NEW YORK STATE OF OPPORTUNITY. Department of Public Service

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January 17, 2018

To the Telecommunications Utilities Addressed:

Subject: Case 17-M-0815 - Proceeding on Motion of the Commission on Changes in Law that May Affect Rates.

On December 22, 2017, the Tax Cuts and Jobs Act (Tax Act) was signed into law. The Tax Act makes significant changes to the federal tax structure, which will impact the tax liabilities of New York's utilities, as well as the associated deferred tax ratemaking. Most immediate is the reduction of the utilities' corporate federal income tax rate to 21%, which is not reflected in the companies' current rates. Utilities may also be impacted by other aspects of the legislation including the treatment of bonus depreciation and net operating losses.

On December 29, 2017, the Commission instituted a proceeding to commence the process of addressing the impact of the Tax Act on the State's utilities and ratepayers. The identified first steps of the process are to solicit information from the utilities to identify and quantify the impact of the Tax Act, schedule a technical conference with the utilities, and issue a Staff proposal within 90 days for treatment of the tax changes, the goal of which will be preserving any net tax benefits for ratepayers. In order to facilitate discussion at the upcoming technical conference, assist in the development of the Staff proposal that is expected to address ratemaking issues and alternatives, and assess the impact of the tax revisions contained within the Tax Act, the telecommunications utilities are asked to respond by February 2, 2018 to the questions in Attachment 1.

Responses should be provided to Charles Reubens at Charles.Reubens@dps.ny.gov,Yves Isaac, at Yves.Isaac@dps.ny.gov, and Ruvain Kudan at Ruvain.Kudan@dps.ny.gov. We recognize that the level of information being requested may be difficult for the smaller companies to provide in this time frame so it may be necessary to prioritize certain responses and follow up later. Should you have any questions pertaining to what information is being requested, how best to gather the requested information, or would like further assistance, please contact Mr. Reubens at (518) 474-8053, Mr. Isaac at 212-417-2072, or Mr. Kudan at (518)-473-4053.

Sincerely,

Doris D Stout

Doris D. Stout, Director
Office of Accounting, Audits and Finance

Attachment

Attachment 1

The following questions pertain to the Tax Cuts and Jobs Act signed into law on December 22, 2017:

A. General

1. Identify, and provide a description, of each tax change that is expected to impact the utility company.

2. Provide the date, and rationale, the utility company expects each tax change to become effective for its operations.

B. Corporate Tax Rate

1. Identify the estimated effects of the tax rate change on years 2018 and 2019, and provide all related calculations and assumptions.

   (a) Current federal income tax expense
   (b) Deferred federal income tax expense (originating and reversing)

2. Identify the effective date of the corporate tax rate change for the utility company, and indicate and explain if the effective date of the change will result in a blended tax rate being used for the first year? If yes, identify the blended rate and show all calculations. If no, explain why there will be no blended rate.

C. Excess Deferred Tax Reserve

1. As a result of the tax rate change to 21%, what is the estimate value of the excess accumulated deferred federal income tax (ADFIT) balance as of December 31, 2017? Provide all calculations. Provide the breakdown of the excess ADFIT by:

   (a) Accelerated Depreciation (i.e. protected)
   (b) Other tax timing differences (i.e. unprotected)

2. As a result of the tax rate change to 21%, what is the estimated value of the excess ADFIT balance as of December 31, 2018, and December 31, 2019? Provide all related calculations. Provide the breakdown of the identified excess ADFIT by:

   (a) Accelerated Depreciation (i.e. protected)
   (b) Other tax timing differences (i.e. unprotected)

3. For the estimated value of the excess ADFIT balances at December 31,2017 and at December 31,2018:

   (a) To be consistent with the Commission's identified goal of preserving the net tax benefits for ratepayers, explain how the Company will account for the excess ADFIT.
   (b) Provide the calculation and the specific accounting the Company plans to implement to record and return the excess ADFIT to ratepayers. Identify all assumptions.
   (c) Identify and explain any and all restrictions the utility company believes exists on the allowed amortization of the excess ADFIT balances. This includes addressing any timing restrictions.
   (d) Identify and explain any and all natural unwinding that would occur of the excess ADFIT balances.

4. Regarding normalization:

   (a) What is the effect of the normalization rules applicable to the excess ADFIT balances for the years 2018 and 2019. State how the utility will apply the normalization rules to the excess ADFIT balances.
   (b) Identify and provide the rationale, for which method of normalization the utility company employs or will employ, specifically the Average Rate Assumption Method (ARAM) or the Reverse South Georgia Method (RGSM).
   (c) Has the utility company maintained sufficient records, i.e. the requisite vintage records, to use the ARAM? If no, explain why not.

D. FAS 109

1. As a result of the tax rate change to 21%, the FAS 109 accounts will need to be revalued.

    (a) What will be the effect on FAS 109 accounts balances as of December 31, 2017?
    (b) Will the revaluation of the FAS 109 accounts impact operating income? If so, what is the expected dollar impact and the rationale?
    (c) Provide the proposed journal entries. resulting from the tax rate change with estimated dollar amounts, for the FAS 109 account balances.

E. Net Operating Losses

1. Currently, what is the amount of net operating tax losses available to the utility company?

2. How will the changes contained in the Tax Act related to deduction of net operating losses effect the utility company?

F. Bonus Depreciation

1. What is the effect on the utility company due to the bonus depreciation changes contained within the Tax Act for the year 2017? The response should at a minimum address cash flow changes, revenue requirement effects/changes, as well any other changes the utility company expects. Provide supporting calculations, and identify all assumptions.

2. What is the effect on the utility company due to the bonus depreciation changes contained within the Tax Act for the years 2018 and 2019? The response should at a minimum address cash flow changes, revenue requirement effects/changes, as well any other changes the utility company expects. Provide supporting calculations, and identify all assumptions.

G. <u>Interest Expense Deduction Limitation</u>

1. For ratemaking purposes, does the utility utilize a consolidated or standalone capital structure?

2. Will the limitation of interest deductibility have any impact on the utility operations, and any revenue requirement impact? If yes, explain in full, and provide the supporting calculations of the various impacts that are expected.

H. <u>Financial Metrics</u>

1. In order to gauge the expected impact on the utility company's financial metrics while assuming the company's revenues have been adjusted to reflect the various tax law changes contained within the Tax Act (post-change), please provide the following calculations for years 2016 and 2017 (pre-change or look-back analysis) and estimates for 2018 and 2019 (post-change or forward looking analysis).

   a. Debt/Earnings Before Interest, Taxes Depreciation and Amortization (EBITDA)
   b. Free Cash Flow (FCF)/Debt
   c. Retained Cash Flow/Debt
   d. Funds From Operations (FFO) interest Coverage
   e. (EBITDA-Capital Expenditure)/Interest Expense

Note:

Retained cash flow(RCF) should be calculated as FFO minus common, preferred, and minority dividends per the company's statement of cash flow.

FFO must be calculated as Cash flow from operations (CFO) before changes in working capital and changes in other short-term and long-term operating leases and liabilities.

Debt should be calculated as short-term debt, plus current portion of long-term debt, plus long-term debt.

Free cash flow (FCF) should be calculated as CFO minus capital expenditures (CAPEX) minus common, preferred, and minority dividends per the company's statement of cash flow.

I. Other Items

1. Individually identify any other provision changes contained within the Tax Act, not mentioned above, which will have an impact on the utility company's revenue requirements. Which of the provision changes is expected to have a material impact?

2. Identify the estimated revenue requirement effects for each of the identified items for each of the years 2018 and 2019. Provide supporting calculations and identify all assumptions.

3. For each of the calendar years 2018 and 2019, identify how the utility company will account for the revenue requirement impact of the tax law changes contained within the Tax Act.

4. In the Commission's December 29, 2017 Order, it identified the goal of preserving the net tax benefits resulting from the changes within the Tax Act for ratepayers. There are various options to provide the benefits to ratepayers, e.g. deferral approach until next rate case, implementation of a sur-credit, implementation in a second stage of a multi-year plan, rate case reopener, offset of other deferrals, etc.

    (a) What is your company's proposal for treatment of the net tax benefits, and how does it propose ratepayers receive this net benefit amount? Explain why this proposed approach is the most optimal.

5. Identify the carrying charge rate that should be utilized pending return of the net tax benefits to customers. Provide the rationale for use of this rate.

J. Rate History

1. Provide the case number of the Company's most recent rate Order and the date that Order was issued.

2. Provide any amounts the Company is currently authorized to withdraw from the State Universal Service Fund (SUSF) and the date(s) the Commission approved those withdrawals.