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CASE MANAGEMENT

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BOARD OF PUBLIC UTILITIES
TRENTON, NJ

PHIL MURPHY
Governor

SHEILA OLIVER
Lt. Governor



State of New Jersey
DIVISION OF RATE COUNSEL
140 EAST FRONT STREET, 4TH FL
P.O. BOX 003
TRENTON, NEW JERSEY 08625

*Send
June 1, 2018*

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BOARD OF PUBLIC UTILITIES
TRENTON, NJ

STEFANIE A. BRAND
Director

May 25, 2018

Via Electronic Mail and Hand Delivery

Ms. Aida Camacho-Welch, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 9th Floor
P.O. Box 350
Trenton, NJ 08625-0350

**Re: In the Matter of the New Jersey Board of Public Utilities' Consideration of
the Tax Cuts and Jobs Act Of 2017
BPU Docket No. AX18010001**

**In the Matter of the Petition of Environmental Disposal Corp. With
Calculation of Rates Under the Tax Cuts and Jobs Act of 2017
BPU Docket No. WR18030235**

Dear Ms. Camacho-Welch:

Enclosed for filing please find an original and ten copies of the Division of Rate Counsel ("Rate Counsel") comments the above-referenced matter. These comments are being submitted pursuant to the Board of Public Utilities' January 31, 2018 and March 26, 2018 Orders in this matter and the schedule agreed upon by the parties. Copies of the comments will also be sent to the parties on the attached service list.

EMS
M. Dupont, Esq.
list copies

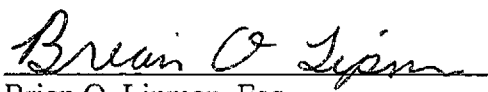
Tel: (609) 984-1460 • Fax: (609) 292-2923 • Fax: (609) 292-2954
<http://www.nj.gov/rpa> E-Mail: njratepayer@rpa.state.nj.us

Ms. Aida Camacho-Welch
May 25, 2018
Page Two

We have also enclosed one additional copy of the materials transmitted. Please stamp and date the copy as "filed" and return to our courier. Thank you for your consideration and attention to this matter.

Respectfully submitted,

STEFANIE A. BRAND
DIRECTOR, DIVISION OF RATE COUNSEL

By: 
Brian O. Lipman, Esq.
Litigation Manager

BOL/lg

**I/M/O the New Jersey Board of Public
Utilities' Consideration of the Tax Cuts
and Jobs Act of 2017**

BPU Docket No. AX18010001

Christine Soares, Esquire
Cozen O' Connor
457 Haddonfield Road
Liberty View, Suite 300
Cherry Hill, NJ 08002

Maria L. Moran
Board of Public Utilities
44 South Clinton Ave.
P.O. Box 350
Trenton, NJ 08625

Aida Camacho-Welch , Secretary
Board of Public Utilities
44 South Clinton Ave.
P.O. Box 350
Trenton, NJ 08625

Matt Koczur
Board of Public Utilities
44 South Clinton Ave.
P.O. Box 350
Trenton, NJ 08625

Mike Kammer
Board of Public Utilities
44 South Clinton Ave.
P.O. Box 350
Trenton, NJ 08625

Suzana Duby, Esquire
New Jersey-American Water Company
1025 Laurel Oak Road
Voorhees, NJ 08043

**I/M/O the Petition of Environmental
Disposal Corporation
With Calculation of Rates under the
Tax Cuts and Jobs Act of 2017
BPU Docket No. WR18030235**

Stefanie A. Brand, Director
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

*Debra F. Robinson, Esq.
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Brian Lipman, Esquire
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, New Jersey 08625

Susan E. McClure, Esq.
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, New Jersey 08625

Kathryn A. Hart, Legal Assistant
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Frank Simpson
New Jersey-American Water Company
1025 Laurel Oak Road
Voorhees, NJ 08043

SERVICE LIST

***Receives all correspondence
except discovery.**

Alex Moreau, DAG
Division of Law
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

Dante Mugrace, Senior Consultant
PCMG and Associates
90 Moonlight Court
Toms River, New Jersey 08753

Carol Artale, Esquire
Board of Public Utilities
44 South Clinton Ave.
P.O. Box 350
Trenton, NJ 08625

Kofi Ocansey
NJ Board of Public Utilities
44 South Clinton Ave., 3rd Floor
Suite 314
P.O. Box 350
Trenton, NJ 08625

Veronica Beke, DAG
Division of Law
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

Ira G. Megdal, Esquire
Cozen O' Connor
457 Haddonfield Road
Liberty View, Suite 300
Cherry Hill, NJ 08002

Jessica Rozier
GDS Associates, Inc.
111 North Orange Avenue
Suite 750
Orlando, FL 32801

Caroline Vachier, DAG
Division of Law & Public Safety
124 Halsey Street – 5th Floor
P.O. Box 45029
Newark, NJ 07101

Paul Flanagan, Executive Director
NJ Board of Public Utilities
44 South Clinton Ave., 3rd Floor
Suite 314
P.O. Box 350
Trenton, NJ 08625

Bethany Rocque-Romaine, Esquire
NJ Board of Public Utilities
44 South Clinton Ave., 3rd Floor
Suite 314
P.O. Box 350
Trenton, NJ 08625

Geoffrey Gersten DAG
Division of Law & Public Safety
124 Halsey Street – 5th Floor
P.O. Box 45029
Newark, NJ 07101

Noreen Giblin, Chief Counsel
NJ Board of Public Utilities
44 South Clinton Ave., 3rd Floor
Suite 314
P.O. Box 350
Trenton, NJ 08625

Alice Bator, Director
NJ Board of Public Utilities
44 South Clinton Ave., 3rd Floor
Suite 314
P.O. Box 350
Trenton, NJ 08625

John Tomac
New Jersey-American Water Company
1025 Laurel Oak Road
Voorhees, NJ 08043

*Audrey Cobb
audrey.cobb@gdsassociates.com

*Patrick Brian
patrickbrin@gdsassociates.com

*Terry Meyes
terry.meyers@gdsassociates.com

Dante DeStafano
New Jersey-American Water Company
1025 Laurel Oak Road
Voorhees, NJ 08043

MAY 30 2018

**Environmental Disposal Corp.
Tax Cuts and Jobs Act Of 2017 Filing
For The Adjustments of Base Rates and Refunds
BPU Docket Nos. AX18010001 and WR18030235**

BOARD OF PUBLIC UTILITIES
TRENTON, NJ

Rate Counsel COMMENTS

This document represents Rate Counsel's comments regarding the Tariffs and proposed plan submitted by Environmental Disposal Corp. ("Company" or "EDC") on March 2, 2018 and made effective April 1, 2018, pursuant to the requirements of the January 31, 2018 Order of the New Jersey Board of Public Utilities ("Board") in consideration of the Tax Cuts and Jobs Act of 2017 ("2017 Tax Act" or "TCJA").

BACKGROUND

On December 22, 2017, President Trump signed into law the 2017 Tax Act with an effective date of January 1, 2018. This Tax Act sets forth changes to the Federal Tax Code of which the most significant change is the reduction of the maximum corporate tax rate from 35% to 21%. After its review of the 2017 Tax Act, the Board determined that the changes in the 2017 Tax Act will provide savings to the New Jersey public utilities as well as revenue over-collections for federal income taxes that are included in the utilities' current rates that no longer have to be paid. As a result, the Board issued an Order dated January 31, 2018 in consideration of the Tax Cuts and Jobs Act ("Board's TCJA Order of 1/31/18") to commence a proceeding to examine the impact resulting from the 2017 Tax Act on the utilities and the current rates under the Board's jurisdiction to determine the appropriate level and mechanism by which rates must be adjusted to reflect the benefits resulting from the TCJA. The Board's TCJA Order makes it very clear that ratepayers should receive the appropriate benefits from the reduction in taxes collected in rates. In this regard, the TCJA Order states:

In consideration of the reduction in tax rate and benefits from the 2017 Act, the rate revenue resulting from expenses relating to taxes reflected in rates but no longer owed as a result of the 2017 Act shall be passed onto the ratepayers.

Among the positive benefits accruing to the ratepayers from the 2017 Tax Act, the Board's TCJA Order mentions that the new tax rate will have a direct impact on the grossing up of the revenue requirement in setting rates; and that the change in the tax rate may have an impact on other factors, including the accumulated deferred income tax balances of the utilities.

The Board's TCJA Order of 1/31/18 includes the following major directives for the affected New Jersey utilities¹ to follow in their respective TCJA proceedings:

¹ The affected utilities are investor owned gas, electric, water and wastewater companies under the jurisdiction of the Board with 2017 revenues equal to or greater than \$4.5 million. Board's TCJA Order of 1/31/18 at p. 5.

- Each affected utility must submit to the Board no later than March 2, 2018, a Petition with a detailed calculation of the impact resulting of the 2017 Tax Act on the revenue requirement by comparing the latest Board-approved test year data and supporting data attached to settlements under the old and new tax laws, and on the revenue requirements collected through annual/periodic clauses comparing the annual data under the old and new tax laws.
- The utilities are directed to defer with interest the effects of the 2017 Tax Act on their books and records effective January 1, 2018. The interest shall be calculated using the Company's short-term debt rate on the deferral related to the revenue requirement adjustment from the tax rate of 35% to the tax rate of 21%. Interest on the deferral related to the accumulated deferred income tax adjustment and other rate factors shall be at the Company's overall allowed weighted average cost of capital ("WACC"). The calculation of the deferred account for the accumulated deferred income tax balances and other rate impacts should be based on December 31, 2017 financial results.
- The utilities are directed to file provisional Tariff rates reflecting the new tax rate of 21% to be effective on April 1, 2018. These Tariff rates will be on an interim basis until a final review is complete and the final rates will be put in effect which, at this time, is anticipated to occur on July 1, 2018. The provisional and final Tariff rates must be supported by detailed workpapers showing how each rate was developed using the last approved rate design on an inter- and intra-class basis and including proof of revenues and a bill impact analysis.
- The utilities are also directed to identify and explain the specific rate mechanisms related to refunding the deferrals to the ratepayers.
- The parties are free to examine the amounts of the deferrals and rate adjustment mechanism and the appropriateness of applying the allowed overall WACC on the portion of the deferral related to the accumulated deferred income taxes and short-term debt on the portion related to the revenue requirement not being adjusted as of January 1, 2018.

In compliance with the Board's TCJA Order of 1/31/18, on March 2, 2018, EDC filed its TCJA Petition including proposed tariffs and a proposed plan to flow through to its ratepayers the revenue requirement savings and revenue over-collection refunds resulting from the 2017 Tax Act.

In an Order dated March 26, 2018, the Board ordered that EDC's TCJA proceeding be designated as Docket No. WR18030235 and directed that EDC's proposed TCJA plan "be reviewed in the instant proceeding, in accordance with the schedule set forth in the Board's January 31, 2018 Order."

EDC'S MARCH 2, 2018 TCJA FILING

EDC's TCJA Petition can be divided into four major areas of tax change consequences, that is (1) the impact of the 2017 Tax Act on EDC's revenue requirement; (2) the tariff design for the implementation of the proposed rate reduction; (3) the over-recovery of income taxes to be deferred and returned with interest; and (4) the impact of the 2017 Tax Act on the

Company's accumulated deferred income taxes. For each of these areas of tax change consequences we will first summarize EDC's proposal and then present our comments on the Company's proposal.

1. Impact of the Act on EDC's Revenue Requirement

EDC Position

EDC has recalculated that the impact of the Tax Act results in an annualized revenue requirement reduction of \$180,535.² This update was based upon the Company's May 23, 2018 response to data request RCR-EDC-A-18. In determining these proposed revenue requirement decreases, the Company has taken the latest Board-approved test year data and supporting data attached to settlement documents and the Board's Order and then recalculated these test year data under the new tax law.

Rate Counsel Position

Based on its review of the Company's calculations in support of its updated revenue requirement provided in the Company's response to RCR-EDC-A-18, Rate Counsel has concluded that the total annualized revenue requirement reduction amount of \$180,535 calculated by the Company is reasonable and acceptable.

2. Tariff Design

EDC has adjusted tariff rates utilizing the Board-approved tariff design in the Company's last base rate case. EDC has proposed to implement the revenue requirement through an across the board rate decrease for both EDC. The impact on EDC's average residential customer is a decrease of 3.44%. Rate Counsel finds EDC's rate design to be appropriate however the revenue adjustment contains a \$50.00 error. The total revenues that resulted from the last rate case are reflected on Exhibit A as \$5,582,691. However, the total current tariff revenue number reflected on Exhibit C is \$5,582,641. EDC should correct the calculations contained in Exhibit C for this error. Once this correction is made, the adjusted tariff rates will be applied to the same level of rate revenues used to calculate the reduction in EDC's income taxes.

3. Over-Recovery of Income Taxes to be Deferred and Returned with Interest

EDC Position

As shown on its response to RCR-EDC-A-18, the Company has updated its total refund amount of \$180,535 on an annual basis, and \$45,208 (including interest) to return to the ratepayers the over-collected income taxes in rates in what it refers to as the "Stub Period," which is the 3-month period January 1 through March 31, 2018. EDC applied its short-term

² In its initial filing, EDC calculated the impact of the 2017 Tax Act to be \$191,801 with respect to its annualized revenue requirement reduction.

borrowing rate of 1.527% as of December 31, 2017 to the accumulated deferral balance to compute the interest of \$72.00.³

The Company proposes to refund the \$45,208 over-collection amount through twelve monthly customer bill credits for the period July 1, 2018 through June 30, 2019.

Rate Counsel Position

Rate Counsel recommends that the Board accept the Company's proposed Stub Period refund amount of \$45,208, which includes interest of \$72.00 which will be credited to customers through a bill credit over a 12-month period beginning July 1, 2018.

4. Impact Of The Tax Act On The Company's Accumulated Deferred Income Taxes.

EDC Position

In response to the Board's directive in the TCJA Order of 1/31/18 to provide a rate mechanism to refund to the ratepayers the excess protected and unprotected accumulated deferred income taxes ("ADIT") created by the federal income tax reduction from 35% to 21%, it is EDC's position that it cannot propose such a rate mechanism without being at risk of violating IRS normalization rules. In its March 2, 2018 TCJA Petition, the Company stated that it cannot begin flowing the benefits of the 2017 Tax Act related to protected ADIT until the Company completes the Average Rate Assumption Method (ARAM) calculations to mitigate the risk of violating normalization rules. The Company further stated that it cannot adequately calculate its unprotected ADIT balance either without violating normalization rules. The Company recommended deferring the excess protected and unprotected ADIT until the resolution of the Company's next rate case.⁴

Rate Counsel's Position

In RCR-EDC-A-8, Rate Counsel requested EDC provide accounting system upgrades needed to remeasure their ADIT. In EDC's response, the company stated "The Company has not been able to determine with certainty to this point whether it can use RSGM. In order to compute ARAM the Company would have to modify its existing systems to have vintage book depreciation. In addition, Company would have to enable its functionality in its Power Tax software to compute reversals of deferred taxes using ARAM. This is a significant project that will not be completed until first quarter of 2019." This response indicates to Rate Counsel that EDC does not have detailed records and might be incapable of performing the detailed calculations required to perform the ARAM calculation with its current accounting software. Likewise, its current plant records appear to be insufficient. On May 9, 2018, EDC stated during a technical conference call that it had utilized the Reverse South Georgia Method ("RSGM") to refund any excess ADIT amounts that resulted from the 1986 Tax Act and all other book/tax items related to tax normalization or unprotected differences, prior to the TCJA. It is EDC's position that all unprotected differences and repairs have been fully

³ $\$180,535/4 = \$45,136$ plus interest of \$72.00 equals \$45,208.

⁴ Company petition dated March 2, 2018, page 6.

normalized (as opposed to being flowed through), and no method has been set up to track those differences separately.

Rate Counsel makes the following observations: (a) Rate Counsel is not convinced that EDC has all of the vintage plant records that would be required to perform ARAM for all its plant assets; (b) EDC may still have to use the RSGM for those plant assets where vintage records are not available; and (c) the additional costly software upgrade, including the cost to research and manually input the records into the software is not cost beneficial and unnecessary in order to provide the customers with the appropriate level of refunding of the excess ADIT. EDC stated American Water Works Inc. estimates that it may take up to 14 months to complete the upgrade process and it could cost an estimated \$15 million for the entire company, and EDC will receive an allocated amount of those costs. This excessive amount of time and money spent on new software, research and manual input will substantially reduce any savings to the customers for the refunding of the excess deferred taxes.

In regard to the costs of the software upgrade, only the costs related to the purchase and installation of the software should be included in customer rates. The costs to research all the historical plant records to determine if the vintage information is available, as well as, all other costs to compile and input of any vintage plant information found, as a result, of that research should be borne by shareholders and not the customers. This plant asset vintage information should have been recorded in the utility plant records at the date each plant asset was placed in service.

Addressing Potential Normalization Violations:

EDC's assertion on the May 9, 2018 technical conference call that it must use ARAM for all its plant assets in order to avoid violating normalization rules is incorrect and does not reflect the IRS's ruling in the PLR 8910012 in which EDC and NJAWC have relied upon to support their position. The IRS's ruling in the PLR 8910012 states: "Subsidiary's use of RSGM as proposed by Commission Staff, would not be consistent with the requirements of the Act for post-1970 years. However, Subsidiary was unable to prove that it *maintained* adequate records for pre-1971 years, and, thus, *must* use the RSGM for said years." (emphasis added). EDC has stated that it has not historically maintained its plant asset records adequately and has utilized RSGM in the past, but the records might be available. In the March 2, 2018 Petition, page 5, section 1. Protected ADIT, first paragraph, EDC stated: "The calculation is very time-consuming and EDC has not yet completed these calculations. For the foregoing reasons, EDC cannot begin flowing the benefits of the Act related to protected ADIT until the Company completes the ARAM calculations to mitigate the risk of violating normalization rules. The Company would risk the loss of the accelerated tax depreciation and the repairs deductions if it violated normalization rules." Based on the IRS ruling in PLR 8910012 cited above, EDC is incorrect. For any plant assets that it has not maintained adequate records or does not have the detailed vintage records, it must use RSGM for those specific assets or years. EDC should not be trying to recreate its records that it has not adequately maintained in order to use ARAM. EDC should use ARAM for those assets where it has adequately maintained its records, and use RSGM for all other plant assets,

including those water and wastewater utilities that it has acquired, which did not maintain the adequate detailed vintage plant/asset records.

Through the discovery process, Rate Counsel requested information from EDC regarding their (i) "Protected" Property Related ADIT, (ii) "Unprotected" property related ADIT, and (iii) "Unprotected" non-property related ADIT. Rate Counsel does not agree with the method to allocate the non-protected – plant and non-protected labor. The following areas are of major concern to Rate Counsel.

Repairs:

EDC appears to have taken a similar position as New Jersey American Water Company, which purchased EDC in 2016, that "all" plant related book/tax timing differences, including repairs deductions, should be based on NJAWC's Consent Agreement dated September 10, 2010. This position is in error. The Consent is only addressing the previously capitalized assets that are under the Form 3115, Application for Change in Accounting Method, requested for the taxable period beginning January 1, 2008 and ending December 31, 2008 ("year of change") related to repairs. It is true that all plant related repairs for "income tax purposes" which were requested to be treated as repairs deductions, which had previously been capitalized for income tax purposes and accelerated depreciation had been taken, would be subject to normalization rules. However, for any future repairs deductions, which are capitalized on the books, but are treated as expenses for income tax purposes during the same year, would not be subject to normalization rules since no tax depreciation had been taken. EDC should separate its book/tax timing difference for repairs deductions into two categories, those subject to normalization (prior accelerated depreciation taken for tax purposes) and those not subject to normalization (no prior accelerated depreciation taken for tax purposes).

Contribution in Aid of Construction:

EDC has taken the position to treat the excess related to Contributions in Aid of Construction ("CIAC") as being protected. EDC has not demonstrated that any accelerated depreciation has been taken for income tax purposes for CIAC. Therefore, it is the position of Rate Counsel that excess deferred income taxes related to CIAC be deemed unprotected.

Unprotected ADIT:

Rate Counsel's position on all unprotected excess deferred taxes (non-plant related) is that EDC should begin returning them over a maximum ten-year period and that amortization should begin as of June 1, 2018. Upon the completion of the software update which will enable the ARAM calculation, thereby identifying the unprotected plant-related ADIT, EDC should be required to flow back the excess unprotected plant-related ADIT over the same amortization period as the unprotected non-plant related ADIT. This flow back should be implemented as soon as the software update is complete instead of deferred to the next rate case as EDC has requested.

Protected ADIT:

Upon the completion of the software update which will enable the ARAM calculation, thereby identifying the protected plant-related ADIT, EDC should be required to flow back the excess protected plant-related ADIT using ARAM unless it is determined that EDC must use a combination of the ARAM and RSGM due to lack of vintage data as stated above in the "Discussion of Potential Normalization Violations." This flow back should be implemented as soon as the software update is complete instead of deferred to the next rate case as EDC has requested.

ARAM/RSGM:

Rate Counsel's position on protected excess ADIT is that EDC has failed to demonstrate that it has adequately maintained its plant/assets vintage records. Therefore, EDC will have to utilize a combination of both ARAM and RSGM: (i) ARAM for those assets where the vintage records have been maintained and (ii) RSGM for those assets where EDC did not adequately maintain the vintage plant/asset records.

Software Update:

EDC should provide the Board and Rate Counsel monthly updates reflecting the status of the determination of ARAM amounts for the applicable plant assets, and RSGM for the non-ARAM applicable plant assets. The Board should also require EDC to complete the update to the software and provide the final excess deferred taxes by type, (a) Protected – Plant-Related (Accelerated Depreciation); and (b) Unprotected – Plant-Related (Non-Accelerated Depreciation) previously categorized as protected, by December 31, 2018 and begin amortization on January 1, 2019.

Deferral to Next Base Rate Case:EDC Position

In its Petition on page 6, second paragraph, EDC proposes to defer the excess protected ADIT liability balance and the refunding of this balance to ratepayers until its next rate case, along with proposing a five-year period (catch-up amount) to refund the excess ADIT liability balance. EDC, also, proposes to defer the excess unprotected ADIT liability balance until the resolution of the Company's next rate case. In response to RCR-EDC-A-11, EDC stated it could not reasonably estimate the timing of the next base rate case filing, due to a 5-year rate freeze, which became effective in January 2016, when New Jersey American Water acquired EDC.

Rate Counsel's Position

Based upon the "Unprotected ADIT" and "Protected ADIT" sections discussed above, Rate Counsel rejects EDC's proposal to defer the excess deferred taxes balances to an unknown date for a future base rate case. The excess deferred income taxes should be addressed in a timely manner and should be addressed at the earliest possible time that will not result in a normalization violation.

RCR-EDC-A-18

MAY 30 2018

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BOARD OF PUBLIC UTILITIES
TRENTON, NJ

NJ Division of Rate Counsel Discovery Requests

Witness: Dante M. DeStefano

RCR-EDC-A-18. Refer to the response to RCR-EDC-A-3. The Attachment C to the Stipulation of settlement shows the Company's 12+0 Revenues at Present Rates as of December 31, 2007, prior to the increase the Board awarded the Company of \$122,165.

- a) Please confirm this to be correct.
- b) Add in the Company's revenue requirement increase of \$122,165 and make the necessary adjustments to produce the rate of return that was authorized by the Board in that proceeding. (\$1,319,430)
- c) Calculate the Federal Income Tax Expense.

Response:

- a) The Company confirms Attachment C to the stipulation shows the pro-forma present rate revenues as of December 31, 2007, upon which the \$122,166 rate increase was authorized. However, the Company believes there to be an error in the "Present Rates 12/31/2007" column, as the Net Operating Income of \$1,172,502 does not agree to the \$1,249,388 found on Attachment A of the stipulation.
- b) Please see attached updated Exhibit A, which corrects an error in the calculation supplied with the original March 2, 2018 filing. The Company had used 35% as the FIT rate for the rate case, but the order instead reflects a 34% rate. This results in a recalculation of the annual revenue requirement adjustment to be \$180,535. See below summary proving the 34% FIT rate.

Revenues	\$	5,582,692
Less: All Expenses and Taxes		(4,263,262)
Plus: FIT		324,030
Pre-Tax Operating Income	\$	1,643,460
Interest Sync		(690,434)
Taxable Income		953,026
34% FIT		324,030
Operating Income		1,319,430

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NJ Division of Rate Counsel Discovery Requests

c) See response to item b) above.

2009 Rate Case Settlement - FIT Expense Calculation
EDC

	12&0 Basis Settlement	21% FIT Rate Adjusted	Tax Savings	Rate Case Final Rev. Req't	Variance
1. Pre-Tax Operating Income	\$ 1,537,337	\$ 1,537,337		\$ 1,643,460	\$ 106,123
2. Interest Deduction	(690,434)	(690,434)		(690,434)	
3. Taxable Income	846,903	846,903		953,026	
4. FIT @ 34% and 21%	287,948	177,850		324,030	
5. Less: Flow thru					
6. Total Federal Income Tax	\$ 287,948	\$ 177,850	\$ 110,098	\$ 324,030	\$ 36,082
(1) Rate Base	\$ 15,487,687				
Weighted Cost of Debt	4.458%				
Pro Forma Interest	\$ 690,434				
Present Rates Operating Income:					
1. Operating Revenues:	\$ 5,460,526	\$ 5,460,526		\$ 5,582,692	\$ 122,166
7. Pre-Tax Operating Income	1,537,337	1,537,336		1,643,460	
8. Income Taxes	287,948	177,850		324,030	
9. Net Operating Income	\$ 1,249,388	\$ 1,359,486	\$ 110,098	\$ 1,319,430	\$ 70,042
Present Rates Revenue Deficiency:					
1. Rate Base	\$ 15,487,687	\$ 15,487,687		\$ 15,487,687	
2. Rate of Return	8.5192%	8.5192%		8.5192%	
3. Operating Income Requirement	1,319,430	1,319,430		1,319,430	
4. Pro Forma Operating Income	1,249,388	1,359,486		1,319,430	
5. Income Deficiency	70,042	(40,057)			
6. Revenue Conversion Factor	1.74417	1.45715			
7. Revenue Deficiency	\$ 122,166	\$ (58,369)	\$ 180,535		
Gross Up:					
Revenue after Assess, uncoll, GRAFT	0.868695	0.868695			
Less: FIT	(0.295356)	(0.182426)			
	0.573339	0.686269			
Revenue [Gross-up] Factor	1.74417	1.45715			

RCR-EDC-A-8

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BOARD OF PUBLIC UTILITIES
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Witness: John Wilde

RCR-EDC-A-8. What type of accounting system upgrades are required by the Company in order to compute the tax savings due to remeasurement of ADIT? What is the timing of such accounting system upgrades?

Response: Under the TCJA excess deferred taxes cannot be refunded any faster than by using the result of average rate of assumption method ("ARAM"). An alternative method, commonly known as the Reverse South Georgia Method ("RSGM") can be used if the Company does not have the records needed to compute ARAM. The Company has not been able to determine with certainty to this point whether it can use RSGM. In order to compute ARAM the Company would have to modify its existing systems to have vintage book depreciation. In addition, the Company would have to enable its functionality in its Power Tax software to compute reversals of deferred taxes using ARAM. This is a significant project that will not be completed until the first quarter of 2019.