NEW JERSEY
AMERICAN WATER

RECEIVED
DEC 09 2017
By CMS

FORWARD
CASE MANAGEMENT
2019 DEC -9 P 2:42
BOARD OF PUBLIC UTILITIES
TRENTON, NJ

Christine Soares
Director, Corporate Counsel
One Water Street
Camden, NJ 08102
christine.soares@amwater.com
P 856.955.4879

December 6, 2019

RECEIVED
MAIL ROOM
DEC 09 2019
BOARD OF PUBLIC UTILITIES
TRENTON, NJ

**VIA E-MAIL AND OVERNIGHT MAIL**

Hon. Aida Camacho-Welch
Secretary
New Jersey Board of Public Utilities
44 South Clinton Ave., 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 New Jersey-American Water Company, Inc. with Calculation of Rates under the Tax Cuts and Jobs Act of 2017, BPU Docket No. WR18030233**

Dear Secretary Camacho-Welch:

Petitioner, New Jersey-American Water Company, Inc. ("New Jersey-American" or the "Company") in above-referenced proceeding hereby submits its updated excess accumulated deferred income taxes ("ADIT") balances and amortization calculations and its proposal for the return of the excess ADIT to its customers.

## I. BACKGROUND

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 ("'TCJA") was signed into law with an effective date of January 1, 2018. The TCJA, among other things, reduced the maximum corporate tax rate from 35% to 21% effective January 1, 2018. On January 31, 2018, the New Jersey Board of Public Utilities (the "Board") issued an Order (the "TCJA Order") which set all affected utility rates as interim and established a proceeding to consider the implications of the TCJA. *See I/M/O New Jersey Board of Public Utilities' Consideration of the Tax Cuts and Jobs Act of 2017*, BPU Docket No. AX18010001 (Jan. 31, 2018). The TCJA Order directed each affected public utility to defer, with interest, the effects of the TCJA on its books and records

Case Mgmt
I. Lampert, Esq.
A. Patnaude, Esq.
M. Kammer
P. Owen, Esq
A. Bator

effective January l, 2018 and file amended tariffs reflecting a reduction in rates resulting from the reduction in the maximum corporate tax rate effective April 1, 2018, as well as a plan to address other rate factors and to refund any over-collection in rates.

On March 2, 2018, New Jersey-American filed a petition (the ''TCJA Filing") in Docket Nos. AX18010001 and WR18030233. The TCJA Filing described the impact of the TCJA on New Jersey-American and included proposed tariffs reflecting a rate reduction resulting from the TCJA. The TCJA Filing also included proposals related to the effects of the TCJA on accumulated deferred income taxes ("ADIT"). The TCJA Filing explained that, due to the risk of violating the Internal Revenue Service ("IRS") normalization rules, the Company could not begin flowing back excess ADIT to customers until it completed the "average rate assumption method" ("ARAM") calculations required by the TCJA. Consequently, the TCJA Filing proposed to defer the excess ADIT liability balance and the return of same to customers until its next base rate case. In the next rate case, when the amortization amount is known, the Company recommended that it would begin to flow back that amount to customers. The amount that would have been returned to customers prior to the commencement of the flow-back (the "catch up amount") would be divided by five years and added to the next five years' annual excess ADIT amortization amounts.

On May 25, 2018, the New Jersey Division of Rate Counsel ("Rate Counsel") filed comments in this matter. Regarding excess ADIT, Rate Counsel among other things disagreed with New Jersey-American's treatment of certain balances and its proposal to defer the flow-back of excess ADIT until the Company's next rate case. Rate Counsel also proposed that unprotected excess ADIT be amortized and returned to customers over a three-year period.

New Jersey-American submitted reply comments on June 5, 2018. Regarding excess ADIT, the Company responded to Rate Counsel's comments and reiterated the Company's request that the Board defer the excess ADIT liability until the Company's next base rate case. In the alternative, the Company requested that the Board defer excess ADIT until the fourth quarter of 2019, by which time the Company intended to have completed the software updates necessary to compute amortization amounts and periods utilizing the ARAM.

On June 10, 2019, New Jersey-American, the Staff of the New Jersey Board of Public Utilities ("Board Staff") and Rate Counsel submitted to the Board a partial stipulation of settlement regarding the refund of the federal income taxes that the Company collected in rates during the stub period (the "Partial Stipulation"). The Partial Stipulation also provided that the effects of the TCJA on ADIT would be addressed at a later stage of this proceeding. (Partial Stipulation ¶ 7.) The Board approved the Partial Stipulation by Order dated July 10, 2019.

## II. UPDATED EXCESS ADIT BALANCES

New Jersey-American has now fully installed and implemented the necessary software modifications and has utilized the ARAM to update its excess ADIT balances and calculate the relevant amortization periods. The non-grossed up excess ADIT balances that resulted from the TCJA's reduction of the federal tax rate is now estimated to be $320,439,255, of which

$322,693,620 is attributable to utility plant investments (both protected and unprotected), and ($2,254,364) is attributable to other aspects of utility operations.[1] These excess ADIT balances, together with calculations illustrating and supporting the Company's excess ADIT proposal, are shown on Attachment A.[2]

It should be noted that, while these estimates are based on actual tax positions taken on tax returns for tax years before the dates the respective legislation was enacted, the taxing jurisdiction may issue guidance that would cause New Jersey-American to propose adjustments affecting the amount of excess ADIT accrued prior to the date of enactment. Similarly, the taxing jurisdiction may audit returns for those years and propose adjustments that would change the amount of accrued excess ADIT. Therefore, the underlying tax positions and excess ADIT balances are subject to change through the statute of limitations period, which is three years after the date the Company files its income tax return.

## III. NEW JERSEY-AMERICAN'S UPDATED EXCESS ADIT PROPOSAL

The Company has completed the ARAM calculation related to its plant in service-related excess ADIT (both protected and unprotected), which represents a credit to customers. The non-plant in service-related balance represents a charge to customers, for which the Company proposes a 20-year amortization period. The Company proposes to return the excess ADIT to customers via a bill credit starting on January 1, 2020 or as soon as practicable thereafter following a Board Order. Additionally, the Company proposes that excess ADIT amortization that has accumulated during the period January 1, 2018 through December 31, 2019 (the "Catch Up Period")" will be amortized over five years and added to the bill credit.

As shown on Attachment A:

- Amortization of plant in service-related excess ADIT produces a non-grossed up credit for customers of $8,674,761, $6,686,646 and $6,968,724 for 2018, 2019 and 2020, respectively.
- Non-plant in service-related excess ADIT, amortized over 20 years, produces an annual *charge* to customers of $112,718.
- The net amount for the non-grossed up credit to customers is therefore a credit of $8,562,042, $6,573,927 and $6,856,006 for 2018, 2019 and 2020, respectively.

[1] Excess ADIT will be returned to customers on an after-tax basis. The amounts to be amortized therefore will be "grossed up" by applying a tax multiplier to the excess ADIT liabilities and assets.

[2] Attachment B indicates which of the federal excess ADIT balances, based on available tax guidance, should be treated as "protected" for tax purposes (that is, subject to required tax normalization), and which may be treated as "unprotected." "Protected" and "unprotected" line items are identified as such, and where additional guidance is needed and expected to be issued in the future, the item is identified as "uncertain."

- The grossed-up amount of the credit is $10,838,028, $8,321,427 and $8,678,488 for 2018, 2019 and 2020 respectively.

- The amount for the Catch Up Period is the sum of the grossed-up amounts for 2018 and 2019 of $10,838,028 and $8,321,427, or $19,159,455.

- The Catch Up Period amount of $19,159,455 is amortized over five years, producing an annual credit of $3,831,891 during the period 2020-2024.

- For 2020, the annual Catch Up Period amortization of $3,831,891 is added to the 2020 grossed-up net excess ADIT amortization amount of $8,678,488, to produce a total of $12,510,379.

- The increase in rate base as a result of decreasing ADIT for the Catch Up Period on average over 60 months and for 2020 on average for 12 months increases the Company's revenue requirement by $635,773, which is an offset to the sur-credit amount.

- The 2020 grossed up net excess ADIT amount of $12,510,379 is reduced by the $635,773 increase in revenue requirement due to the increase in rate base, to produce a 2020 sur-credit to customers of $11,874,607.

- The 2020 excess ADIT sur-credit will be returned to customers over 12 months, starting January 1, 2020.

- After twelve months, the sur-credit will change based on the amount of the 2021 net excess ADIT amortization.

- The annual catch up period amount of $3,831,891 will be added to the 2021, 2022, 2023, and 2024 net excess ADIT amortizations.

The use of the ARAM to normalize protected excess ADIT is required by the TCJA. Although New Jersey-American Water no longer believes that the IRS Consent Agreement discussed in its reply comments *requires* excess ADIT that resulted from its repairs deductions to be normalized, the Company proposes to normalize *all* plant-related excess ADIT pursuant to the ARAM, whether protected or not, because it is in the long-term best interests of its customers to do so.

Excess ADIT related to plant in service is a permanent tax benefit that relates to the deduction of costs not yet recovered in rates from customers, and it should be returned to those customers who will be required to pay the costs of the investment to which those permanent differences relate. The use of the ARAM to determine the amortization closely aligns the amortization of these permanent differences to the investments that gave rise to the benefits, and thus to the customers who will bear the cost of those investments over their lives. In addition, the use of the ARAM will lower the total cost of capital recovered from customers over the underlying useful life of the plant in service investment. This is because as long as ADIT (including excess ADIT) remains with the Company, it reduces rate base, providing customers with a weighted average cost of capital rate of return. The use of ARAM also will add to the stability of cost of service rates over the useful life of the property.

New Jersey-American believes that the long-term customer benefits provided by its use of the ARAM to amortize unprotected plant in service-related excess ADIT outweighs any that might be provided by the three-year period proposed by Rate Counsel. By severing the relationship between the investment and the tax benefit, the shorter amortization period would provide a short-term benefit to today's customers at the expense of tomorrow's customers, who will continue to pay for the investments, thus creating generational inequities. Moreover, returning excess ADIT faster will create higher rates in the future, and over time will actually result in customers paying more than they would have if the excess ADIT had remained in rate base reducing the Company's weighted average cost of capital over the life of the underlying assets. The artificially-accelerated three-year period would also decrease New Jersey-American's cash flow from operations, and may have a negative impact on New Jersey-American's financial metrics, thus increasing its cost of capital. Therefore, a three-year amortization for unprotected excess ADIT is not in the best interests New Jersey-American's customers.

## IV. CONCLUSION

New Jersey-American respectfully submits this supplement and requests authorization to implement an excess ADIT sur-credit as provided for herein. The Company further seeks any additional relief as the Board deems just and reasonable.

Respectfully submitted,

Christine Soares

Christine Soares

CS:dlc

c: Service list (via email, w/enc.)

Attachment A

**Excess ADIT - Proposal to Credit Customers**

| **Excess Taxes (See Attachment B)** | Net Excess | | |
|---|---|---|---|
| | Total Company | EDC | NJ-AW |
| Total Plant Related | $323,848,813 | $1,155,193 | $322,693,620 |
| All Other Non Plant | (2,262,435) | (8,070) | (2,254,364) |
| Total Excess | $321,586,378 | $1,147,123 | $320,439,255 |

==========================================================================

**Amortization Per ARAM**

| | Total Company | | | |
|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2021 |
| Total Plant Related | $8,727,156 | $6,735,439 | $7,017,298 | $7,331,186 |
| All Other Non Plant (20 year amortization) | (113,122) | (113,122) | (113,122) | (113,122) |
| Total Excess Amortization | $8,614,034 | $6,622,317 | $6,904,177 | $7,218,064 |
| Grossed-Up (21%) | $10,903,841 | $8,382,680 | $8,739,464 | $9,136,790 |

| | EDC | | | |
|---|---|---|---|---|
| Amortization Per ARAM | 2018 | 2019 | 2020 | 2021 |
| Total Plant Related | $52,395 | $48,793 | $48,575 | $55,927 |
| All Other Non Plant (20 year amortization) | (404) | (404) | (404) | (404) |
| Total Excess | $51,992 | $48,390 | $48,171 | $55,524 |
| Grossed-Up (21%) | $65,812 | $61,253 | $60,976 | $70,283 |

| | NJ-AW | | | |
|---|---|---|---|---|
| Amortization Per ARAM | 2018 | 2019 | 2020 | 2021 |
| Total Plant Related | $8,674,761 | $6,686,646 | $6,968,724 | $7,275,259 |
| All Other Non Plant (20 year amortization) | (112,718) | (112,718) | (112,718) | (112,718) |
| Total Excess | $8,562,042 | $6,573,927 | $6,856,006 | $7,162,541 |
| Grossed-Up (21%) | $10,838,028 | $8,321,427 | $8,678,488 | $9,066,507 |

==========================================================================

**Proposal for Refunding to Customers: (Beginning 01/01/2020)**

| | Total Company | EDC | NJ-AW |
|---|---|---|---|
| Catch-up Period Excess (2018 & 2019) | $19,286,520 | $127,065 | $19,159,455 |
| Catch-up Period - 5 year Amortization | 3,857,304 | 25,413 | 3,831,891 |
| Year 2020 | 8,739,464 | 60,976 | 8,678,488 |
| Subtotal | $12,596,768 | $86,389 | $12,510,379 |
| Revenue impact of rate base change (see below) | (640,163) | (4,390) | (635,773) |
| **Tax Credit to Customers - 2020 (over 12 months)** | **$11,956,606** | **$81,999** | **$11,874,607** |

| Revenue impact of rate base change: | | | |
|---|---|---|---|
| Increase in Rate Base (Prorated) (see Attachment C) | $5,805,068 | $39,811 | $5,765,257 |
| ROR (last Case) | 7.46% | 7.46% | 7.46% |
| Return | $433,128 | $2,970 | $430,157 |
| Revenue Conversion Factor | 1.4780 | 1.4780 | 1.4780 |
| Revenue Requirement Effect | $640,163 | $4,390 | $635,773 |

Attachment B

**Excess ADIT - Proposal to Credit Customers**

| | | Net Excess Total Company | Net Excess EDC | Net Excess NJ-AW | |
|---|---|---|---|---|---|
| Net Excess Amortization from Powertax | | | | | |
| Method / Life | ARAM | $200,824,014 | $2,421,652 | $198,402,362 | Protected |
| Cost of Removal | ARAM | 16,101,636 | 12,749 | 16,088,887 | Uncertain |
| Repairs - M/L | ARAM | 676,822 | 13,430 | 663,392 | Unprotected |
| Repairs Other | ARAM | 94,597,659 | 161,046 | 94,436,613 | Unprotected |
| Taxable CIAC | ARAM | (685,559) | 0 | (685,559) | Protected |
| All Other | ARAM | 30,475,749 | (1,424,963) | 31,900,711 | Uncertain |
| Powertax Rpt 259 | | 341,990,320 | 1,183,914 | 340,806,405 | |
| Federal NOL | | (9,844,900) | 0 | (9,844,900) | Uncertain |
| Plant Items outside PowerTax | | | | | |
| Plant Customer Advances | Proportional to ARAM | (9,681,934) | (33,517) | (9,648,417) | Unprotected |
| Plant CWIP | Proportional to ARAM | 1,043,429 | 3,612 | 1,039,817 | Unprotected |
| CIAC WIP | Proportional to ARAM | (374,758) | (1,297) | (373,461) | Unprotected |
| Plant 481 | Proportional to ARAM | 2,058,957 | 7,128 | 2,051,830 | Unprotected |
| Plant Cost of Removal Refund Liability | Proportional to ARAM | (5,194,000) | (17,981) | (5,176,019) | Uncertain |
| Customer Advances Reserve | Proportional to ARAM | 325,000 | 1,125 | 323,875 | Unprotected |
| Plant Cost of Removal reclass | Proportional to ARAM | 3,008,020 | 10,413 | 2,997,607 | Uncertain |
| Plant Purchase Premium Regulatory Asset | Proportional to ARAM | 518,679 | 1,796 | 516,883 | Unprotected |
| Total Plant Related | | 323,848,813 | 1,155,193 | 322,693,620 | |
| All Other Non Plant | | (2,262,435) | (8,070) | (2,254,364) | |
| Total Excess | | $321,586,378 | $1,147,123 | $320,439,255 | |