

OFFICE OF THE ILLINOIS ATTORNEY GENERAL'S RESPONSES TO  
COMMONWEALTH EDISON'S FOURTH SET OF DATA REQUESTS  
DIRECTED TOWARDS MICHAEL L. BROSCH

ICC DOCKET No. 14-0312

Date Issued: August 5, 2014

Date Responded: August 11, 2014

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ComEd→AG 4.01. Is Mr. Brosch aware of any regulatory commission order, regulatory literature, empirical research, economic literature, accounting literature, financial literature or other published authority where income taxes related to the receipt of interest on regulatory assets, including deferred recovery of a utility's revenue requirement, are addressed? If Mr. Brosch's answer is anything but an unqualified "no," please provide citations to all such sources. If any such sources are not readily and publicly available to ComEd (i.e., from local libraries or on-line sites accessible by ComEd and its counsel), please provide copies thereof.

**AG Response:**

OBJECTION: The People of the State of Illinois object to this data request on the grounds that it is overbroad, unduly burdensome, and/or not reasonably calculated to lead to the discovery of admissible evidence. In particular, and without limitation, the People of the State of Illinois object to the extent this data request seeks documents or information beyond the scope of their testimony in this proceeding. Without waiving this objection, the People respond as follows:

Yes. The Hawaii Public Utilities Commission ("HPUC") has affirmatively found that income taxes related to the receipt of interest on regulatory assets, specifically the deferred recovery of a utility's revenue requirement, should be recognized as an offset to the regulatory asset balance that is allowed to earn interest until such balances have been recovered.

The HPUC initiated, in Docket No. 2013-0141, an investigation of the sales decoupling and rate adjustment mechanism ("Mechanism") that is currently being used to regulate the Hawaiian Electric Companies (Hawaiian Electric Company, Maui Electric Company, Ltd. and Hawaii Electric Light Company), also referred to generally as the "HECO Companies". The existing Mechanism was established in prior Docket No. 2008-0274 before the HPUC. Under the Mechanism, each of the Hawaiian Electric Companies has established a Revenue Balancing Account ("RBA") that causes a regulatory asset/liability to be recorded on the utilities' books to accumulate the difference between actual recorded

adjusted revenues and authorized revenue levels. A six percent annual interest rate is applied to the RBA regulatory asset account that was authorized in Docket No. 2008-0274 and the interest added at six percent becomes part of the balance to be collected from ratepayers upon reconciliation of cumulative over or under-recoveries of the authorized revenue requirement. This reconciliation, with interest, process is very similar to the reconciliation with interest approach used under EIMA in Illinois.

Mr. Brosch was involved, on behalf of the State of Hawaii's Department of Commerce and Consumer Affairs ("Consumer Advocate"), in the initial design, negotiation and implementation of the existing Mechanism that was approved by the HPUC in Docket No. 2008-0274. Mr. Brosch is also assisting the Consumer Advocate in the pending investigation of the Mechanism within Docket No. 2013-0141.

In its Decision and Order No. 31908 issued February 7, 2014, several of the "Schedule A" issues that were addressed in filed Statements of Position and hearings were ruled upon by the HPUC. In this order, the HPUC ruled that the six percent interest rate previously authorized should be reduced to the utilities' most recently approved short-term debt cost rate. The HPUC also directed the HECO Companies to immediately investigate their ability to defer the payment of income taxes on the accrued amounts of revenue under the Mechanism, and report the results of that investigation, along with recommendations as to deferred tax treatment, to the commission and the parties within 120 days of this order.

The HECO Companies had historically taken an income tax position that included accrued revenues associated with decoupling reconciliation in their taxable income, unlike the opposite tax accounting positions taken by ComEd and the Ameren Illinois Companies that such accrued revenues are not includable on their affiliated group income tax returns. Upon receipt of the HPUC Decision and Order No. 31908, the HECO Companies solicited and ultimately received a Private Letter Ruling from the Internal Revenue Service permitting a change in accounting to exclude accrued revenues from taxable income. At this time, the HECO Companies are applying interest to the accrued revenue regulatory asset balance on a net of tax basis for each of the three utilities.

In a letter filed on April 3, 2014 in Docket No. 2013-0141, the HECO Companies stated:

In connection with Decision and Order No. 31908, issued on February 7, 2014, this letter informs the Commission of the Hawaiian Electric Companies' progress in investigating the tax treatment of the decoupling revenue included in the Revenue Balancing Account ("RBA") balances.

In its Reply Statement of Position, the Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs raised the issue of whether the Companies would be able to defer the payment of income taxes on the accrued amounts of decoupling revenues, and if so, whether it would be appropriate to apply the interest rate to a net-of-income tax RBA balance.

Pursuant to the order, the Companies completed their review of the tax methods available for recognizing the RBA revenue and the procedures for changing accounting methods. Based on the facts and circumstances, the Companies found it appropriate to change its tax treatment from the book method of RBA revenue recognition to a recognition method based on when rates are adjusted for the RBA revenues (June 1 subsequent to the measurement year). Consequently, the Companies filed with the Internal Revenue Service ("IRS") an application to change their accounting method to such alternative method on March 24, 2014. The IRS response time is difficult to predict and depends on factors such as its workload and the complexity of the application, but the Companies expect to receive some feedback by the end of June 2014.

In a subsequent letter filed by the HECO Companies in Docket No. 2013-0141 on May 19, 2014, the utilities reported receipt of required IRS approval to defer income tax recognition of accrued revenues, pending reconciliation, and made downward adjustments to their regulatory asset balances to implement net of income tax interest accruals, stating:

As stated in their letter dated May 6, 2014, of the above subject, the Hawaiian Electric Companies" hereby notify the Commission of their implementation of the change in their tax accounting method as approved by the Internal Revenue Service and its impact on the amount of interest to be accrued for the revenue balancing account ("RBA"). This letter fulfills the requirement in Decision and Order No. 31908 for the Companies to report within 120 days the results of the investigation and their recommendations as to the approved deferred tax treatment.

Attachments 1, 2, and 3 reflect the Hawaiian Electric, Hawai'i Electric Light, and Maui Electric calculations, respectively, of the revised January through April 2014 monthly RBA balances and associated interest amounts based on the newly-approved revenue recognition method for tax purposes. The Consumer Advocate has also reviewed and has agreed with the Companies' method of calculating the revised RBA balances for the application of the interest rate, consistent with the Consumer Advocate's suggested

methodology in its statement of position regarding the decoupling investigation. The attachments also show the recorded amounts for the same period and the calculation of the adjustments\* that will be made in May 2014 to restate the RBA interest for the year. Based on the Companies' calculations, the March 2014 year-to-date interest accrual will be adjusted downward by \$293,634, \$37,028, and \$37,909 for Hawaiian Electric, Hawaii Electric Light, and Maui Electric, respectively.

Documents cited in this discussion that are not confidential are publicly available at:

<http://dms.puc.hawaii.gov/dms/>

Insert the Docket Number 2013-0141 into the “Docket Quick Link” box and select the “Documents” tab to browse all filed documents in sequential order.

For convenience, ComEd->AG 4.01 Attachment 1 contains excerpts from HPUC Order No. 31908 and copies of the letters referenced above.

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

-----In the Matter of----- )  
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PUBLIC UTILITIES COMMISSION )  
 )  
Instituting an Investigation to )  
Reexamine the Existing Decoupling )  
Mechanisms for Hawaiian Electric )  
Company, Inc., Hawaii Electric )  
Light Company, Inc., and Maui )  
Electric Company, Limited. )  
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DOCKET NO. 2013-0141

DECISION AND ORDER NO. 31908.

**FILED**  
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PUBLIC UTILITIES  
COMMISSION

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DECISION AND ORDER

In this Decision and Order ("Order"), the Commission orders the HECO Companies<sup>1</sup> to make certain modifications to their decoupling mechanisms, and to include these modifications in their upcoming decoupling filings due on March 31, 2014. In addition, the commission is deferring certain issues for consideration in the second phase of this proceeding, as further discussed below.

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<sup>1</sup>The "HECO Companies" are Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited ("MECO").

does not depend upon an allocation of the various types of debt and equity.

The HECO Companies' argument here is unclear; there is no discernible linkage between the determination of an appropriate interest rate for the RBA balances and the consolidated cost of capital. Taken to its extreme, the argument would require that, for any interest rate associated with surcharges identified by the HECO Companies that utilize the ROR, an adjustment would have to be made to made to the short term debt rate, with the result that the interest rate on those surcharges could increase the ROR above the authorized level, a result that clearly would be neither just nor reasonable.

The commission also notes that outstanding RBA balances represent temporary over- or under- recovery of overall approved revenues. Outstanding RBA balances do not directly or solely represent utility expenditures that are eligible to earn a return at the utility's CCOC.

6. The commission is deeply concerned with the HECO Companies' response to the CA's observation that the HECO Companies may be able to defer the payment of income taxes on the accrued amounts of decoupling revenues. The HECO Companies concede that when the RBA balance is in a state of under-collection, the potential recognition of

RBA revenues would be beneficial to customers since the Companies could delay payment of income taxes on these revenues by approximately five months.

While the commission recognizes that this issue could cut both ways (that is, if there is a surplus to be returned to ratepayers, additional taxes might be due under the Companies' current practices), it is clear that this is an issue that could and should have been addressed and analyzed by the HECO Companies prior to or contemporaneous with the implementation of the decoupling mechanism. Surely, the Companies' auditing and tax departments are aware of the benefits of deferring taxes; stated differently, the Companies' knew or should have known that accrual of RBA balances could have deferred tax ramifications.

While the HECO Companies maintain that their method of accounting for RBA accrued revenues is reasonable, that is not the issue. As regulated utilities, the HECO Companies have a duty not only to act in a reasonable fashion, but in a manner which results in the greatest savings to ratepayers consistent with the provision of safe, adequate, and reliable service. The HECO Companies have clearly not acted so as to accomplish this goal with respect to the issue of deferred taxes.

The commission is hereby directing the HECO Companies to immediately investigate the possibility that they may be able