. Does NW Natural track book accumulated depreciation by FERC account and by asset vintage? If yes, please provide accumulated depreciation by FERC account and by asset vintage as of 12/31/2017 (actual), 12/31/2018 (forecast) and 12/31/2019.

g. Does NW Natural track tax accumulated depreciation by FERC account and by asset vintage? If yes, please provide tax accumulated depreciation by FERC account and by asset vintage as of 12/31/2017 (actual), 12/31/2018 (forecast) and 12/31/2019.

**Response:**

NW Natural filed a TCJA related deferral application with the utility commission of Oregon on December 29, 2017. In addition, Staff at the Oregon Public Utility Commission filed a deferral application on December 29, 2017 with respect to the TCJA implications for NW Natural. As a result, regulatory accounting is being utilized to defer

the net benefits associated the TCJA, including estimated excess deferred tax balances recorded at the end of 2017, and an estimate of the excess revenue occurring in 2018.

A TCJA tax workshop was held on February 28, 2017 that included representatives from all of the investor owned electric and gas utilities in Oregon, Staff from the Oregon Public Utility Commission, and representatives from Northwest Industrial Gas Users, Citizens Utility Board of Oregon, Sierra Club, Fred Meyer, Wal-Mart, and other interested parties. In follow up correspondence from Ms. Sommer Moser, from the Oregon Department of Justice (see email to all parties dated March 23, 2018), it was noted that supplemental filings regarding TCJA deferral applications are due later in April. It is NW Natural's intention to submit these supplemental filings.

- a) It is not the intention of NW Natural to exclude the benefit of the excess deferred income taxes. The calculation of rate base, as included in the revenue requirement model referenced in NW Natural 1200, continues to include a reduction to rate base for the full amount of the revalued deferred income taxes (excess) recorded upon enactment of the TCJA. As a result, customers would continue to benefit from the excess deferred income taxes in the revenue requirement determination at the authorized rate of return.

Until such time that customers receive the benefit of the excess deferred taxes in another manner (*Examples:* bill credit, offset to existing regulatory assets, allocation or offset to a capital project, etc. as discussed at the workshop) they would continue to benefit from the lower rate base balance.

Each of the examples noted above provides a meaningful economic return to customers:

**Bill Credit** – Bill credits would be a dollar for dollar refund of excess deferred income taxes. The reduction in the excess deferred income tax balance would also result in an increase to rate base and related revenue requirement.

**Existing Regulatory Asset Offset** – Applying excess deferred income taxes as an offset to an outstanding regulatory asset, such as the pension balancing account, would result in a reduction to the customer recovery requirement of the regulatory asset balance and reduce the future interest charge on that balance. The reduction in the excess deferred income tax balance would also result in an increase to rate base and related revenue requirement.

**Capital Project Allocation** - Applying excess deferred income taxes as an offset to new or existing capital projects would reduce the cost basis of the asset, its cost of recovery inclusion in depreciation, and its corresponding influence on rate base. The reduction in the excess deferred income tax balance would also result in an increase to rate base and related revenue requirement.

It is anticipated that the amortization of excess deferred income taxes subject to normalization will result in annual amounts that vary, perhaps significantly, from

year to year. As a result, inclusion in base rates per the revenue requirement of a particular annual amount, such as that may occur in a single test year, may result in a disconnect in later years when the amount that has been built into base rates per the revenue requirement differs significantly from the actual amortization amount in those later years. It may be more appropriate to address the annual amortization of these normalized amounts in a separate mechanism that can reflect the annual change in amortization in real time. This would help to ensure that in years that amounts are increasing that customer benefits are not delayed, and in years that amounts are decreasing that normalization violations do not occur.

- b) Customers continue to benefit from the estimated excess deferred income tax balance as it is currently included as a reduction to rate base. As provided in §13001(d)(1), of the TCJA, a normalization violation occurs if excess tax reserves are reduced more rapidly, or to a greater extent than such reserve would be reduced under the average rate assumption method (ARAM). An accelerated reduction of the excess deferred income tax balance, beyond that which would be provided for under ARAM, was not included in the filing. Please see the discussion in a) above.
- c) It is not the intention of NW Natural to exclude the benefit of the excess revenue deferral occurring in 2018. NW Natural is currently recording a deferral of estimated excess revenue in 2018, based on the forecasted benefit of the lower federal corporate income tax rate provided in the TCJA, for the period from January 1 through October 31, 2018. To determine the net reduction to income tax expense from the TCJA, NW Natural is utilizing a forecasted annual results of operations report to perform a with and without TCJA calculation. Beginning in January of 2018, the reduced tax amount, grossed up for income taxes, is recorded as a reduction to current revenue, with an equal offset to a new regulatory liability account. The actual deferral amount, for the full ten month period, will not be known until after October of 2018. In addition, the application of earnings test consideration usually applies to deferrals. Earnings test implications may not be known until the calendar year is complete.

The determination of the deferral amount, using actual 2018 results, is consistent with the direction provided by Ms. Sommer Moser, from the Oregon Department of Justice (see email to all parties dated March 23, 2018), in follow up correspondence from the tax workshop held in late February. Deferrals of revenue, such as that one at issue here, are usually subject to amortization over the gas year (November to October) or in a single lump sum if significant. In the meantime, NW Natural is accruing interest, to the benefit of customers, until a determination can be made regarding the disposition of this deferral balance.

- d) See files enclosed:

UG 344 NWIGU DR 42 Attachment 1- Deloitte Accounting for Income Taxes Qtrly Hot Topics.pdf

UG 344 NWIGU DR 42 Attachment 2- Deloitte Frequently Asked Questions About Tax Reform.pdf

UG 344 NWIGU DR 42 Attachment 3- Deloitte Power and Utilities Quarterly Accounting Update.pdf

UG 344 NWIGU DR 42 Attachment 4- PwC Accounting considerations of US tax reform.pdf

UG 344 NWIGU DR 42 Attachment 5- PwC Sample Disclosure Tax Reform.pdf

UG 344 NWIGU DR 42 Attachment 6 – PwC SEC staff provides accounting and reporting.pdf

UG 344 NWIGU DR 42 Attachment 7- PwC Tax reform readiness.pdf

- e) As noted in the discussion in a), above, it is anticipated that the amortization of excess deferred income taxes subject to normalization will result in annual amounts that vary, perhaps significantly, from year to year. As a result, inclusion in base rates per the revenue requirement of a particular annual amount, such as that may occur in a single test year, may result in a disconnect in later years when the amount that has been built into base rates per the revenue requirement differs significantly from the actual amortization amount in those later years. It may be more appropriate to address the annual amortization of these normalized amounts in a separate mechanism that can reflect the annual change in amortization in real time. This would help to ensure that in years that amounts are increasing that customer benefits are not delayed, and in years that amounts are decreasing that normalization violations do not occur.

As noted in part c) of “UG 344 NWIGU DR 38 NWN Response.docx,” the future annual amortization amounts of EDIT balances subject to normalization is not yet known. It will take additional time to prepare the amortization schedules under the normalization rules.

- f) and g) The request for accumulated book and tax depreciation, in the context of this overall data request NWIGU DR 42, appears to be an effort to gather information to allow a third party to prepare their own ARAM amortization analysis. The information requested, on its own, would be insufficient to prepare an analysis of this nature. However, we are providing book and income tax projected accumulated depreciation for the years ending 2017, 2018 and 2019 attached as UG 344 NWIGU 42 Attachment 8. This information includes depreciation on assets placed in service through 2017 (does not include projected additions for 2018 or 2019). The accumulated depreciation figures are segregated by asset vintage (the year the assets were placed in service). The book accumulated depreciation figures include method / life depreciation but do not include other plant accruals, such as cost of removal, salvage value, gain /

loss on disposal, etc. The income tax accumulated depreciation figures are also method / life depreciation for the ease of comparison.



**BEFORE THE  
PUBLIC UTILITY COMMISSION OF OREGON**

**UG 344**

In the Matter of )

NORTHWEST NATURAL GAS )  
COMPANY, dba NW NATURAL, )

Request for a General Rate Revision. )  
\_\_\_\_\_ )

**EXHIBIT 503  
TO THE  
REBUTTAL AND CROSS-ANSWERING TESTIMONY  
OF BRADLEY G. MULLINS  
ON BEHALF OF  
ALLIANCE OF WESTERN ENERGY CONSUMERS**

**JUNE 20, 2018**

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200743030**  
Release Date: 10/26/2007  
Index Number: 167.22-01

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B06  
PLR-155208-06

Date:  
July 20, 2007

LEGEND:

Taxpayer =  
  
PriorCo =  
Subsidiary =  
Generating =  
State =  
Commission =  
Act =  
Application =  
Method =  
x =  
y =  
z =  
Director =

Dear :

This letter responds to the request, dated November 27, 2006, filed on behalf of Taxpayer for a ruling on the normalization effects of the treatment of two of Taxpayer's deferred tax accounts as proposed by the Commission. The accounts are excess deferred federal income tax (EDFIT), consisting of deferred taxes described in § 203(e) of the Tax Reform Act of 1986, and accumulated deferred investment tax credits (ADITC) under former § 46(f) of the Internal Revenue Code.

The representations set out in your letter follow.

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Taxpayer conducts its regulated electric utility business through Subsidiary, an LLC formed under the laws of State and treated as a disregarded entity for federal tax purposes. Taxpayer is engaged, through Subsidiary, in the business of providing electric transmission and distribution services to retail electric providers in State. Taxpayer's primary business, conducted as PriorCo, had traditionally been the generation, transmission, and distribution of electric power. It is subject to the regulatory jurisdiction of Commission.

State enacted the Act, providing for restructuring of electric utilities in State. Act requires generally that electric utilities in State separate their generation, transmission and distribution, and retail electric provider elements into separate units. PriorCo, a corporation formed under the laws of State, of which Taxpayer is the successor for federal tax purposes, conveyed all of its electric generation facilities to Generating on

Taxpayer submitted Application, seeking recovery of \$x. In Commission issued its final order, allowing Taxpayer to recover \$y, which included interest through

Among the issues raised is the Commission's reduction of the amount of stranded costs that Taxpayer is allowed to recover by approximately \$z, the net present value of the Taxpayer's EDFIT and ADITC balances with respect to certain former generation assets.

Commission, in its order of , ordered that the stranded costs recoverable by Taxpayer be reduced by the net present value of Taxpayer's ADITC balance associated with certain former generation assets and by the net present value of its EDFIT balance. Taxpayer had argued to the Commission that flowing the economic benefits of the unamortized ADITC and EDFIT to ratepayers by reducing the amount of stranded costs recoverable by Taxpayer after the distribution assets were transferred would violate the normalization provisions of the Code. Taxpayer and Commission request a ruling concerning whether requiring Taxpayer to reduce the stranded costs recoverable by the net present value of Taxpayer's ADITC balance associated with certain former generation assets and by the net present value of its EDFIT balance would violate the normalization rules set forth in former section 46(f)(2) and section 168(i)(9)

#### EDFIT.

Section 168(f)(2) of the Code provides that the depreciation deduction determined under section 168 shall not apply to any public utility property (within the

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meaning of section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(1)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 1.167(l)-1(h)(1)(i) of the regulations provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.

Section 1.167(1)-1(h)(1)(iii) of the regulations provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used.

Section 1.167(1)-1(h)(2)(i) of the regulations provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under section 1.167(1)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under section 167(a).

Section 203(e) of the Act provides another way in which a normalization method of accounting is not being used for public utility property.

According to section 203(e)(1) of the Act, a normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of section 167 or 168 of the Code if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than this reserve would be reduced under the average rate assumption method (ARAM).

The term "excess tax reserve" is defined in section 203(e)(2)(A) of the Act as the excess of:

(i) the reserve for deferred taxes as described in former section 167 (1)(3)(G)(ii) or 168(e)(3)(B) (ii) of the Code as in effect on the day before the date of the enactment of the Act, over;

(ii) the amount that would be the balance in this reserve if the amount of the reserve were determined by assuming that the corporate rate reductions provided in the Act were in effect for all prior periods.

Section 203(e)(2)(B) of the Act defines the ARAM and explains the calculations under this method. ARAM is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its books of account that gave rise to the reserve for deferred taxes. Under the ARAM, if timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying:

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- (i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by;
- (ii) the amount of the timing differences that reverse during this period.

Rev. Proc. 88-12, 1988-1 C.B. 637, provides further guidance as to the application of the ARAM to the excess tax reserve. Section 2.04 of Rev. Proc. 88-12 provides that under the ARAM, excess tax reserves pertaining to a particular vintage or vintage account are not flowed through to ratepayers until such time as the timing differences in the particular vintage account reverse. Moreover, it is a violation of section 203(e) of the Act for taxpayers to adopt any accounting treatment that, directly or indirectly, circumvents the rule set forth in the previous sentence. Section 2.04 also provides that section 203(e) of the Act does not modify the normalization requirements of former section 167(l) or section 168(i) of the Code.

Sections 3 and 4.01 of Rev. Proc. 88-12 provide that a taxpayer who lacks sufficient vintage account data necessary to apply the ARAM, can use the "Reverse South Georgia Method." In general, a taxpayer uses that method if it (a) computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and (b) reduces the excess tax reserve ratably over the remaining regulatory life of the property.

For a public utility to use accelerated depreciation in determining its federal income tax liability, section 203(e) of the Act requires that normalization accounting be used to reduce the excess tax reserve in calculating the rates to be charged the utility's customers and in maintaining the regulated books of account. Under section 203(e) of the Act, the immediate flow through of the excess tax reserve to the utility's customers is prohibited. Instead, the excess tax reserve is to be reduced and flowed through to cost of service no more rapidly that this reserve would be reduced under the ARAM, or, where appropriate, the Reverse South Georgia Method.

Section 203 (e) of the Act limits the rate at which the excess tax reserve may be reduced and flowed through to the utility's customers in setting rates. It does not require the utility to flow through the excess tax reserve to its customers, but permits the utility to do so provided the reduction to cost of service is not more rapidly than would be under the ARAM. Thus, section 203 (e) of the Act imposes a limitation on when the excess tax reserve may be returned to the utility's customers in the form of reduced rates.

In the present case, Taxpayer has transferred the generating assets. Retirements of public utility property subject to the normalization requirements of section 168 are reflected in adjustments to the deferred tax reserve as well as its

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excess tax reserve (see section 1.167(1)-1(h)(2)(i), and Rev. Proc. 88-12, 1988-1 C.B. at 638). As a result of the transfer, the reserves cease to exist. A violation of the normalization rules will occur if there is any reduction to Taxpayer's rate base, after the assets are transferred, for the unamortized EDFIT reserve attributable to accelerated depreciation on public utility property. This is true even where such a reduction is indirect. Further, both ARAM and the Reverse South Georgia Method rely on mechanisms requiring a regulatory life. Once the asset is sold, the regulatory life ceases to exist.

Thus, Taxpayer will violate the requirements of the depreciation normalization rules set forth in former section 167(l), section 168, and section 203(e) of the Act, if it reduces its stranded costs by the net present value of its EDFIT associated with the generation assets.

### ADITC

Former section 46(f) of the Code provides an election for ratable flow through under which an elector may flow through the investment tax credit to cost of service. However, former 46(f)(2)(A) provides that no investment tax credit is available if the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit determined under former 46(a) and allowable by section 38. Also, under former section 46(f)(2)(B) no investment tax credit is available if the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit determined under former 46(a) and allowable by section 38.

Former section 46(f)(6) of the Code provides that for purposes of determining ratable portions under former section 46(f)(2)(A), the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account shall be used.

Under section 1.46-6(g)(2) of the regulations, "ratable" for purposes of former section 46(f)(2) of the Code is determined by considering the period of time actually used in computing the taxpayer's regulated depreciation expense for the property for which a credit is allowed. Regulated depreciation expense is the depreciation expense for the property used by a regulatory body for purposes of establishing the taxpayer's cost of service for ratemaking purposes. Such period of time shall be expressed in units of years (or shorter periods), units of production, or machine hours and shall be determined in accordance with the individual useful life or composite (or other group asset) account system actually used in computing the taxpayer's regulated expense. A method of reducing is ratable if the amount to reduce cost of service is allocated ratable in proportion to the number of such units. Thus, for example, assume that the regulated depreciation expense is computed under the straight line method by applying a composite annual percentage rate to original cost (as defined for purposes of computing

depreciation expense). If cost of service is reduced annually by an amount computed by applying a composite annual percentage rate to the amount of the credit, cost of service is reduced by a ratable portion. If such composite annual percentage rate were revised for purposes of computing depreciation expense beginning with a particular accounting period, the computation of ratable portion must also be revised beginning with such period. A composite annual percentage rate is determined solely by reference to the period of time actually used by the taxpayer in computing its regulated depreciation expense without reduction for salvage or other items such as over and under accruals.

The method prescribed by section 1.46-6(g)(2) of the regulations for determining whether the taxpayer's cost of service for ratemaking is reduced by more than a ratable portion of the investment tax credit depends upon correlating the credit with the regulatory depreciable useful life actually used for the property that generated the credit. That the correlation must remain constant and current is illustrated by the requirement that the ratable portion must be adjusted to reflect correspondingly any revision to the composite annual percentage rate applied for purposes of computing regulated depreciation expense.

Should the property for which the investment tax credit is allowed become no longer available for computing the regulated depreciation expense, there could no longer be any correlation between the property and the credit. In that event, the requirements of former section 46(f)(2) of the Code are violated if any portion of the credit is used to reduce the taxpayer's cost of service.

In this case, Taxpayer has transferred the assets that generated the investment tax credit and, as a result, the asset for which regulated depreciation expense is computed is no longer available. Consequently, no portion of the related unamortized ADITC remaining at the date of sale may be used to directly or indirectly reduce Taxpayer's cost of service.

Thus, Taxpayer will violate the requirements of the investment tax credit normalization rules set forth in former section 46(f), if it decreases its stranded costs by the net present value of the ADITC balance associated with the generation assets.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your



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authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman  
Senior Technican Reviewer, Branch 6  
(Passthroughs & Special Industries)