STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. M-100, SUB 138

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of Implementation of House Bill 998 – An Act to Simplify the North Carolina Tax Structure and to Reduce Individual and Business Tax Rates	))))	ORDER ADDRESSING THE IMPACTS OF HB 998 ON NORTH CAROLINA PUBLIC UTILITIES

BY THE COMMISSION: On July 23, 2013, North Carolina Session Law 2013-316 (House Bill (HB) 998), An Act to Simplify the North Carolina Tax Structure and to Reduce Individual and Business Tax Rates (the Tax Simplification and Reduction Act), was signed into law, having previously been ratified by the North Carolina General Assembly.

HB 998, among other things, made changes to the general statutes concerning the State corporate income tax. These changes will impact the cost of services provided by affected investor-owned public utilities subject to the jurisdiction of the Commission. Effective for taxable years beginning on or after January 1, 2014, a tax is imposed on the State net income of every C Corporation doing business in North Carolina at the rate of 6%.[1] Effective for taxable years beginning on or after January 1, 2015, said tax is imposed at the rate of 5%. Further, a new section, G.S. 105-130.3A, was added to the General Statutes concerning possible future rate reduction triggers.

Additionally, Part IV of HB 998 made several changes to the general statutes with respect to gross receipts/franchise taxes; these changes become effective July 1, 2014.

On October 1, 2013, the Commission issued an Order initiating this generic proceeding and requesting comments from the parties.

On October 29, 2013, Duke Energy Carolinas, LLC (DEC) and Duke Energy Progress, Inc. (DEP) (collectively DEC/DEP) filed a Motion for Extension of Time to File Initial Comments. DEC/DEP requested an extension of time for the filing of initial comments until November 12, 2013, which was granted by the Commission on November 1, 2013.

[1] Prior to the passage of HB 998 the corporate income tax rate was 6.9%.

Initial comments were filed on November 12, 2013, by DEC/DEP; Virginia Electric and Power Company, d/b/a Dominion North Carolina Power (Dominion); Piedmont Natural Gas Company, Inc. (Piedmont); Public Service Company of North Carolina, Inc. d/b/a PSNC Energy (PSNC Energy); Aqua North Carolina, Inc. (Aqua); Utilities, Inc.; Ellerbe Telephone Company (Ellerbe); Pineville Telephone Company (Pineville); and the Public Staff. Toccoa Natural Gas (Toccoa) filed its initial comments on November 14, 2013. Frontier Natural Gas Company, LLC (Frontier) was requested by the Commission's October 1, 2013 Order to file initial comments, but did not do so.

On November 21, 2013, the Public Staff filed a Motion for Extension of Time to File Reply Comments. The Public Staff requested an extension of time for parties to file reply comments until December 16, 2013, which was granted by the Commission on November 25, 2013.

On December 4, 2013, Dominion filed a Request to File Additional Responsive Comments. Dominion's request, that the Commission allow all parties an opportunity to submit responsive comments to the reply comments on or before January 15, 2014, was granted by the Commission on December 12, 2013.

On December 6, 2013, the Commission issued an Order Providing for the Provisional Recovery of Certain Incremental Revenue Requirements. In that Order, the Commission determined that the incremental revenue requirement impact associated with the change in the level of State income tax expense included in each utility's cost of service due to HB 998 would be deemed to be collected on a provisional basis beginning January 1, 2014, pending final disposition of the matter by the Commission. The Commission further required the utilities subject to the provisions of the Order to utilize regulatory asset and/or liability accounts (or other balance sheet accounts), as appropriate, for this purpose. The Commission also excused utilities with annual jurisdictional revenues of $250,000 or less from participation in this docket with respect to all tax impacts of HB 998. However, the Commission reserved the right to revisit this aspect of the Order after reply comments were filed.

On December 13, 2013, DEC/DEP filed revised Attachments 1 and 2 to its initial comments.

On December 16, 2013, reply comments were filed by the Attorney General; PSNC Energy; and the Public Staff. On December 17, 2013, the Attorney General filed a letter to correct typographical errors in its December 16, 2013 reply comments. On December 30, 2013, the Public Staff filed a correction to its reply comments. On January 15, 2014, the Public Staff filed a second correction to Table 1 of its reply comments to correct a typographical error in its December 30, 2013 correction.

Additional responsive comments were filed on January 15, 2014, by Dominion and PSNC Energy. On January 17, 2014, PSNC Energy filed a correction to its January 15, 2014 responsive comments.

Petitions to intervene were filed and granted by the Commission in this proceeding for the Carolina Industrial Groups for Fair Utility Rates I, II, and III (CIGFUR), Carolina Utility Customers Association, Inc. (CUCA), and the Public Works Commission of the City of Fayetteville. The Attorney General's intervention is recognized pursuant to G.S. 62-20. The Public Staff's intervention is recognized pursuant to G.S. 62-15(d).

The Commission's October 1, 2013 Order identified several issues in need of resolution. Each issue identified by the October 1, 2013 Order is addressed by this Order.

ISSUE 1

The Commission's first request in its October 1, 2013 Order asked that the respondents:

> Provide the estimated annual cost-of-service effect, on an item-by-item basis, of the changes to the levels of income tax and gross receipts/franchise tax expenses expected due to the enactment of HB 998. Please show the amount of each change and the related levels of tax expense before and after each change. Such information is to be presented on an NCUC jurisdictional basis (e.g., on an NC retail or NC intrastate basis, as appropriate).

In responding to this informational request, the Companies addressed the fundamental question: How should the Commission handle the impacts of HB 998, including the reduction in the State corporate income tax rate, for ratemaking purposes?

POSITIONS OF THE PARTIES

Electric Utilities Initial Comments

DEC/DEP noted that there are several changes to the general statutes in HB 998 with respect to utility gross receipts/franchise taxes that will become effective July 1, 2014. DEC/DEP noted that these changes include a repeal of the current utility gross receipts/franchise tax. DEC/DEP maintained that since utilities are subject to the higher of gross receipts/franchise tax or the general franchise tax (G.S. 105-114(a4)), the Companies will be subject to the general franchise tax after the repeal of the utility gross receipts/franchise tax.

DEC/DEP also noted that effective July 1, 2014, the preferential sales tax rate for electricity will be repealed. DEC/DEP stated that starting from that date, the tax rate on electricity sales will increase from 3% to the combined general sales tax rate, which is currently 7%.

DEC/DEP provided information requested by the Commission individually for each Company as Attachment 1 to their comments. Attachment 1 displays the revenue requirement approved in the last general rate case proceeding for each utility, and then adjusts for the January 1, 2014 and January 1, 2015 State income tax rate changes and the other tax changes mandated by HB 998.

DEC/DEP stated that potential rate changes for income taxes for calendar years 2014 and beyond are not ripe for any immediate action. DEC/DEP stated that these tax changes are best considered within a general rate case. DEC/DEP stated that, moreover, the change in the North Carolina State income tax rate also increases the amount in cost of service for federal income taxes. DEC/DEP noted that both companies have recently had rates set pursuant to rate cases[2] and maintained that while HB 998 mandates rate changes for other tax changes, it is silent on rate changes related to changes in the State income tax rates. Therefore, according to DEC/DEP, there is no mandate that the Commission change rates for prospective income tax changes.

DEC/DEP acknowledged that the Commission has, in limited circumstances, required changes in rates based on tax changes. Following a federal income tax decrease (lowering corporate tax rates from 46% to 34% effective July 1, 1987), the Commission opened Docket No. M-100, Sub 113, to investigate rate changes. DEC/DEP asserted that Docket No. M-100, Sub 113, and the appeals that followed, established that the Commission has the authority to reduce rates absent a rate case for tax changes.[3] DEC/DEP asserted however, that the magnitude of the dollar amount at issue in this proceeding is significantly lower and this distinction should be considered. DEC/DEP maintained that in this proceeding the benefit to customers would amount to approximately $0.25 per month for DEC customers and $0.15 per month for DEP customers based on a typical residential customer's bill. DEC/DEP further noted that the impact to the Companies is large – approximately $20 million in the aggregate. DEC/DEP stated that the Commission has just recently set rates for both companies; and reducing those newly established rates to reflect a single reduction in an expense item without considering potential offsetting increases in expenses would partially upend those Orders. DEC/DEP requested that the Commission not change rates for the corporate income tax rate changes in HB 998.

Dominion summarized the statutory changes to North Carolina's tax laws impacting utilities enacted in HB 998. Dominion stated that the Legislature's intent in enacting HB 998 was to simplify the North Carolina tax structure and to reduce individual and business tax rates. Dominion noted that, in so doing, the Legislature generally reduced or modified the taxes to be paid by both utilities and their customers. Dominion asserted that in certain instances, such as the repeal of the gross receipts tax

[2] See Order Granting General Rate Increase, Docket No. E-2, Sub 1023, issued May 30, 2013, and Order Granting General Rate Increase, Docket No. E-7, Sub 1026, issued September 24, 2013.

[3] See State ex rel. Utilities Com. V. Nantahala Power & Light Co., 326 N.C. 190 (N.C. 1990) (hereinafter Nantahala).

(GRT), the application of the general franchise tax to a utility's cost of service and the change in the sales tax rate applicable to electric service, the Legislature provided specific direction to the Commission regarding when and how to ensure that customers received the net benefit of the enacted tax changes. Dominion stated that, in other instances, such as the change in State corporate income tax rates, the Legislature was silent regarding what specific action is necessary to pass on the benefits of the tax change to customers. Dominion further stated that regardless of whether action is specifically required by HB 998, the Commission's duty remains to ensure that the rates of all public utilities remain just and reasonable. Dominion's comments focused on: (1) adhering to the specific directive in HB 998 for the Commission to provide the benefits of the GRT/general franchise tax and sales tax changes to customers through an adjustment to rates; and (2) ensuring that the benefits to any tax rate changes impacting cost of service and rates are effectively passed on to customers through mechanisms that ensure rates remain just and reasonable.

Dominion provided an attachment (Attachment 1) to its comments outlining the estimated annual cost-of-service effect resulting from the changes enacted by HB 998. Dominion stated that the changes for State income taxes reflected in Attachment 1 are based on the Company's cost of service approved in its last North Carolina base rate case by the Commission's December 21, 2012 Order in Docket No. E-22, Sub 479 (*2012 Base Rate Case Order*). Dominion stated that the net revenue requirement effect of the HB 998 reductions in the North Carolina corporate income tax rate is a reduction of $387,000[4] effective January 1, 2014, compared to a total base revenue requirement of $344 million, and an additional reduction of $417,000 effective January 1, 2015. Dominion noted that this equates to a change in revenue requirement of slightly more than 0.1%.

Dominion further noted that its Attachment 1 presents the effect of the elimination of the North Carolina GRT currently applicable to North Carolina electric utilities' sales. Dominion stated that in Attachment 1, Page 7, the Company has calculated the annual cost of service impact of the repeal of GRT on July 1, 2014, to be $11,125,000. Dominion stated that this calculation is also based on cost of service information from the Company's 2012 Base Rate Case Order, and is determined by application of the current 3.22% GRT rate to the appropriate North Carolina revenue. Dominion asserted that the revenue requirement level of gross receipts taxes to be eliminated from current rates is $11,187,000.

Dominion stated that its Attachment 1 recognizes the application of the North Carolina general franchise tax beginning July 1, 2014. Dominion noted that HB 998 provides that the Company remains subject to the North Carolina GRT for electric utilities through June 30, 2014. Further, Dominion maintained that pursuant to G.S. 105-114(a4), for the calendar year 2014, electric utilities are liable for the greater of the North Carolina GRT through June 30, 2014, or the North Carolina general franchise tax for calendar year 2014. Dominion stated that it projects that the North Carolina GRT through June 30, 2014, will be the greater of the two taxes. As a result,

[4] Attachment 1, Page 1 shows $384,000.

the Company projected that the North Carolina franchise tax will not become effective for the company until January 1, 2015. Dominion noted that since gross receipts taxes were included in the company's last base rate application in lieu of the general franchise tax, the amount of the general franchise tax included in Attachment 1 is based on calculations provided by the company's tax department utilizing December 31, 2011 balances which correspond to the test period used in its last base rate case, grossed up by the appropriate retention factor to determine the revenue requirement. Dominion noted that, as required by HB 998, its North Carolina base rates as approved in the 2012 Base Rate Case Order would increase $1,336,000 for the revenue requirement associated with the general franchise tax liability to become effective for the calendar year 2015.

Natural Gas Utilities Initial Comments

Piedmont stated that it stipulated in its general rate case in Docket No. G-9, Sub 631, to certain prospective changes to its base rates regarding the corporate income tax changes in HB 998. Specifically, Piedmont noted that it agreed to make downward adjustments to its rates to recognize the reductions in the State corporate income tax rates for fiscal years beginning November 1, 2014, and November 1, 2015, concurrent with the effectiveness of such revised State income tax rates to Piedmont. Piedmont further stipulated to work with the Public Staff and CUCA on an appropriate mechanism for effectuating such reductions and to file notice of such rate reductions with the Commission prior to implementation.

Piedmont noted that the Stipulation between Piedmont, the Public Staff, and CUCA calculates $10,493,778 of State income tax expense, based on $891,195,435 of total annual operating revenues after the stipulated rate increase. Piedmont stated that this annual tax expense was calculated using the current corporate income tax rate of 6.9%, which is applicable to Piedmont through October 31, 2014. Piedmont stated that using a 6.0% income tax rate would have yielded an annual State income tax expense of $9,044,289 based on $889,727,069 of total annual operating revenues and using a 5.0% income tax rate would have yielded an annual State income tax expense of $7,457,630 based on $888,128,176 of total annual operating revenues.

Piedmont further stated that the Stipulation does not include any expense associated with the franchise tax due to the piped natural gas excise tax credit currently allowed under G.S. 105-122(d1). According to Piedmont, absent the piped natural gas excise tax credit, it would have made a franchise tax payment of $1,909,550 in January 2013 for its gross receipts for the fiscal year ended October 31, 2012. Piedmont noted that inclusion of this amount in Piedmont's current general rate case proceeding would have increased the cost of service by $1,925,614. Piedmont maintained that the effect of the repeal of the piped natural gas excise tax credit in HB 998 is that Piedmont's first required payment of the franchise tax will be for its gross receipts for the fiscal year beginning November 1, 2014.

Piedmont requested that the effective date of each rate change associated with HB 998 be made consistent with the treatment set forth in the Stipulation.

PSNC Energy stated that, with respect to natural gas utilities, HB 998: (1) repeals G.S. 105-164.13(44), which provides an exemption from sales and use tax for sales of piped natural gas; (2) adds G.S. 105-164.4(a)(9) to make the general sales and use tax applicable to gross receipts derived from sales of piped natural gas billed on or after July 1, 2014; and (3) repeals Article 5E of Chapter 105 of the General Statutes, which imposes an excise tax on piped natural gas. PSNC Energy noted that local distribution companies (LDCs) subject to the excise tax are granted a credit on their annual franchise taxes pursuant to G.S. 105-122(d1) equal to one-half of the excise taxes payable under Article 5E of Chapter 105. PSNC Energy stated that the net effect of these changes is that, beginning July 1, 2014, natural gas utilities will be subject to the sales and use tax under G.S. 105-164.4(a)(9) instead of an excise tax under Article 5E of Chapter 105 and will no longer be eligible for the franchise tax credit in G.S. 105-122(d1). PSNC Energy noted that HB 998 directs the Commission to adjust the rates of natural gas utilities "to reflect the repeal of Article 5E of Chapter 105 of the General Statutes, the repeal of the credit formerly allowed under G.S. 105-122(d1), and the resulting liability of companies for the tax imposed on sales of piped natural gas under G.S. 105-164.4".

PSNC Energy provided, in Appendix A to its comments, the estimated annual effect to PSNC Energy's cost-of-service of the changes to the levels of income and franchise tax expense expected due to the enactment of HB 998. PSNC Energy explained that column (a) of Appendix A sets forth the net operating income for return, rate base, and overall return as determined in PSNC Energy's last general rate case (Docket No. G-5, Sub 495); column (b) of Appendix A sets forth adjustments to State and federal income taxes to reflect the change in the State income tax rate from 6.9% to 6.0% effective January 1, 2014; column (d) of Appendix A sets forth adjustments to general taxes and State and federal income taxes to reflect the increase in franchise tax expense due to the loss of the tax credit currently allowed under G.S. 105-122(d1); column (f) of Appendix A sets forth adjustments to State and federal income taxes to reflect the change in the State income tax rate from 6% to 5% effective January 1, 2015; and column (h) of Appendix A displays that the net operating income effect of all the tax changes is $54,719, which does not impact the overall rate of return of 8.54%.

Toccoa stated that it is a small municipally-owned natural gas system (as opposed to being a C corporation) and consequently it is not subject to income and other tax obligations. Toccoa stated its belief that no tax allowances were included in any determination of its revenue requirements when the Commission established its rates. Toccoa asserted, therefore, that no adjustment to Toccoa's existing rates would be necessary or appropriate as a result of the passage of HB 998.

Telecommunications Utilities Initial Comments

Ellerbe noted that it is still subject to rate of return regulation.[5] Ellerbe stated that its existing rates have been in effect since its last general rate case in 1992. Ellerbe asserted that any reduction in Ellerbe's current rates, as a result of either State income tax or gross receipts/franchise tax rate reductions provided for in HB 998, relative to any tax allowance included in the determination of Ellerbe's revenue requirement made in the course of setting Ellerbe's rates in 1992, would likely be de minimis with respect to any Ellerbe customer's rates.

Pineville stated that it is still subject to rate of return regulation. Pineville stated that it has not had a general rate case since its rates were set by the Commission in the mid-1970's when Pineville became subject to the Commission's jurisdiction. Pineville asserted that because the Town of Pineville is a municipal corporation (as opposed to being a Subsection C or Subsection S business corporation), it is not subject to income and other taxes. Pineville noted that, as a result, it believes that no tax allowances were included in any determination of Pineville's revenue requirements when the Commission set its rates. Pineville further stated that it believes that no adjustment to its existing rates would be necessary or appropriate as a result of the passage of HB 998.

Water/Sewer Utilities Initial Comments

Aqua noted that it filed an Application for General Rate Increase in Docket No. W-218, Sub 363, on August 2, 2013, and that the evidentiary hearing was scheduled to begin on January 27, 2014. Aqua asserted that the change in the corporate State income tax rate, scheduled for January 1, 2014, would occur during the rate case examination. Aqua stated that, similarly, the July 1, 2014 changes in gross receipts/franchise taxes will likely occur shortly after issuance of the Commission's final order in the rate case. Aqua suggested that the impact of the tax changes on Aqua's rates should be resolved in its pending rate case.[6]

Utilities, Inc. stated that it has six regulated public utility subsidiaries in North Carolina: Carolina Water Service, Inc. of North Carolina (CWSNC); Bradfield Farms Water Company; Carolina Trace Utilities, Inc.; CWS Systems, Inc.; Elk River Utilities, Inc.; and Transylvania Utilities, Inc. Utilities, Inc. noted that CWSNC is currently involved

[5] Ellerbe filed its Notice of election of Subsection (h) regulation (pursuant to G.S. 62-133.5(h)) on December 30, 2013, with an effective date of January 1, 2014. Therefore, Ellerbe is no longer subject to rate of return regulation.

[6] A Stipulation between Aqua and the Public Staff was filed on January 17, 2014. The Stipulation addresses the expense impacts of HB 998 on Aqua and the details are outlined starting on Page 6 of the January 17, 2014 Stipulation. On May 2, 2014, in Docket No. W-218, Sub 363, the Commission issued an Order Granting Partial Rate Increase, Approving Rate Adjustment Mechanism, and Requiring Customer Notice. Findings of Fact 17-20 of the May 2, 2014 Order address the tax changes effectuated by HB 998.

in a general rate case before the Commission in Docket No. W-354, Sub 336,[7] and due to this fact its recommendations and responses to the Commission's questions will be different for CWSNC than for the Company's other five subsidiary companies.

For CWSNC, Utilities, Inc. stated that on June 28, 2013, it filed an Application for General Rate Increase in Docket No. W-354, Sub 336, and that the evidentiary hearing was scheduled to begin on December 2, 2013. Utilities, Inc. maintained that, thus, the change in the corporate State income tax rate, scheduled for January 1, 2014, would occur during the pendency of the rate case examination by the Commission and that the July 1, 2014 changes in gross receipts/franchise taxes will likely occur shortly after issuance of the Commission's Order in the rate case. Utilities, Inc. recommended that the impact of the tax changes on CWSNC's rates should be resolved in the pending general rate case and specified in the Order issued in that case.[8]

Utilities, Inc. stated that, due to the press of multiple proceedings now pending before the Commission it had been unable to prepare and finalize its response on behalf of the Company's five remaining subsidiary public utilities. Utilities, Inc. therefore requested permission to amend its filing on behalf of Bradfield Farms Water Company, Carolina Trace Utilities, Inc., CWS Systems, Inc., Elk River Utilities, Inc., and Transylvania Utilities, Inc., until the company had been able to prepare a full response. Utilities, Inc. stated that such response would be filed as soon as reasonably possible, but no later than Monday, November 25, 2013 (the day reply comments were due).

Natural Gas Utilities Reply Comments

PSNC Energy stated that it would not respond to any specific point made in the comments that were filed by the other parties in this docket. However, PSNC Energy stated, its review of the comments prompted PSNC Energy to make two general observations to the Commission.

First, PSNC Energy asserted that because the effect of HB 998 is not substantial and material, no adjustment of rates is warranted. PSNC Energy stated that there is support in the comments for the proposition that an immediate adjustment to utility rates may not be warranted because of the minimal impact caused by the reductions in State income tax rates. PSNC Energy stated that, specifically, the comments point out that,

[7] A Stipulation between CWSNC, the Public Staff, and the Corolla Light Community Association, Inc. was filed on November 27, 2013. HB 998 expense impacts were reflected in the Stipulation as outlined beginning on Page 9 of the Stipulation. An Amended Stipulation between the Parties was filed on January 10, 2014. HB 998 expense impacts were reflected in the Amended Stipulation as outlined beginning on Page 8.

[8] On March 10, 2014, the Commission issued its Order Granting Partial Rate Increase, Approving Rate Adjustment Mechanism, and Requiring Customer Notice. The Order granted the Amended Stipulation with the exception of Sections 17-20. Ordering Paragraph No. 12 of the March 10, 2014 Order states: "12. That CWSNC shall work with the Public Staff on the appropriate mechanisms for effectuating the changes mandated by House Bill 998, effective July 1, 2014 and January 1, 2015, as stipulated, and shall file notice of the proposed rate reductions with the Commission by June 1, 2014 and December 1, 2014, as stipulated."

unlike with the other tax changes affecting electric and natural gas utilities, HB 998 does not mandate that the Commission adjust utility rates to account for the lowering of corporate income tax rates to 5%. PSNC Energy maintained that, moreover, while the Commission has the authority to reduce utility rates to reflect income tax rate changes pursuant to the Nantahala holding, the Commission should refrain from doing so when the impact on utility rates is relatively small.

PSNC Energy noted that the Commission did not order reductions in utility rates when the State corporate income tax rate was reduced from 7.75% to the current rate of 6.9%.[9] PSNC Energy stated that this is consistent with the Commission's determination after the Nantahala decision that it would use those same procedures to increase or decrease utility rates only if a change in income tax rates is "clearly substantial and material" when measured against the utilities' total cost of service.[10] PSNC Energy noted that in that matter the Commission found that a change in income tax rates amounting to 0.53% of a utility's test-year revenues was not substantial and material.

PSNC Energy stated that based on the "substantial and material" analysis the Commission should refrain from changing utility rates based upon lower corporate income taxes in this proceeding. PSNC Energy reiterated that, as shown on Appendix A to PSNC Energy's initial comments, the net reduction in expenses associated with HB 998's enactment would amount to $54,719. PSNC Energy stated that this is less than 0.01% of PSNC Energy's test-year revenues. PSNC Energy further stated that disregarding the increased expense associated with taxes other than income taxes, the reduction would total $812,056, or approximately 0.12% of test year revenues. PSNC Energy argued that this is well below the impact that the Commission has held requires no adjustment to utility rates in similar proceedings.

Second, PSNC Energy maintained that, due to the lack of uniformity in the application HB 998, any Commission action should be tailored to address each company's circumstances. For example, PSNC Energy stated that, beginning July 1, 2014, electric utilities will no longer be subject to the current utility GRT because of the repeal of G.S. 105-116, but will become subject to the standard franchise tax under G.S. 105-122 by virtue of the repeal of G.S. 105-114(a4). PSNC Energy noted that, on the other hand, natural gas utilities will not be subject to the excise tax under Article 5E of Chapter 105, and, as a consequence, will lose the franchise tax credit allowed under G.S. 105-122(d1). PSNC Energy asserted that the effect of these changes to taxes other than income taxes would appear to be a slight net benefit to the electric utilities and a detriment to natural gas utilities. PSNC Energy noted that a comparison of Attachment 1 of DEP/DEC's initial comments and Attachment 1 of Dominion's initial comments, with Appendix A of PSNC Energy's initial comments and page 2 of Piedmont's initial comments demonstrates its assertion. PSNC Energy

[9] North Carolina Session Law 1996-13-es, Section 2.1.

[10] Order Denying Application for Rate Adjustment and/or for Institution of a Rulemaking Investigation, Docket No. M-100, Sub 122, at 9, issued on October 23, 1991.

maintained that these differences should caution against the Commission taking a one-size-fits-all approach to implementing any changes as a result of HB 998.

Other Utilities Reply Comments

No electric utilities, water or sewer utilities, or telecommunications utilities filed reply comments.

Other Parties Comments

The Attorney General noted that Session Law 2013-316 required the Commission to make corresponding changes in rates to reflect some of the tax changes. The Attorney General also noted that HB 998 is silent with respect to the income tax changes for all utilities and the effect of the GRT and corporate franchise tax changes on water and sewer utilities. The Attorney General asserted that, however, even absent an express mandate in HB 998, the Commission has authority to flow through the effect of tax changes to consumers in the form of rate reductions by ordering appropriate adjustments in this proceeding.

The Attorney General recommended that the Commission consider the impacts of HB 998 in their totality and with a directive to utilize any tax reductions as a benefit to consumers in the form of rate decreases, ensuring that consumers' rates are as low as possible, and flowing through such reductions to consumers as soon as reasonably possible.

The Attorney General argued that it is important for utility customers to receive the full benefit of the tax reductions, especially given the challenging economy in recent years. The Attorney General stated that when determining appropriate rates the Commission should exercise its authority to include the effect of the income tax rate reductions for utilities. According to the Attorney General, it would be inequitable to, for example, increase customer rates to account for the corporate franchise tax applicable to certain utilities, but to not account at the same time for the reduction in the income tax paid by those utilities.

The Attorney General stated that some customers will see a significant increase in the effective sales taxes starting in July, 2014. The Attorney General stated that the effective tax rate applicable to sales of electric and gas service, for example, will increase from 3% to 7% for most customers after July, 2014, and will be reflected on bills as a separate line item. The Attorney General stated that if the Commission does not adjust utility rates to reflect the new, lower income taxes, the utilities will continue to be collecting taxes from ratepayers at the higher State income tax rates approved in each utility's most recent rate case. The Attorney General noted that utility rates were set in those rate cases based on the assumption that the utility will pay a 6.9% State income tax rate; pursuant to HB 998 that tax rate will now be lower.

Finally, the Attorney General stated that the Commission should exercise its authority to adjust the rates of all water and sewer utilities to take into account the repeal of the GRT. The Attorney General asserted that this reduction should be passed through to consumers, instead of simply allowing the utilities to benefit from the reduction.

The Public Staff described the changes to utilities tax law discussed above and noted that Section 4 of HB 998 directs the Commission to adjust the rates of electric and natural gas utilities for the provisions of HB 998 that affect the liability of these utilities with regard to GRT, piped natural gas taxes, corporate franchise taxes, and sales taxes. The Public Staff stated that HB 998 is silent with regard to the income tax changes for all utilities and the effect of the GRT and corporate franchise tax changes on water and sewer utilities.

The Public Staff stated that after reviewing the initial comments of Toccoa, Ellerbe, and Pineville, the Public Staff agrees, for the reasons set forth in those comments, that their rates should not be adjusted in response to the tax changes enacted in HB 998.

The Public Staff stated that it had analyzed the effect of HB 998 on the revenue requirements of the six major electric and natural gas utilities and found that the impact of HB 998 varies considerably among the utilities. The Public Staff submitted the following Table 1,[11] which provides a comparison of the revenue requirement effects (in thousands of dollars) on each of the utilities upon full implementation of HB 998 for the 2015 tax year:

[11] On December 30, 2013, and January 15, 2014, the Public Staff filed revisions to Table 1 in its reply comments due to typographical errors. The chart presented in this Order reflects Table 1 as amended.

For the Tax Year 2015 and Thereafter
(thousands of dollars)

	Reduction in SIT Rate	Repeal of GRT	General Franchise Tax	Total
Electric Utilities:				
DEC	($13,681)	($154,766)	$19,823	($148,624)
DEP	($5,557)	($107,148)	$7,981	($104,724)
Dominion	($1,361)	($11,187)	$1,336	($11,211)
LDCs:				
PSNC	($1,269)		$1,234	($35)
Piedmont	($3,067)		$1,926	($1,142)
Intrastate Pipeline:				
Cardinal	($117)			($117)

The Public Staff asserted that, if only the changes in Section 4 of HB 998 are considered, the revenue requirement for the electric utilities would decrease significantly because the decrease due to the repeal of the GRT would exceed the increase resulting from the franchise tax increase, whereas the revenue requirement of the LDCs, which do not pay the GRT, would increase. The Public Staff noted that the piped natural gas tax paid by the LDCs is not a component of the revenue requirement, but rather an excise tax added to the customer's bill. The Public Staff stated that, likewise, the sales tax collected by the electric utilities and paid to the State is a non-revenue-requirement excise tax. The Public Staff stated that Cardinal Pipeline, which does not pay the GRT, franchise tax, or piped natural gas tax, is affected only by the change in the State income tax rate. The Public Staff maintained that with the exception of DEC and DEP, the decrease in State income taxes offsets or nearly offsets the increase in corporate franchise taxes for all the major electric and natural gas utilities. The Public Staff noted that for DEC and DEP, the decrease in State income taxes offsets approximately 70% of each utility's corporate franchise tax increase.

The Public Staff acknowledged the difference in materiality between the decrease in the federal income tax rate that led to the rate reductions ordered by the Commission in Docket No. M-100, Sub 113, and the changes in the State income tax rate pursuant to HB 998 that are being addressed in this docket. The Public Staff also acknowledged that the Commission denied the request of Nantahala Power & Light Company in Docket No. M-100, Sub 122, for a rate increase to reflect an increase in the State corporate income tax rate from 7% to 7.75% and other various increases. The Public Staff noted that in that Order the Commission held that the tax rate increases were "insubstantial" compared to the federal income tax rate decrease from 46% to 34% addressed in Docket No. M-100, Sub 113. The Public Staff further noted that the Commission did not require rate reductions when the federal corporate income tax rate decreased from 48% to 46% in 1978.

The Public Staff stated, however, that the Commission initiated the present docket to consider the impact of HB 998 in its totality. The Public Staff asserted that the utilities and their customers will be impacted differently by the various provisions of HB 998, and, thus, the Public Staff believes it is reasonable that the Commission consider the effect of income tax rate reductions when determining appropriate rate adjustments. The Public Staff noted that were these considerations not taken into account the revenue requirements of the LDCs would increase despite the fact that the overall effect of HB 998 is a small decrease in revenue requirement. The Public Staff stated that PSNC Energy commented that the franchise tax increase is offset by the effect of the lower State income tax rates, and, therefore, no adjustment of rates under HB 998 Section 4.2(a)(2) is necessary. The Public Staff asserted that it would be inequitable for the Commission to increase the rates of LDCs for the corporate franchise tax, when the effect is more than offset by the income tax rate reduction.

The Public Staff, therefore, recommended that the Commission adjust electric and natural gas utility rates and the rates of Aqua[12] and CWSNC for the income tax, GRT, and corporate franchise tax changes resulting from HB 998. In addition, the Public Staff recommended that the Commission adjust the rates of the remaining water and sewer utilities to reflect the reduction in GRT. The Public Staff stated that much, if not all, of the corporate franchise tax that will be paid by the electric utilities and LDCs is offset by the reduction in the State income tax rate to 5%. Consequently, the Public Staff asserted it would be inappropriate for the corporate franchise tax increase to be considered in determining the amount of any rate adjustments for electric and natural gas utilities without also considering the largely offsetting effect of the reduction in State income taxes.

The Public Staff further stated that, as noted in the initial comments filed by Piedmont, the Stipulation filed in its pending rate case contains provisions that require rate adjustments for the reductions in State income taxes. The Public Staff noted that the Stipulation does not, however, provide for an adjustment in rates for the increase in the franchise tax. The Public Staff recommended that Piedmont be permitted to adjust its rates for the increase in franchise taxes.

The Public Staff further noted that Frontier Natural Gas did not file initial comments. The Public Staff maintained that as a for-profit LDC, Frontier Natural Gas will benefit from the reduction in State corporate income tax rates and will pay the corporate franchise tax. The Public Staff stated that Frontier Natural Gas provides gas service pursuant to rates established in connection with the granting of its certificate, not rates established in a general rate case based on specific items of cost. The Public Staff stated that, as an LDC, Frontier does not pay the GRT, noting that Frontier's rates were adjusted to reflect the removal of GRT by the Commission's June 30, 1999 Order Approving Tariffs, Amending Rules, and Requiring Notice, in Docket No. G-100, Sub 78.

[12] The Public Staff noted that for Aqua, the effect of the State income tax reduction from 6% to 5% is a $151,000 decrease in revenue requirement and the franchise tax is an $114,000 increase in revenue requirement.

The Public Staff recommended that, as Frontier presented a unique situation, the Commission not adjust Frontier's rates as the result of HB 998.[13]

With regard to water and sewer utilities, the Public Staff noted that the Commission is not required by HB 998 to make any rate adjustments for these utilities. The Public Staff stated that Aqua and CWSNC (excluding Nags Head), which comprise approximately two-thirds of the revenues and customers of water and sewer utilities regulated by the Commission, had rate cases pending before the Commission and had suggested that the impacts of HB 998 be resolved in those proceedings.

The Public Staff noted that the Stipulation of CWSNC, the Public Staff, and Corolla Light Community Association, Inc., filed in Docket No. W-354, Sub 336, on November 27, 2013, contains provisions requiring rate adjustments consistent with the HB 998 changes to State income taxes, GRT, and franchise taxes.[14] The Public Staff stated that the Aqua rate case was still in the investigation stage, and there was currently no agreed-upon resolution of the State income tax, GRT, and franchise tax issues.[15]

For the remaining water and sewer utilities, the Public Staff recommended that their rates be reduced to reflect the repeal of the GRT.[16] The Public Staff argued that these utilities will no longer pay the GRT, and, thus, removing the GRT from rates will place them in the same situation as they were in prior to repeal of the GRT. The Public Staff stated that it does not believe that the net effect of the income tax and corporate franchise tax impacts on these utilities will be sufficient to warrant further rate reductions.

With regards to the sales tax impacts of HB 998, the Public Staff stated that the revenue requirement for electric utilities and LDCs does not include sales taxes, but

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[13] The Commission notes that on February 14, 2014, Frontier filed an Application for Adjustment of Rates and Charges to Track Changes in Wholesale Costs of Gas (See Docket No. G-40, Sub 122). However, the filing is not a general rate case.

[14] An Amended Stipulation between the Parties was filed on January 10, 2014. HB 998 impacts were reflected in the Amended Stipulation as outlined beginning on Page 8. On March 10, 2014, the Commission issued its Order Granting Partial Rate Increase, Approving Rate Adjustment Mechanism, and Requiring Customer Notice. The Order granted the Amended Stipulation with the exception of Sections 17-20. Ordering Paragraph No. 12 of the March 10, 2014 Order states: "12. That CWSNC shall work with the Public Staff on the appropriate mechanisms for effectuating the changes mandated by House Bill 998, effective July 1, 2014 and January 1, 2015, as stipulated, and shall file notice of the proposed rate reductions with the Commission by June 1, 2014 and December 1, 2014, as stipulated."

[15] A Stipulation between Aqua and the Public Staff was filed on January 17, 2014. The Stipulation addressed the impacts of HB 998 on Aqua and the details were outlined starting on Page 6 of the January 17, 2014 Stipulation. On May 2, 2014, in Docket No. W-218, Sub 363, the Commission issued an Order Granting Partial Rate Increase, Approving Rate Adjustment Mechanism, and Requiring Customer Notice. Findings of Fact 17-20 of the May 2, 2014 Order address the tax changes effectuated by HB 998.

[16] The GRT was 4% for water companies and 6% for sewer companies.

these taxes are included in the total amount billed to customers. The Public Staff noted that electric utility customers will pay 0.5% more with the 7% sales tax, as compared to the current 3.22% GRT and 3% sales tax,[17] and natural gas sales customers will pay approximately 2% to 3% more with the 7% sales tax as compared to the piped natural gas tax. The Public Staff noted that some customers, such as manufacturers and natural gas transportation customers do not pay a sales tax, and, thus, will experience reductions in the amount billed.

Further, the Public Staff noted that the rates of each electric, water, and sewer utility should first be reduced to reflect the repeal of the GRT. The Public Staff stated that the GRT is assessed based on revenue, so removing the GRT component included in each rate ensures that each ratepayer will receive the proper benefit of the repeal. The Public Staff stated that the effect of the remaining tax changes should be distributed among ratepayers based on test year billing quantities for each utility; per kWh for electric utilities and per therm for natural gas utilities. The Public Staff recommended that base rates be adjusted to reflect the eventual State corporate income tax rate of 5% and the corporate franchise tax, and that riders be used for the temporary changes, such as the one-year 6% State corporate income tax rate and excess deferred tax flowback.

Electric Utilities Responsive Comments

Dominion maintained that the gross receipts, franchise, and sales tax changes are legislatively mandated to be adjusted now, and Dominion, DEC, and DEP have presented consistent and undisputed approaches to affect those rate adjustments. Dominion asserted that, as contemplated by the General Assembly, these adjustments can be accomplished easily and the steps to do so can be taken immediately by the Commission. Dominion maintained that the comments of Dominion, DEC, and DEP provide consistent recommendations regarding these legislatively mandated rate adjustments and increases in sales tax rates, as follows:

(1) **GRT and General Franchise Tax**

Dominion, DEC, and DEP agree that the optimal approach to address the repeal of the GRT and to reflect the application of the general franchise tax to utility operations effective July 1, 2014, would be to adjust base rates on July 1, 2014, to reflect the net of the elimination of the GRT and inclusion of utility operations in the general franchise tax, and then to order a rate decrement to provide for the difference in tax liability for the six months July 1 to December 31, 2014. Dominion noted that no other parties filed applicable comments or disagreed with this approach.

(2) **Sales Tax**

[17] The Public Staff noted that this reflects adjustment of the sales tax base for removal of the 3.22% GRT [(1+ new sales tax rate of 7%) x (1- 3.22% GRT rate)] / (1+ old sales tax rate of 3%).

> Dominion noted that no ratemaking action from the Commission is required for Dominion, DEC, and DEP to update the sales tax rate applied to electric sales. Dominion asserted that the Commission should order the utilities to implement the required change to their billing systems coincident with the July 1, 2014 effective date of the increased sales tax rate set forth in HB 998. Dominion noted that no other parties filed applicable comments or disagreed with this approach.

Dominion further commented that Piedmont's, PSNC Energy's, and the Public Staff's comments show that the natural gas LDCs are not similarly situated to the electric utilities, and, therefore, another approach to comply with Subsection 4.2 of HB 998 may be more appropriate for them. Dominion specified that the LDCs do not pay either the GRT or the general franchise tax because they were exempt from the GRT and allowed a credit that offset the general franchise Tax. Conversely, the electric utilities were subject to both taxes but were liable for only the greater tax.

Dominion argued that a single issue rulemaking adjustment to Dominion's State corporate income tax component of rates would be unreasonable and inappropriate in this proceeding. Dominion stated that, unlike the GRT and general franchise tax provisions, the General Assembly provides no specific direction in HB 998 concerning how to proceed with regard to HB 998's staggered changes to the State corporate income tax. Dominion asserted that, therefore, the Commission must determine the appropriate response. Dominion stated that the threshold question presented is whether it is reasonable and appropriate to direct a single issue adjustment to rates through the current rulemaking versus addressing the change in a future general rate case. Dominion noted that the Commission recognized in its October 23, 1991 Order Denying Application for Rate Adjustment and/or Institution of a Rulemaking Investigation in Docket No. M-100, Sub 122, that its authority to direct single issue ratemaking action through a rulemaking versus through a general rate case proceeding is limited to where: (1) the tax reduction affects all utilities uniformly; (2) a large number of utilities are affected, making individual hearings for all inappropriate; and (3) no adjudicative-type facts are in dispute as to require a trial-type hearing for each individual utility. Dominion also argued that a single issue change to costs and expenses must be clearly substantial and material when measured against the utility's total cost of service to justify a rulemaking adjustment to previously established rates outside of a general rate case. Dominion further asserted that while not controlling, this Commission's caution in imposing single issue ratemaking adjustments outside of a general rate case is fully consistent with the high standard imposed by the Federal Energy Regulatory Commission (FERC). The standard used by the FERC to determine whether a single issue or "spot" adjustment to previously established rates is appropriate is whether the change in expenses is "so substantial that they would render the rate unreasonable". Dominion argued that in these circumstances such an approach would not be reasonable or appropriate.

First, Dominion argued that because the General Assembly provided express and explicit direction for the Commission to adjust the electric utilities' rates to reflect the repeal of the GRT and the resulting liability for the general franchise tax, the omission of such a mandate in regards to the State corporate income tax change suggests a legislative intent not to immediately modify currently effective rates through rulemaking. Dominion stated that it is the law in North Carolina that when a statute lists the situations to which it applies, it implies the exclusion of situations not contained in the list.[18] Dominion maintained that while a rulemaking presents a reasonable and efficient administrative approach to accomplish the General Assembly's intent to affect the tax changes set forth in HB 998, Section 4.2, ordering other tax changes through rulemaking should not be presumed appropriate and should be carefully scrutinized to assess whether adjustment outside of a general rate case is appropriate.

Second, Dominion argued that it appears to be a controverted issue whether the various utilities are sufficiently similarly situated that a rulemaking approach would be appropriate. Dominion stated that its review of the comments of the various parties suggest that the electric utilities are not similarly situated to any of the other utilities impacted by HB 998. As discussed above, Dominion noted that the tax changes enacted by HB 998 affect the electric utilities differently than the natural gas LDCs and other utilities. Dominion asserted that this lack of uniformity is most clearly shown in the Public Staff's main argument in support of imposing the State corporate income tax change via rulemaking. Dominion noted that the Public Staff argued that it is only fair that the Commission include the effect of the income tax reductions in determining the appropriate rate adjustments for the utilities because otherwise it would be inequitable to increase the rates of the LDCs for the general franchise tax when the effect is more than offset by the State corporate income tax rate reduction. Dominion asserted that, however, this rationale applies only to the natural gas LDCs as they have not been subject to the GRT, while the electric utilities are currently subject to the higher of the general franchise tax or the GRT. Dominion maintained that as Attachment 1, page 1 to its initial comments showed, the decrease in rates resulting from elimination of GRT substantially exceeds the prospective increase to the general franchise tax and is consistent with data provided by DEC and DEP.

Dominion further noted that the electric utilities are dissimilarly situated to Piedmont, Aqua, and CWSNC, which currently have rate cases pending before the Commission. Dominion argued that for these utilities, the impact of HB 998, including the State corporate income tax changes to their rates, is proposed to be addressed through the general ratemaking process under G.S. 62-133 instead of as a single issue adjustment through rulemaking. Dominion stated that it believes that this approach is more reasonable than imposing a rulemaking adjustment to the electric utilities' recently-established rates for only a single issue within rates comprehensively determined by the Commission to be just and reasonable. Dominion asserted that the utilities are not similarly situated and that a one-size-fits-all rulemaking approach would

[18] *See* Evans v. Diaz, 333 N.C. 774, 779-80 (1993) (applying doctrine of expressio unius est exclusion alterius).

not be well suited to impose a single issue rate adjustment on Dominion outside of a general rate case.

Third, Dominion argued that a State corporate income tax rate adjustment through the current rulemaking would be inappropriate because HB 998's staggered State corporate income tax changes fail to satisfy the Commission's well-established standard for taking this unusual action. Dominion noted that the Commission has taken the position that a single issue change to costs and expenses must be clearly substantial and material when measured against the utility's total cost of service to justify a rulemaking adjustment to previously-established rates outside of a general rate case. Dominion stated that in all other instances, a general rate case where all items of the cost of service are carefully scrutinized is the most appropriate forum for rate relief.

Dominion argued that it is undisputed in this proceeding that the staggered reduction in the State corporate income tax from 6.9% to 5.0% over the next two calendar years is not material and substantial when compared to the Tax Reform Act of 1986. Dominion noted that both Dominion and PSNC Energy asserted in this docket that each staggered State corporate income tax reduction would approximate a 0.1% change to the utility's respective cost of service. Dominion noted the Public Staff's concession of the difference in materiality between the Tax Reform Act of 1986 Federal income tax change and the current HB 998 State corporate income tax change. Dominion stated that the Public Staff also appropriately points the Commission to its prior Orders in Docket No. M-100, Sub 122, where the Commission: (1) held that an increase in State corporate income tax from 7.0% to 7.75%, plus a staggered four-year surtax, an increase in the sales and use tax, and the imposition of the regulatory fee, did not represent substantial and material changes dictating a single issue adjustment to rates; and (2) noted that it had previously not required rate reductions when the Federal corporate income tax rate decreased from 48% to 46% in 1978. Dominion asserted that the State corporate income tax changes at issue in this docket are analogous to the tax changes in these prior dockets where the Commission found the substantial and material threshold unsatisfied.

Fourth, Dominion argued that ordering a State income tax rulemaking adjustment is not as straightforward as suggested by the Public Staff and the Attorney General. Dominion maintained that the accumulated deferred income tax (ADIT) impact to rate base resulting from the State corporate income tax change is materially different and more complex than simply directing the GRT and the general franchise tax changes mandated by HB 998, Subsection 4.2. Dominion argued that, unlike the State corporate income tax rate change, the GRT and the general franchise tax changes do not affect this element of the utilities' cost of service.

Dominion further stated that the Company's determination of the net changes in revenue requirement due to the State corporate income tax accounts for the comprehensive revenue requirement effects of the State corporate income tax change, while, according to Dominion, the Public Staff's determination did not account for these effects. Dominion stated that the Public Staff did not explain its choice to make

incomplete adjustments in the development of its position. Dominion disagreed with the Public Staff's Table 1 characterization of the revenue requirement effects of HB 998 on each of the electric utilities for tax year 2015. Dominion stated that its calculation of the revenue requirement (Attachment 1 to its initial comments) includes an offset to the change in revenue requirement associated with the reduction in the State corporate income tax rate for the effect of the elimination of the liability for ADIT from the cost of service and the resulting increase in federal income taxes. Dominion argued that its calculation is a comprehensive change because the cost of service used to develop the revenue requirement supported by rates approved in the Company's last general rate case included the rate base reduction associated with the ADIT. Dominion stated that the incremental ADIT liability will cease to exist due to the reduction in the State corporate income tax rate, and, therefore, unless the revenue requirement is increased the Company will not have base rates in place that will cover the current cost of service.

Dominion stated that it does not believe sufficient information exists in the current record for the Commission to implement the Public Staff's recommendations. Dominion argued that additional information and evidence, and possibly additional adjudicative proceedings, would be required to reconcile Dominion's detailed analysis of the State corporate income tax change with the Public Staff's comments. Dominion stated that, moreover, given the complexity of such an undertaking, it would no longer be a ministerial adjustment to rates and basic fairness would dictate that Dominion should be permitted to broaden the scope of such a proceeding beyond a single issue.

Finally, Dominion argued that from a policy perspective, neither the Public Staff's invocation of fairness nor the Attorney General's generalized desire to achieve rates as low as possible as soon as reasonably possible should replace the Commission's standard for adjusting rates outside of a general rate case only in limited circumstances. Dominion asserted that contrary to the generalized entreaties of the consumer advocates to engage in single issue ratemaking in this proceeding, rates comprehensively established under Chapter 62 through a general rate case are deemed prima facie just and reasonable, and efforts to adjust rates outside of a general rate case should remain the exception and not the rule.

Dominion noted that no party in the current proceeding has alleged that Dominion's rates should become unjust and unreasonable if the State corporate income tax change is not implemented immediately, and the consensus of both the utilities and the Public Staff in this proceeding is that the State corporate income tax change is not material or substantial. Accordingly, Dominion requests that the Commission find that immediately adjusting the State corporate income tax rate through rulemaking is inappropriate and that this change is more properly considered in the context of a general rate case.

Natural Gas Utilities Responsive Comments

PSNC Energy stated that the Public Staff's analysis of HB 998 confirms PSNC Energy's assertion that there are disparate effects of HB 998 on the various public

utilities, and, therefore, that the Commission should not assume that a single course of action would be appropriate for every utility. PSNC Energy pointed out that Table 1 of the Public Staff's reply comments shows that the net revenue requirement impact for PSNC Energy is a $32,000 decrease which would equate to an annual savings of approximately $0.03 for an average residential customer.

PSNC Energy stated that, due to the differences in impact of HB 998, the Commission should consider alternatives that are appropriate for each utility. PSNC Energy noted that its responsive comments discuss alternatives in more detail and present the Commission with a recommended approach believed to be suitable for PSNC Energy and its customers. PSNC Energy suggested that the Commission consider two alternative rate adjustments to reflect the impact of HB 998. First, PSNC Energy asserted that the Commission could wait until the next general rate case in which to make adjustments as a result of the changes from HB 998. PSNC Energy noted that although Section 4.2(a)(2) of HB 998 states that the Commission "must adjust" rates for gas utilities to reflect the repeal of the excise tax and associated franchise tax credit, the statute does not specify when this adjustment must take place. PSNC Energy argued that given the insubstantial impact of the income tax reductions and the fact that they are largely offset by the increased expenses due to the repeal of the franchise tax credit, both of which are demonstrated on the Public Staff's Table 1, it makes sense for the Commission to wait until PSNC Energy's next general rate case to make all of these adjustments. Second, PSNC Energy argued that the Commission could make a single adjustment to PSNC Energy's rates in January 2015 to account for all of the known changes brought about by HB 998. PSNC Energy asserted that this would prevent PSNC Energy's customers from experiencing a series of small rate increases and decreases as a result of HB 998's enactment. However, PSNC Energy reiterated its belief that the better approach is to make the adjustment as part of its next general rate case when all revenue, expense, and rate base items are subject to examination.

Other Responsive Comments

No water or sewer utilities, telecommunications utilities, and neither the Attorney General nor the Public Staff filed responsive comments.

DISCUSSION AND CONCLUSIONS

As discussed above and analyzed in the parties' comments, HB 998 includes a number of tax changes that impact public utilities. Based on the comments filed, there are two public utilities, Toccoa and Pineville, that are not subject to State income tax or any other tax because they are municipally-owned. Therefore, the Commission finds that it is appropriate to exclude these two utilities from further consideration in this docket.

Additionally, the Public Staff noted that Frontier provides gas service pursuant to rates established in connection with the granting of its certificate, not rates established

in a general rate case based on specific items of cost. The Public Staff maintained that Frontier presents a unique situation and recommended that the Commission not adjust Frontier's rates as the result of HB 998. The Commission agrees with the Public Staff, and, therefore, finds it appropriate to exclude Frontier from further consideration by the Commission in this docket.

At the time this docket was initiated, CWSNC and Aqua had open rate cases. On March 10, 2014, in Docket No. W-354, Sub 336, the Commission issued an Order Granting Partial Rate Increase, Approving Rate Adjustment Mechanism, and Requiring Customer Notice. Ordering Paragraph No. 12 of the March 10, 2014 Order states:

> That CWSNC shall work with the Public Staff on the appropriate mechanisms for effectuating the changes mandated by House Bill 998, effective July 1, 2014 and January 1, 2015, as stipulated, and shall file notice of the proposed rate reductions with the Commission by June 1, 2014 and December 1, 2014, as stipulated.

On May 2, 2014, in Docket No. W-218, Sub 363, the Commission issued an Order Granting Partial Rate Increase, Approving Rate Adjustment Mechanism, and Requiring Customer Notice. Findings of Fact 17-20 of the May 2, 2014 Order address the tax changes effectuated by HB 998. The May 2, 2014 Order accounts for the changes to the GRT, the general franchise tax, and the State corporate income tax.

The recent CWSNC and Aqua rate case proceedings resolve HB 998 expense issues for CWSNC and Aqua. Therefore, the Commission finds that it is appropriate to exclude CWSNC and Aqua from further consideration by the Commission in this docket with respect to the HB 998 GRT, general franchise tax, and State corporate income tax changes. CWSNC and Aqua are required to adhere to the Commission's finding concerning excess deferred income taxes discussed as Issue 2 in this Order.

In October, 2013, Piedmont had a pending rate case proceeding open. On December 17, 2013, in Docket No. G-9, Sub 631, the Commission issued an Order Approving Partial Rate Increase and Allowing Integrity Management Rider, which, among other things, accepted Paragraph 22 of the stipulation wherein Piedmont agreed to adjust its rates as a result of the prospective decrease in North Carolina corporate income tax rates. Specifically, the Commission noted on page 42 of the Order that HB 998:

> [E]stablishes two prospective downward adjustments in the North Carolina corporate income tax rates to be effective for tax years 2014 and 2015, which begin, respectively, on November 1, 2014 and November 1, 2015. In Paragraph 22 of the Stipulation, the Stipulating Parties agree that Piedmont will adjust its rates, coincident with the effectiveness of these new tax rates as to Piedmont, for the purpose of making appropriate adjustments to Piedmont's rates as a result of the implementation of House Bill 998.

However, the Commission agrees with the Public Staff's recommendation that Piedmont also be allowed to adjust its rates for the general franchise tax liability mandated by HB 998, which was not reflected in the stipulation filed during the rate case. The Commission finds that Piedmont should make this adjustment at the same time as it recognizes the decrease in State corporate income tax rates (November 1, 2014).

In addition, the Commission notes that it is now appropriate to exclude Ellerbe from further consideration by the Commission in this docket because it has recently elected to operate as a Subsection (h) ILEC.

Other than the seven public utilities noted above, all other electric, natural gas, water, and sewer public utilities with annual revenues of $250,000 or more remain to be addressed by the Commission.[19] As recognized by all of the parties, Section 4.2 of HB 998 mandates that the Commission adjust rates for electric and natural gas public utilities to reflect the repeal of the GRT, the imposition of the general franchise tax, and the change in sales tax. As Dominion noted in its Responsive Comments, the gross receipts, general franchise, and sales tax changes are legislatively mandated to be reflected in a rate adjustment, and Dominion, DEC, and DEP presented consistent and undisputed approaches to affect these rate adjustments.

The only major issue in contention is whether the Commission should also adjust the rates of public utilities in the context of this rulemaking proceeding to recognize the reductions in the State corporate income tax rate enacted by HB 998. Dominion, DEC, DEP, and PSNC Energy asserted that the Commission should not include the decrease in the State corporate income tax rate when making rate adjustments in this proceeding because doing so would equate to single issue ratemaking and the State corporate income tax rate change is not "substantial and material." The Attorney General and the Public Staff advocated that the Commission consider the tax changes enacted by HB 998 in their totality when making rate adjustments to ensure that consumers receive the maximum benefit of the changes to which they are entitled, whether the adjustments were mandated by the General Assembly or not.

As specifically noted by several parties the Commission has the authority to reduce utility rates to reflect income tax rate changes in a rulemaking pursuant to the Court's holding in Nantahala. The Nantahala Court stated:

> that the Commission was acting within its authority when it ordered the affected utilities, including Nantahala, to determine the amount of savings resulting from the [Tax Reduction Act of 1986] and to pass these savings on to the ratepayers. The Commission properly formulated a rule which applied uniformly to the affected utilities which were similarly situated. The circumstances surrounding this procedure made it appropriate for the

[19] Water and sewer companies with annual revenues of less than $250,000 are discussed as a separate issue (Issue 6) in this Order.

> Commission to use a rulemaking procedure because: 1) the tax reduction affected all utilities uniformly; 2) a large number of utilities were affected, making individual hearings for all inappropriate; and 3) no adjudicative-type facts were in dispute so as to require a trial-type hearing for each individual utility.[20]

Several parties to this proceeding argued, however, that the Nantahala holding and subsequent Commission orders dictate that the Commission should refrain from exercising that authority when the impact on utility rates is relatively small. DEC and DEP stated that the benefit to customers of the State corporate income tax change is indeed small, and would amount to approximately $0.25 per month for DEC customers and $0.15 cents per month for DEP customers based on a typical residential customer's monthly bill. Dominion noted that each staggered State corporate income tax rate reduction would approximate a 0.1% change to Dominion's cost of service. PSNC Energy noted that, as shown on Appendix A to PSNC Energy's Reply Comments, disregarding the increased expense associated with taxes other than income taxes, the reduction in expenses associated with HB 998's enactment would amount to $812,056, or approximately 0.12% of PSNC Energy's test-year revenues.

Dominion stated that the threshold question presented is whether it is reasonable and appropriate for the Commission to direct single issue adjustments to rates for the State corporate income tax change through the current rulemaking versus addressing such changes in individual future general rate cases. The Commission recognized in its October 23, 1991 Order in Docket No. M-100, Sub 122, that its authority to direct single issue ratemaking action through a rulemaking versus through a general rate case proceeding is limited to when the three criteria enumerated in Nantahala have been met. The Commission concluded in that docket that an increase in the State corporate income tax from 7.0% to 7.75%, and other minimal changes, did not represent substantial and material changes necessitating a rulemaking proceeding. In its Order, the Commission noted that it had previously not required rate reductions when the federal corporate income tax rate decreased from 48% to 46% in 1978.[21] No party to this proceeding has presented evidence that, were the Commission not to address the State corporate income tax change through the current rulemaking, the resulting rates would be unreasonable or cause the utilities to exceed the returns authorized in each utility's most recent rate case. Rather, the Public Staff and the Attorney General argued that the Commission, as it is already required to adjust rates pursuant to some of the tax changes in HB 998, should consider the tax changes in HB 998 in their totality when making the necessary rate adjustments.

After a full review and analysis of the filings in this proceeding and a complete review of HB 998 and prior Commission and Court decisions, the Commission agrees with the Attorney General and the Public Staff. The Commission concludes that HB 998

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[20] Nantahala at 203.

[21] No party requested any action; however, neither did the Commission initiate any action on its own.

should be viewed in its totality and the corresponding changes in rates should comprehensively reflect the full intent of the changes effectuated by HB 998, including the changes to the State corporate income tax rate. The Supreme Court of North Carolina has stated that:

> "Legislative intent controls the meaning of a statute." To determine legislative intent, a court must analyze the statute as a whole, considering the chosen words themselves, the spirit of the act, and the objectives the statute seeks to accomplish.[22]

In passing HB 998, entitled An Act to Simplify the North Carolina Tax Structure and to Reduce Individual and Business Tax Rates, the General Assembly took a comprehensive approach to tax reform. The legislation is comprised of numerous tax repeals, reductions, and increases designed to work as one comprehensive set of reforms. The Commission concludes that such a comprehensive approach is also appropriate when implementing the many tax changes contained in HB 998 that affect utility rates. All parties have recognized the Commission's authority, when appropriate, to order a change in rates via a rulemaking due to an income tax change. However, several of the public utilities, Dominion in particular, have presented arguments that it would be inappropriate for the Commission to exercise this authority with respect to the State corporate income tax changes in HB 998. The Commission disagrees.

Dominion, DEC and DEP argued that the Commission should not act in response to the State corporate income tax changes because the General Assembly did not specifically mandate that the Commission do so. Section 4.2(a) of HB 998 mandates that the Commission adjust rates for electric and natural gas public utilities to reflect the repeal of the GRT, the imposition of the general franchise tax, and the change in sales tax.[23] Dominion stated that because

> the General Assembly provided express and explicit direction for the Commission to adjust the Electric Utilities' rates to reflect the repeal of the GRT and the resulting liability for the general franchise tax suggests a legislative intent not to immediately modify currently effective rates for the [State corporate income tax] change through rulemaking.

Quoting Evans vs. Diaz ("when a statute lists the situations to which it applies, it implies the exclusion of situations not contained in the list"[24]), Dominion suggested that a similar application of the doctrine of expressio unius est exclusion alterius should prohibit the

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[22] Brown v. Flowe, 349 N.C. 520, 522 (1998) (quoting Shelton v. Morehead Mem'l Hosp., 318 N.C. 76, 81 (1986)).

[23] The Commission notes that the change in the sales tax will be reflected in a customer's bill as a separate line item charge, rather than through an adjustment to rates as suggested by Section 4.2 of HB 998.

[24] Evans v. Diaz, 333 N.C. 774, 779-80, (1993).

modification of rates to reflect the changes to the State corporate income tax rate as they are not listed in Section 4.2(a). The Commission is unpersuaded by this argument.

The changes to the GRT, sales tax, and general franchise tax are contained in Part IV (Electricity and Piped Natural Gas Changes) of HB 998. Section 4.2(a) of HB 998 pertains to the implementation of the utility-specific changes contained in Part IV. It is logical that in Part IV the legislature would direct the Commission, as the rate regulator of public utilities, in matters related to the implementation of this utility specific section of the new law. In contrast, the changes to the State corporate income tax rate are contained in Part II (Corporate Income Tax Changes) of HB 998 and apply to all C Corporations. Inasmuch as the vast majority of corporations affected by the changes to the State corporate income tax rate are not subject to Commission regulation, or any other economic or price regulation, it is equally logical that the legislature would not direct the Commission regarding the implementation of a non-utility specific tax change. The North Carolina Court of Appeals addressed this issue in a recent holding citing the United States Supreme Court interpretation of the doctrine, stating:

> [h]owever, "the canon expressio unius est exclusio alterius does not apply to every statutory listing or grouping; it has force only when the items expressed are members of an 'associated group or series,' justifying the inference that items not mentioned were excluded by deliberate choice, not inadvertence."[25]

In this matter, as mentioned above, the items at issue are not members of an associated group or series, but, rather, are contained in completely separate Parts of an expansive piece of legislation. The Commission disagrees with Dominion that the General Assembly's intent regarding the implementation of Part II of HB 998 can be inferred from the absence of a mandate in the distinctly separate Part IV.

Further, as noted above, Dominion argued that the failure to explicitly direct the Commission to address the changes to the State corporate income tax "suggests a legislative intent not to immediately modify currently effective rates for the [State corporate income tax] change through rulemaking." The Commission notes that the General Assembly did not state in Section 4.2(a) the method by which the Commission must adjust rates. In particular, the legislation makes no mention of a rulemaking. There is nothing in the statute to support Dominion's assertion that Section 4.2(a) suggests legislative intent to not modify effective rates through rulemaking but to allow such action in a general rate case.

Second, Dominion argued that a rulemaking may not be appropriate for the implementation of the State corporate income tax changes because the various utilities may not be similarly situated. To further this argument, Dominion noted that natural gas LDCs have not been subject to the GRT, while electric utilities are currently subject to

[25] Patmore v. Town of Chapel Hill, 2014 WL 1365981 (N.C. Ct. App. 2014) (quoting Barnhart v. Peabody Coal Co., 537 U.S. 149, 168 (2003).).

the higher of the general franchise tax or the GRT. The issue at hand, however, is not the application of the changes to the GRT, but the application of changes to the State corporate income tax. The changes to the State corporate income tax rate are uniform for all C corporations. Dominion's argument is better suited to claim that the changes to the GRT and the general franchise tax would not be suitable in a rulemaking. As noted above, Section 4.2(a) does not explicitly state the type of proceeding in which these adjustments to rates must be made. However, in the same Reply Comments, Dominion states

> the Gas LDCs are not similarly situated to the Electric Utilities, and therefore, another approach to complying with Subsection 4.2 of HB 998 may be more appropriate for them. [Dominion] submits that the Commission can direct the Electric Utilities to adjust their rates to comply with this legislative direction through a rulemaking Order issued in this proceeding.

Dominion appears to suggest that the differences in applicability of the GRT and general franchise tax between electric utilities and LDCs render a rulemaking an appropriate method to address the changes to the GRT and general franchise tax for the electric utilities, but, concurrently, the same differences render a rulemaking an inappropriate method to address the changes to the State corporate income tax rate.

Furthermore, the present changes to corporate income tax are the same type, albeit at the State level rather than federal, that the Nantahala Court deemed appropriate to be addressed via rulemaking. Additionally, as the Commission did in advance of the changes discussed in Nantahala, the Commission, in its December 6, 2013 Order issued in this Docket, required that the utilities collect the incremental revenue requirement impact associated with the change in the level of State corporate income tax expense included in each utility's cost of service on a provisional basis beginning January 1, 2014.

Dominion, the Public Staff and several other parties also noted the Commission's October 23, 1991 Order Denying Application for Rate Adjustment and/or Institution of a Rulemaking Investigation in Docket No. M-100, Sub 122, in which the Commission declined to initiate a rulemaking to reflect a change in the State corporate income tax rate from 7.0% to 7.75%. In the October 23, 1991 Order, the Commission stated:

> Rulemaking procedures should only be used to increase or decrease public utility rates when changes are clearly substantial and material. Otherwise, a general rate case where all items of the cost of service are carefully scrutinized is the most appropriate forum for rate relief.

Several parties also noted that the Commission took no action to adjust rates in 1978 when the federal corporate income tax rate was reduced from 48% to 46%. Dominion argued that, unlike the changes in 1986 reducing the federal corporate income tax rate from 46% to 34%, the changes in HB 998 to the State corporate income tax are not

substantial enough to merit adjustment outside of a general rate case. The Commission finds that the above-cited instances are distinguished from the present issue. The question posed in those cases was whether it was appropriate to initiate a rulemaking proceeding based on a change to a corporate tax rate. The question posed in this matter is whether it is appropriate to adjust rates for all relevant tax changes enacted as part of comprehensive tax reform, or to only adjust for changes the Commission was specifically mandated to make, in a rulemaking proceeding that has already been initiated. In this unique circumstance, the Commission finds it appropriate to address the changes in HB 998 in their totality in the rulemaking rather than to view the legislation in piecemeal fashion.

For the reasons stated above, the Commission does not find that an analysis to determine if the State corporate income tax reductions are "substantial and material", similar to that conducted by the Commission in its October 23, 1991 Order in Docket No. M-100, Sub 122, is appropriate in this specific scenario (where a rulemaking has already been initiated to consider several tax changes and the question posed is simply which tax changes to include.) However, were the Commission to apply this analysis, the Commission would be consistent with its previous cases to find the present changes in the State corporate income tax rate to be substantial and material. When determining if the 1991 change in the State corporate income tax rate (7.0% to 7.75%) merited consideration in a rulemaking, the Commission stated that the 1986 Tax Reform Act "significantly and materially reduced the federal corporate income tax by 26.1% from 46% to 34%." The Commission further stated:

> While some may argue that the 11% increase in the State corporate income tax rate from 7.0% to 7.75% is substantial, we do not agree, particularly when compared to the TRA-86 rate reduction of 26.1%.

The change to the State corporate income tax rate effectuated by HB 998 (6.9% to 5.0%) is more than twice as large as the 1991 change. Further, the percentage change in the rate (a factor, as demonstrated above, that was relied heavily upon by the Commission to determine if the 1991 change was substantial and material) in this matter equates to a 27.5% reduction in the rate. This percentage change in the rate is not only significantly greater than the 11% increase found by the Commission to not be substantial and material, but actually exceeds the percentage change in the rate (26.1%) effectuated by the 1986 Tax Reform Act and considered by the Nantahala Court.[26] Several parties noted that the change in the State corporate tax rate would result in rate reductions if passed through or potential over-collection if not addressed. For example, DEC stated that the State corporate income tax changes would result in a reduction of approximately $0.25 per-month ($3.00 per-year) for its typical residential customer. The Commission is not persuaded that such a reduction in rates is insignificant.

[26] The Commission notes that the 1978 federal corporate income tax rate decrease, upon which no party requested any action and the Commission initiated no action of its own, equates to a 4.2% reduction in the rate (48% to 46%).

Dominion further argued that a rulemaking adjustment to account for the changes to the State corporate income tax rate in HB 998 is "materially different and more complex" than accounting for the changes to the GRT and the general franchise tax changes. The Commission's determination below in Issue 2 regarding excess deferred income taxes is intended to alleviate some of this complexity in a manner that is agreeable to all parties. Further, the Commission notes that, pursuant to its December 6, 2013 Order issued in this Docket, the utilities were required to identify the incremental revenue requirement impact associated with the change in the level of State corporate income tax expense included in each utility's cost of service and collect these revenues on a provisional basis, utilizing regulatory asset and/or liability accounts, as appropriate. No party has made an assertion that it has been unable to comply with this portion of the Order. The Commission additionally notes that, pursuant to this Order, the utilities will be required to file implementation proposals and the Public Staff is required to review these filings. Any issues regarding the implementation of the requirements of this Order may be addressed in these filings and subsequent review.

Finally, Dominion argued that no party has alleged that its rates would become unjust and unreasonable were the State corporate income tax changes not implemented. Dominion argued that the Public Staff and Attorney General's invocation of fairness should not replace the Commission's standard for adjusting rates outside of a general rate case only in limited circumstances. Again, the Commission notes that this argument would be more persuasive were the issue at hand whether to initiate a rulemaking to adjust rates. However, as discussed above, the issue in this matter is whether to include or exclude certain tax changes from a rulemaking that has already been initiated to adjust rates for tax changes. The Commission initiated this Docket to address the tax changes enacted by HB 998. As a result of HB 998, rates will be adjusted regardless of the incorporation of the State corporate income tax rate. The Commission further notes that it cannot project when each utility's next general rate case will occur. It may be some time before an adjustment may be made during a general rate case for some utilities, while others, which had rate cases ongoing at the time of the changes, will account for them immediately.[27] Therefore, as it is within the Commission's authority, a rulemaking has already been initiated, and rates must already be adjusted, the Commission finds that it is appropriate to address the tax changes that will affect utility rates in HB 998 comprehensively, including the changes to the State corporate income tax rate.

Additionally, Section 4.2(a) of HB 998 did not mandate that the Commission must adjust the rates for water and sewer utilities (with $250,000 or more in annual jurisdictional revenues) to reflect the repeal of the GRT and the applicability, as appropriate and at the company's discretion, of the general franchise tax. The Commission finds good cause to make such an adjustment in the context of a rulemaking proceeding. Both the Public Staff and the Attorney General recommended that the reduction in the GRT for water and sewer companies be flowed through to ratepayers, and no party commented in opposition to this proposal. Pursuant to

[27] The Commission notes that a period of 25 years elapsed in between DEP's two most recent general rate cases.

G.S. 105-116, water and sewer utilities pay a GRT of 4% of revenues for water operations and 6% of revenues for sewer operations. A GRT is applicable to all receipts, thus, the 4-6% reduction would result in a 4-6% reduction in rates if the elimination were flowed through. The Commission, consistent with its finding above in regards to the State corporate income tax rates, has determined that it is appropriate to address the tax changes presented in HB 998 in a comprehensive fashion. Further, the Commission notes that it considers a 4-6% reduction in rates to be substantial and material.

The same issue for water and sewer companies with less than $250,000 in annual jurisdictional revenues is addressed in Issue 6 below.

All electric, natural gas and water and sewer public utilities with annual revenues of $250,000 or more, except for those specifically excluded in the above discussion, should file their proposals to adjust their rates to reflect the changes in the State corporate income tax, the GRT, and the general franchise tax effectuated by HB 998 by no later than 20 days after the issuance of this Order. The Public Staff is requested to file comments on the proposals no later than 20 days after they are submitted to the Commission.

Finally, the Commission agrees with Dominion and other parties that no ratemaking action is required to update the sales tax rate applied to electric and natural gas sales. The Commission hereby directs the utilities to implement the required change to their billing systems coincident with the July 1, 2014 effective date of the increased sales tax rate set forth in HB 998.

ISSUE 2

The Commission's second request in its October 1, 2013 Order asked that the respondents provide:

> A complete detailed narrative explanation of how the Utility proposes to account for and treat excess deferred income taxes that were accrued in earlier years under income tax rates that were in excess of those set forth in HB 998.

POSITIONS OF THE PARTIES

Electric Utilities Initial Comments

DEC/DEP stated that in accordance with Generally Accepted Accounting Principles (GAAP), the Companies have already moved an estimated amount of previously recorded deferred income taxes that were accrued in earlier years under income tax rates that were in excess of those set forth in HB 998. DEC/DEP stated that the result of the change on deferred taxes is an excess in State deferred income taxes, offset somewhat by a deficit in federal deferred income taxes. DEC/DEP noted that the

amount of excess deferred income taxes was removed from the Company's accumulated deferred income tax balance. DEC/DEP stated that the Company grossed-up this amount to a pre-tax amount and recorded the pre-tax amount as a deferred credit on the balance sheet awaiting Commission approval to re-classify this amount to a regulatory liability. DEC/DEP stated that the Companies recorded pre-tax deferred credits of approximately $173 million for DEC ($119 million on a North Carolina retail basis based on DEC's recent cost of service study based on the methodology approved by the Commission in DEC's most recent rate case) and $81 million for DEP ($56 million on a North Carolina retail basis based on DEP's recent cost of service study based on the methodology approved by the Commission in DEP's most recent rate case). DEC/DEP requested that the Commission grant permission to establish a regulatory liability on each Company's accounting records for the North Carolina retail allocated portions of these deferred credits.

DEC/DEP stated that the Commission has several options given that, unlike the GRT change or sales tax change, there is no requirement in HB 998 for a change in rates related to income tax changes. The first option presented by DEC/DEP, based on the assumption that the Commission grants the Companies' request to establish a regulatory liability, is for the Commission to approve an amortization period to begin in 2014 without a change to customer rates. DEC/DEP stated that, while the Commission has previously adjusted rates for tax changes more material than those at issue here, as a general rule, the Commission has not typically changed base rates for a single cost increase or decrease outside of a general rate case proceeding; accordingly, beginning amortization without a change in rates would be consistent with general past practice. DEC/DEP noted that the amortization would be reflected in quarterly surveillance reports filed with the Commission, and the Commission could monitor the Companies' returns in these reports and measure such returns based on annual information.

Alternatively, according to DEC/DEP, the Commission could approve an amortization period to begin in 2014 and concurrently reduce customers' rates. DEC/DEP stated that should the Commission decide to reduce customer rates for this amortization, DEC/DEP request that the amortization begin concurrently with the first rate reduction resulting from this docket. DEC/DEP stated that since the amortization of the regulatory liabilities will increase rate base compared to what was included in the Companies' most recently approved rate cases in Docket Nos. E-2, Sub 1023, and E-7, Sub 1026, the Companies request that the Commission make a corresponding change to base rates to reflect the increase in rate base. DEC/DEP noted that the amounts that were moved out of accumulated deferred income tax accounts were included as a reduction to rate base in each of the utilities' last rate cases. DEC/DEP noted that they intend to include the regulatory liabilities as a reduction to rate base, as well; but as the regulatory liabilities are amortized, rate base will increase. DEC/DEP also requested that a two-year rider be implemented for the amortization of the regulatory liability. DEC/DEP stated that Attachment 2 to their comments contains an example of the Companies' proposal should the Commission select this option and order a reduction in customer rates for the amortization of this regulatory liability.

Finally, DEC/DEP stated that the Commission could approve the regulatory liability and require that amortization not immediately begin, but instead require it to be considered in each Company's next base rate case or retain the option to designate it for a customer-specified purpose such as environmental remediation or to potentially avoid or delay a future rate case, if appropriate.

Dominion noted that in response to HB 998, and in accordance with GAAP, the Company has reduced the net liability recorded on its books in the form of ADIT to reflect the prospective changes in the North Carolina income tax rate from 6.9% to 6.0% and from 6.0% to 5.0% scheduled effective January 1, 2014, and January 1, 2015, respectively. Dominion stated that the reduction in the net liabilities produced a credit to deferred State income tax expenses for the quarter ended September 30, 2013, for financial reporting purposes. Dominion stated that it has calculated the amount of excess deferred State income taxes net of federal income taxes resulting from HB 998 credited to income for financial reporting purposes in July, 2013, to be $5,601,859.

Dominion noted that for regulatory purposes, subject to the Commission's final determination in this proceeding, Dominion proposes to credit to income the excess deferred income taxes over a two-year period starting with January 1, 2014, the initial implementation date of the HB 998 income tax rate decrease. Specifically, Dominion proposes that the excess deferred income taxes and ADIT attributable to the 0.9% rate decrease, effective January 1, 2014, should be treated as a reduction to State income tax expense, and related increase in rate base, in 2014, and the 1.0% rate decrease, effective January 1, 2015, should similarly be treated as a reduction to State income tax expense, and related increase in rate base, in 2015. Dominion recommended that the Commission consider the combined effect of the changes made in HB 998 for State income taxes, including the reduction to existing ADIT, through the Section 62-133 general ratemaking process. Dominion asserted that, under this approach, the combined effect of the HB 998 income tax rate changes, including the excess deferred income taxes, would affect the Company's earned return on common equity for calendar years 2014 and 2015, the years in which the income tax rate is being reduced by the changes enacted in HB 998.

Natural Gas Utilities Initial Comments

Piedmont proposed that excess deferred income taxes be held in a deferred tax liability regulatory asset account until they can be amortized as (credits to) income tax expense for ratemaking purposes in Piedmont's next general rate case proceeding. Piedmont noted that this amortized treatment is consistent with the method to handle excess deferred federal income taxes for ratemaking purposes used by Piedmont and the Commission.

PSNC Energy stated that the reduction in the State corporate income tax rate from 6.9% to 5% will result in excess deferred State income taxes. PSNC Energy maintained that the decrease in State income taxes will cause federal income taxes to increase which will result in deficient deferred federal income taxes. PSNC Energy

asserted that it will reduce deferred State income taxes by the amount of the excess, and, at the same time, will increase deferred federal income taxes by the amount of the deficit. PSNC Energy requested Commission approval to record the net adjustment to deferred taxes as a regulatory liability which will result in no net change in rate base until amortization of the liability begins. PSNC Energy stated that, in accordance with Federal Accounting Standards Board requirements, the adjustments to deferred taxes will be grossed up to a pre-tax amount when recorded in a regulatory liability.

PSNC Energy stated that there are several ways to address excess deferred taxes, including its proposal for the amortization of the regulatory liability to be addressed in PSNC Energy's next general rate case. PSNC Energy noted that another option is to establish a rider to PSNC Energy's rates which would refund the regulatory liability to customers through a temporary decrement to rates over an appropriate period.

Toccoa maintained that because it is a small, municipally-owned natural gas system (as opposed to being a Subsection C business corporation), it is not subject to income and other tax obligations. Toccoa stated that no tax allowances were included in any determination of Toccoa's revenue requirements when the Commission established its rates, and, therefore, no adjustment to Toccoa's existing rates would be necessary or appropriate as a result of the passage of HB 998.

Telecommunications Utilities Initial Comments

Ellerbe stated that it does not believe that it will have excess deferred income taxes or other tax savings at a level to warrant any adjustment in Ellerbe's current rates.

Water/Sewer Utilities Initial Comments

The initial comments of **Aqua** and **Utilities, Inc.**, with regard to Issue 2 are the same as those summarized above in the discussion of Issue 1.

Public Staff Reply Comments

The Public Staff stated that the amount of excess deferred income taxes should be set aside in a regulatory liability account and refunded to customers. The Public Staff noted that utility rates were set based on the assumption that the utility will pay a 6.9% State corporate income tax rate. The Public Staff asserted that because the tax rate has now changed, the utilities have collected more in deferred taxes than is needed to pay future income taxes. The Public Staff stated that until the Commission adjusts utility rates to reflect the new lower tax rates, the utilities will continue to collect taxes from ratepayers at the higher State corporate income tax rates approved in each utility's most recent rate case. Therefore, according to the Public Staff, the amount of excess deferred taxes that should be flowed back to ratepayers is the amount determined as of the date utility rates are adjusted to reflect the new lower tax rate used to compute deferred tax expense. The Public Staff stated that December 31, 2013, would be the

proper date for use in determining the amount of excess deferred taxes that should be flowed back to ratepayers. The Public Staff noted that these excess deferred taxes can be flowed back now or held until the next rate case.

The Public Staff attached Table 2 to its reply comments which provides its estimate of the revenue requirement effect, in thousands of dollars, of flowing back the excess deferred taxes as of December 31, 2013, for the six major electric and natural gas utilities over a two-year period, including the related increase in rate base.

(In thousands of dollars)

	Tax Year 2014	**Tax Year 2015**	**Tax Year 2016 and Thereafter**
Electric Utilities:			
DEC	($56,202)	($55,281)	$8,249
DEP	($26,766)	($26,327)	$3,812
Dominion	($4,253)	($4,253)	$627
LDCs:			
PSNC	($4,102)	($4,102)	$663
Piedmont	($11,303)	($11,303)	$1,597
Intrastate Pipeline:			
Cardinal	($790)	($790)	$127

The Public Staff asserted that ADIT are reflected in the determination of the revenue requirement for each utility as a reduction in rate base. The Public Staff stated that as the excess portion of ADIT, referred to above as excess deferred income tax, is flowed back to ratepayers, the amount of the ADIT rate base deduction is reduced and revenue requirement increases. The Public Staff maintained that the increase in the revenue requirement for the "Tax Year 2016 and Thereafter" period reflects the effect of the increase in rate base after the excess deferred income tax has been flowed back to ratepayers. The Public Staff noted that all of the amounts shown in the table above are estimated December 31, 2013 amounts. The Public Staff asserted that, as a result, the rate impacts related to the data in the table above should be determined using billing quantities as of December 31, 2013, because the rate case billing quantities will not properly match the data in the table.

Parties Responsive Comments

Dominion argued that adopting its proposal to address excess deferred income taxes would be fair to both customers and the electric utilities, and will ensure that customers receive the benefits of the State income tax changes enacted by HB 998. Dominion noted that the impacts to Dominion's excess deferred income taxes resulting from the State corporate income tax change enacted by HB 998 should not be immediately adjusted through this rulemaking proceeding. Dominion argued that, absent

express direction from the General Assembly otherwise, the purpose of this proceeding should be to ensure the benefits of any tax rate changes impacting the utilities' cost of service and rates are effectively passed on to customers through mechanisms that ensure the utilities' rates remain just and reasonable. Dominion maintained that the State corporate income tax/excess deferred income taxes impacts to Dominion's rates do not cause Dominion's rates to become unjust and unreasonable, and, therefore, North Carolina's general ratemaking procedures are the best mechanism to affect the rate change and protect both ratepayers and the utility from increasing or decreasing rates without consideration of the total costs of service used to develop the revenue requirement supporting rates.

Dominion asserted that, specific to the impacts of excess deferred income taxes resulting from the State corporate income tax change, its proposal for the treatment of excess deferred income taxes and DEC/DEP's first recommendation provide a solution that allows consideration of all costs in the cost of service. Dominion noted that a two year amortization of the excess deferred income taxes, for regulatory purposes, without a change in rates coupled with a review of the retail North Carolina jurisdictional results takes into consideration the complete cost of service and protects the customer from paying too much while protecting the utility from under-recovery of its cost of service. Dominion stated that its proposal includes a refund to ratepayers of any earnings above Dominion's authorized return on equity resulting from the change in State corporate income tax/excess deferred income taxes over the two year amortization period. Dominion argued that this approach is fair to both Dominion and customers and will ensure the benefits of HB 998's State corporate income tax changes provide a benefit to customers while also ensuring Dominion's rates remain just and reasonable.

PSNC Energy noted that the Public Staff stated in its reply comments that excess deferred income taxes could be flowed back now or held to the next rate case. PSNC Energy noted that it had acknowledged these two options, but, upon further reflection, it believes that the better course is to address the amortization of the regulatory liability associated with excess deferred income taxes in PSNC Energy's next general rate case. PSNC Energy argued that this would provide certainty as to the amount to be amortized instead of having to base the flow-back calculation on an estimate as is shown in Table 2 of the Public Staff's reply comments.

PSNC Energy stated that the Public Staff's proposal would use billing quantities as of December 31, 2013, to match the estimates shown in Table 2. PSNC Energy asserted that the standard practice for implementing rate adjustments between rate cases has been to use volumes determined in the gas utility's most recent rate case; the determination is not a matter of simply looking at current billing volumes. PSNC Energy noted that, traditionally, billing quantities determined in a rate case reflect actual test year sales volumes which have been adjusted for customer growth, normal weather, and other appropriate adjustments.

PSNC Energy stated that the resulting excess deferred income taxes should be dealt with in PSNC Energy's next general rate case. PSNC Energy noted that in the

event the Commission nevertheless decides to adopt the Public Staff's proposal and implement rate adjustments immediately, PSNC Energy would request the opportunity to confer with the Public Staff and attempt to reach agreement on the appropriate calculation. PSNC Energy stated that if such an agreement could not be reached, the amount of the rate adjustments ultimately would have to be decided by the Commission.

DISCUSSION AND CONCLUSIONS

After reviewing all of the comments filed on this issue, the Commission concludes that it is reasonable for excess deferred income taxes that were accrued in earlier years under State corporate income tax rates that were in excess of those set forth in HB 998 for all utilities, as appropriate, including Piedmont, Aqua, and CWSNC, to be held in a deferred tax regulatory liability account until they can be amortized as reductions to income tax expense for ratemaking purposes in each utility's next general rate case proceeding. The Commission agrees with PSNC Energy's comments that recognizing the amortization of the excess deferred income taxes in the next general rate case of a utility would provide for certainty as to the amount to be amortized instead of having to base the flow-back calculation on an estimate. No party objected to this option of handling the excess deferred income taxes in question.

ISSUE 3

In addition to the above discussed information requests, the Commission also requested that the respondents answer two questions in its October 1, 2013 Order. The Commission's first question stated:

> In the event that the Commission should determine that rate reductions are in order due to the combined effect of the changes made in HB 998, should such rate reductions be reflected in rates concurrently or should they be made separately to coincide with the effective dates set forth in HB 998?

POSITIONS OF THE PARTIES

Electric Utilities Initial Comments

DEC/DEP stated that in the event that the Commission orders rate reductions for the amortization of the regulatory liability requested for the excess deferred taxes previously discussed, the Company believes that such rate reductions should, along with the changes to reflect the sales tax increase and gross receipts/franchise tax, be implemented to coincide with the effective dates set forth in HB 998.

DEC/DEP stated that the repeal of the current utility gross receipts/franchise tax is effective July 1, 2014. DEC/DEP noted that, since utilities are subject to the higher of the utility's gross receipts/franchise tax or the general franchise tax pursuant to G.S. 105-114(a4), the Companies will be subject to the general franchise tax after the

repeal of the utility gross receipts/franchise tax. DEC/DEP maintained that for 2014, half a year of utility franchise tax remains higher than the general franchise tax, thus, the Companies will not pay the general franchise tax. However, DEC/DEP noted that the Companies must pay the general franchise tax starting in 2015. DEC/DEP stated that in order to accommodate these changes occurring at separate times, the Companies propose a decrease to base rates for the net impact (decrease to utility gross receipts/franchise tax and increase to general franchise tax) of the change, and to implement an additional decrement rider for the second half of 2014 when the Companies will not be subject to either tax.

DEC/DEP noted that the increase in sales tax necessitates no ratemaking action from the Commission because the sales tax is a separate line item on customers' bills, and that amount can be changed without any tariff changes.

Dominion stated that the tax changes enacted by HB 998 affecting the utilities' operations are relatively complex both in terms of the number of changes to different taxes enacted, as well as HB 998's approach of staggering the effective dates of the changes over the next few years. Dominion stated that in addition to prescribing when each newly enacted tax law change will occur, the Legislature provided precise direction to the Commission in Section 4.2(a) of HB 998 that the Commission "must adjust" rates for Dominion and other electric utilities to reflect the repeal of the GRT, the application of the general franchise tax to utility operations, and the increase in the sales tax rate. Dominion stated that it views Section 4.2(b) of HB 998 as clearly showing the Legislature's intent that these specific tax law changes be recognized in rates coincident with their July 1, 2014, effective date.

Dominion stated that where the Legislature has provided this specific direction, the Company recommends that the Commission implement this rate adjustment through either a decrement rider or through a combination of an adjustment to base rates and a decrement rider depending upon the utility's circumstances. Dominion noted that it projects its 2014 tax responsibility to be based upon the North Carolina GRT, as the GRT through June 30, 2014, is estimated to be greater than the alternative 2014 general franchise tax liability. Dominion recommended that the Commission implement this required rate adjustment by directing Dominion to adjust base rates on July 1, 2014, to reflect the elimination of the GRT and inclusion of utility operations in the general franchise tax, and then to order a rate decrement to reconcile the difference in tax liability over the six months July 1 to December 31, 2014. Dominion asserted that both the base rate change and the decrement could be approved concurrently. Dominion stated that for a utility that expects to transition to the franchise tax on July 1, 2014, a single adjustment either to base rates or through implementation of a decrement rider would be appropriate. Dominion stated that the Commission should direct each of the utilities to file a proposal to implement these required July 1, 2014 rate adjustments by March 1, 2014.

Dominion stated that HB 998 directs the Commission to adjust rates to implement the change in the sales tax rates imposed on the sale of electricity effective

July 1, 2014. Dominion noted that this change does not affect the utility's cost of service and is effectively a "pass through" in rates (i.e., the utility simply collects the statutory rates of sales tax for remittance to the State), thus, the Commission should order the utilities to implement the required change to their billing systems coincident with the effective date of the increased sales tax rate. Dominion stated that doing so would require little administrative burden for the Company.

Dominion, as discussed above, stated that, in the absence of specific direction from the Legislature to adjust rates, the Commission should seek to provide the benefits of the corporate income tax changes to customers in the most equitable and efficient manner possible. Dominion stated that, due to the staggered implementation of these tax rate changes and the difficulty of repeatedly adjusting rates to reflect the changes as they occur, a single historical review of whether any rate change to affect a refund is most appropriate. Dominion stated that the Commission can ensure customers receive the full benefit of the income tax changes through the general ratemaking process under G.S. 62-130 and G.S. 62-133. Dominion recommended the following actions to ensure that the combined effect of the income tax changes do not unduly benefit the utilities to the detriment of customers:

> (1) Declare the combined revenue requirement effect of the HB 998 changes to State corporate income tax rates, including the credit to income of any excess deferred income taxes resulting from the reduction to existing ADIT, to be provisional or interim until such time as each Utility files for a base rate increase.
>
> (2) Direct the electric utilities to measure the impact of the impact of the State corporate income tax rate changes on their North Carolina jurisdictional earnings for 2014 and 2015 based on calendar year ES-1 Reports by adjusting their actual return on equity to reflect: (i) an increase to ADIT in 2014, representing the appropriate partial restoration of the 2013 adjustment to write-off the excess deferred income taxes, thereby decreasing rate base, and (ii) a decrease to State income tax expense representing a credit to income of the excess deferred State income taxes over the two year period, 2014 to 2015.
>
> (3) Direct each electric utility to address the results of this modified annual ES-1 earnings analysis for calendar years 2014 and 2015 (performing a separate review for each calendar year, as the income tax rate changes each year) in its next general rate case application to determine if the utility over-earned its authorized ROE, including the calculation of any adjustment required to amortize the over-recovery over a specified period. The Public Staff would also review the results of the utility's ES-1 earnings analysis as part of its rate case investigation.
>
> (4) If the Company's actual earned ROE, as measured by the adjusted ES-1 Report for either 2014, 2015, or both, exceeds the utility's currently-authorized ROE, the amount in excess of the authorized ROE due to the combined changes in income tax expenses resulting from the changed income tax rates would be

credited against the North Carolina jurisdictional cost of service in the utility's next base rate application over a period of seven (7) years.

(5) To ensure customers fully benefit from any over-recovery of the utility's cost of service, the Commission could also require that any amount deemed to be credited or refunded should include an interest component pursuant to G.S. 62-130(e).

Natural Gas Utilities Initial Comments

Piedmont proposed that, consistent with the treatment set forth in the Stipulation, each of the rate changes associated with HB 998 be made to coincide with the effective date for the Company.

PSNC Energy argued that, due to the overall minimal impact to its net operating income and lack of impact to the overall rate of return shown on Appendix A, it does not believe that a rate adjustment is warranted. PSNC Energy stated that it recognizes that Section 4.2(a)(2) of HB 998 requires the Commission to adjust natural gas utility rates to reflect the loss of the franchise tax credit currently allowed under G.S. 105-122(d1). PSNC Energy stated that, however, as shown on Appendix A, the effect of this loss is offset by the lower State corporate income tax rates enacted by HB 998. Accordingly, PSNC Energy asserted, no adjustment of rates under HB 998 Section 4.2(a)(2) is necessary. PSNC Energy stated that if the Commission nevertheless determines that rate adjustments are appropriate to address the full impact of HB 998, PSNC Energy submits that rates should be adjusted to coincide with the effective dates set forth in HB 998.

Water/Sewer Utilities Initial Comments

Aqua stated that given: (1) the pendency of the rate increase application in Docket No. W-218, Sub 363; (2) the necessity of determining and calculating the tax impact on revenue requirements and rates; and (3) the goal of regulatory and corporate efficiency, it would note that the prospective changes in rates driven by these tax changes will be captured in the Commission's decision and Order in the rate case and recommended that the timing of any rate reductions be driven by the timing of the rate case and the imminent changes in both tax rates.

Other Comments

The Public Staff, in its initial comments, recommended that the rate reductions should be made and tariffs re-filed concurrently with the dates the tax law changes become effective. Toccoa, Ellerbe, Utilities, Inc., and Pineville did not comment on this question. No party filed reply or responsive comments on this question.

DISCUSSION AND CONCLUSIONS

The Commission concludes, consistent with its conclusion discussed in Issue 1, that all changes recognized through this Order should be made effective consistent with the dates the tax law changes become effective (July 1, 2014, for the GRT, general franchise tax and Sales tax changes and January 1, 2014, and January 1, 2015, for the State corporate income tax changes). The Commission notes that its December 6, 2013 Order, issued in this Docket, required that the utilities collect the incremental revenue requirement impact associated with the change in the level of State corporate income tax expense included in each utility's cost of service on a provisional basis beginning January 1, 2014. Affected public utilities should file their proposals to adjust their rates to reflect the changes in the State corporate income tax, the GRT and the general franchise tax effectuated by HB 998 by no later than 20 days after the issuance of this Order. The Public Staff is requested to file comments on the proposals no later than 20 days after they are submitted to the Commission.

ISSUE 4

The Commission's second question in its October 1, 2013 Order stated:

> If the Commission should be unable to enter a final ruling regarding the issues discussed in this Order prior to January 1, 2014, should the Commission, prior thereto, enter an order placing the utilities on notice that the State income tax expense component of their cost of service is deemed to be collected on a provisional basis pending final disposition of this matter by the Commission?

DISCUSSION AND CONCLUSIONS

This issue was resolved by the Commission's December 6, 2013 Order Providing for the Provisional Recovery of Certain Incremental Revenue Requirements. The Commission ordered that the incremental revenue requirement impact associated with the change in the level of State income tax expense included in each utility's cost of service due to HB 998 would be deemed to be collected on a provisional basis beginning January 1, 2014, pending final disposition of this matter by the Commission. Further, the Commission required that the utilities utilize regulatory asset and/or liability accounts (or other balance sheet accounts), as appropriate, for the present purpose. With this Order, the Commission has concluded that the rates of public utilities should be adjusted now to reflect the State corporate income tax changes resulting from HB 998. Therefore, the Commission concludes that the utilities should include in their proposals to adjust their rates provisions that will refund to customers the amounts collected on a provisional basis pursuant to the Commission's December 6, 2013 Order beginning January 1, 2014.

ISSUE 5

The Commission's October 1, 2013 Order stated:

> The Public Staff is requested to include, in its initial comments, a specific recommendation of how the Commission should proceed with respect to water and sewer companies that are not taxed as C Corporations for income tax purposes (as well as for gross receipts/franchise tax purposes).

POSITIONS OF THE PARTIES

The Public Staff, in its initial comments, stated that HB 998 reduces the State income tax rate for C Corporations from the current rate of 6.9% to 6% effective for taxable years beginning on or after January 1, 2014 and further reduces the rate from 6% to 5% effective for taxable years beginning on or after January 1, 2015. The Public Staff noted that utilities regulated by the Commission that are not taxed as C Corporations include limited liability companies (LLCs) (which are not corporations), S Corporations, partnerships, sole proprietorships, and non-profits. The Public Staff maintained that, with the exception of non-profit utilities, the Commission has included an income tax allowance in its determination of revenue requirements for these utilities, calculated as if the utilities were C Corporations, and the income tax rates should therefore be adjusted accordingly. The Public Staff noted that, because the Commission does not include an income tax allowance in its determination of rates for non-profits, the rates of non-profits need not be adjusted.

The Public Staff asserted that currently, pursuant to G.S. 105-116, water and sewer utilities pay a GRT of 4% of revenues for water operations and 6% of revenues for sewer operations. The Public Staff noted that Section 4.1(a) of HB 998 repeals G.S. 105-116 effective July 1, 2014. The Public Staff stated that prior to the enactment of HB 998, water and sewer utilities were not liable for payment of the standard franchise tax under G.S. 105-122, since pursuant to G.S. 105-114(a4), they were permitted to credit GRT payments against any liability resulting from the standard franchise tax, and the GRT uniformly exceeded the standard franchise tax. The Public Staff noted that with the repeal of G.S. 105-116, water and sewer companies will no longer be subject to GRT effective July 1, 2014, and, instead, utilities that are taxed as C Corporations will be subject to the standard franchise tax under G.S. 105-122. The Public Staff asserted that this will likely result in a significant decrease in tax liability for these companies.

The Public Staff noted that the franchise tax is not a revenue-based tax like the GRT, which is a set percentage of gross revenues; instead, it is based on the higher of: (1) capital stock, surplus, and undivided profits; (2) investment in tangible property in the State; and (3) appraised valuation of property in the State for the company. The Public Staff stated that this will make the calculation of any rate reduction more complex, although a similar calculation and rate reduction were done for the sixteen telephone

companies in Docket No. P-100, Sub 149. The Public Staff recommended that the Commission direct water and sewer utilities to provide a calculation of the rate reduction and submit it to the Commission and the Public Staff for review and Commission approval.

No party filed reply or responsive comments on this issue.

DISCUSSION AND CONCLUSIONS

The Pubic Staff was the only party to provide comments on this issue. The Public Staff stated that all utilities regulated by the Commission, with the exception of not-for-profits, are subject to State corporate income taxes. As the Public Staff maintained that, with the exception of non-profit utilities, the Commission has included an income tax allowance in its determination of revenue requirements for utilities regulated by the Commission that are not taxed as C Corporations, calculated as if the utilities were C Corporations, the Commission concludes that the rates of these utilities should be adjusted accordingly. The Commission's conclusions, discussed in Issue 1 and in Issue 6 for water and sewer companies with less than $250,000 in annual jurisdictional revenues, address the issue of rate adjustments for the changes to the State corporate income tax rates for utilities regulated by the Commission that are not taxed as C Corporations include limited liability companies (LLCs) (which are not corporations), S Corporations, partnerships, sole proprietorships, and non-profits. The Commission notes, for example, that a non-profit, which had not included an income tax allowance in its determination of revenue requirements would make no adjustment based on the Commission's determinations regarding changes in the State corporate income tax rates.

ISSUE 6

The Commission's October 1, 2013 Order stated:

> In its initial comments, the Public Staff is also requested to include comments on whether it is reasonable and appropriate to excuse all public utilities with annual jurisdictional revenues of $250,000 and less or some other amount from participation in this Docket with respect to the income tax changes mandated in HB 998.

POSITIONS OF THE PARTIES

The Public Staff, in its initial comments, stated that the changes to the revenue requirement as a result of all of the tax changes outlined in HB 998 will affect relatively small public utilities as well as the larger ones. The Public Staff maintained that, in its view, requiring these small utilities to calculate and implement rate adjustments as a result of the tax changes would unnecessarily divert the limited resources of these utilities. Therefore, the Public Staff stated that it would be reasonable for the Commission to excuse utilities with annual jurisdictional revenues of $250,000 or less

from participation in this docket with respect to the income tax changes, as well as all of the other tax impacts of HB 998.[28]

The Attorney General, in its reply comments, stated that the Commission should exercise its authority to adjust the rates of all water and sewer utilities to take into account the repeal of the GRT. The Attorney General asserted that this reduction should be passed through to consumers, instead of simply allowing the utilities to benefit from the reduction.

The Public Staff, in its reply comments, stated that it has reconsidered its position and now recommends that the rates of all water and sewer utilities be adjusted for the repeal of the GRT. The Public Staff stated that the fairly significant reduction in rates due to the repeal of the GRT should be passed through to ratepayers and that implementation of rate changes for the repeal of the GRT can be accomplished in an administratively expedient manner.

No party addressed this issue in responsive comments.

DISCUSSION AND CONCLUSIONS

The Commission, in its December 6, 2013 Order, as recommended by the Public Staff in its initial comments, excused utilities with annual jurisdictional revenues of $250,000 or less from participation in this docket with respect to the income tax changes, as well as all of the other tax impacts of HB 998. However, the Commission specifically stated that the excusal was provisional, pending the receipt of reply comments. Based upon the reply comments, the Commission agrees with the revised position of the Public Staff. Accordingly, the Commission finds that it is appropriate to rescind its provisional finding in the December 6, 2013 Order that utilities with annual jurisdictional revenues of $250,000 or less should be excused from participation in this docket.

Only the Public Staff and the Attorney General submitted comments regarding this issue, both recommending that the Commission reduce the rates for all water and sewer companies, regardless of the company's annual jurisdictional revenues, to reflect the repeal of the GRT. Neither party specifically recommended that the Commission adjust rates for those companies to reflect the State corporate income tax rate changes or the general franchise tax changes. The Commission has concluded in Issue 1 above that the HB 998 changes to State corporate income tax rates will be recognized in this proceeding. This conclusion also applies to water and sewer utilities with annual jurisdictional revenues of less than $250,000.

The Commission finds that, as is the case discussed in Issue 1 for water and sewer companies with greater than $250,000 in annual jurisdictional revenues and consistent with its approach to address the changes in HB 998 comprehensively, the

[28] However, as explained subsequently, the Public Staff (in its reply comments) reversed its initial position regarding GRT, arguing that the repeal of such taxes should be flowed through to ratepayers.

reduction in GRT for water and sewer companies with less than $250,000 in annual jurisdictional revenues is significant (4% for water companies and 6% for sewer companies). The Commission concludes that the rates of these utilities should be adjusted to reflect the reduction; water and sewer companies with less than $250,000 in annual jurisdictional revenues shall refile tariffs to reflect the elimination of the GRT, effective July 1, 2014, and the changes to the State corporate income tax rates effective January 1, 2014 and 2015. Water and sewer companies with less than $250,000 in annual jurisdictional revenues that are taxed as C Corporations (including those electing S-corporation status) are permitted, at their discretion, to net the increase in the general franchise tax with the decrease in the GRT. Water and sewer utilities with less than $250,000 in annual jurisdictional revenues should file their proposals to adjust their rates to reflect the changes in the State corporate income tax, the GRT and the general franchise tax effectuated HB 998 by no later than 20 days after the issuance of this Order. The Public Staff is requested to file comments on the proposals no later than 20 days after they are submitted to the Commission.

IT IS, THEREFORE, ORDERED as follows:

1. That it is not appropriate to adjust the rates of Toccoa, Ellerbe, Pineville, Frontier, Aqua, or CWSNC in this proceeding due to HB 998.

2. That Piedmont is hereby allowed to adjust its rates for the general franchise tax liability mandated by HB 998 which was not reflected in the stipulation in Piedmont's recent rate case proceeding. Piedmont should make this adjustment at the same time as it makes its first change to recognize the decrease in the State corporate income tax rate (November 1, 2014).

3. That the Commission's finding in its December 6, 2013 Order in this Docket that utilities with annual jurisdictional revenues of $250,000 or less are excused from participation in this docket with respect to the income tax changes, as well as all of the other tax impacts of HB 998, is hereby rescinded.

4. That all electric, natural gas, water, and sewer utilities, other than those addressed specifically in Ordering Paragraphs 1 and 2 above, are hereby required to adjust their rates to reflect, as applicable, the changes to the GRT, the State corporate income tax, and the general franchise tax effectuated by HB 998.

5. That all electric, natural gas, water, and sewer utilities, other than those addressed specifically in Ordering Paragraphs 1 and 2 above, should file proposals to adjust their rates to reflect, as applicable, the changes to the GRT, the State corporate income tax, and the general franchise tax effectuated by HB 998 by no later than 20 days after the issuance of this Order. Water and sewer companies taxed as C Corporations (including those electing S-corporation status) may net, at their discretion, the increase in the general franchise tax with the required decreases in the GRT and State corporate income tax. The Public Staff is requested to file comments on the proposals no later than 20 days after they are filed with the Commission.

6. That the electric and natural gas utilities are hereby required to implement the required change to their billing systems coincident with the July 1, 2014 effective date of the increased sales tax rate set forth in HB 998.

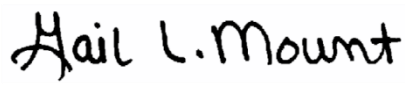
7. That excess deferred income taxes for all utilities, as appropriate, including Piedmont, Aqua, and CWSNC, shall be held in a deferred tax regulatory liability account until they can be amortized as credits (i.e., reductions) to income tax expense for ratemaking purposes in each utility's next general rate case proceeding. All utilities, as appropriate, including Piedmont, Aqua, and CWSNC, are hereby required to establish a deferred tax regulatory liability account and shall not begin amortization of amounts recorded in such accounts pending further order of the Commission.

8. That the utilities affected by the Commission's December 6, 2013 Order in this Docket should include in their proposals to adjust their rates pursuant to Ordering Paragraph 5 of this Order provisions that will refund to customers the amounts collected on a provisional basis beginning January 1, 2014, pursuant to the December 6, 2013 Order.

ISSUED BY ORDER OF THE COMMISSION.

This the 13th day of May, 2014.

NORTH CAROLINA UTILITIES COMMISSION



Gail L. Mount, Chief Clerk

Chairman Edward S. Finley, Jr., dissenting in part.

DOCKET NO. M-100, SUB 138

CHAIRMAN EDWARD S. FINLEY, JR., DISSENTING IN PART: The majority has determined that a reduction in the state corporate income tax rate of 0.9% on January 1, 2014 must result in a retroactive reduction in base rates to the state's utilities in this generic rulemaking docket without compliance with any of the requirements of G.S. 62-133 necessary to adjust base rates in a general rate case. In my view this rate adjustment departs from decades of well-reasoned and thoughtful court and Commission precedent and starts with a result sought to be reached and moves from there in an effort to circumvent the existing law and precedent rather than to follow it. I am convinced that if the change in the state corporate income tax rate were an increase from 6.0% to 6.9% it would be unlawful and inappropriate to flow through this increase to base rates. The result should not be different because the tax rate went down. Before base rates should be changed in a rulemaking docket, the change must be substantial and material. There are and should be no exceptions. The reduction of 0.9%, nor the subsequent one not yet in effect, is neither. Unlike objects subject to the laws of gravity, when it comes to income tax rates, what goes down usually comes back up. This decision, the legal and policy support for which is so easily dismissed, in effect writing out the substantial and material test, is not beneficial to consumers. It removes an important safeguard. The reduction in residential rates, even if treating the two reductions as one, is insufficient to cover the postage to return the monthly payment. My concern is, like the proverbial bad penny, this opinion of minimal value to anyone will come back to plague the Commission in years to come.

The majority's decision to decrease base rates to reflect the reduced state corporate income tax rate in the present rulemaking violates the fundamental principle against single-issue ratemaking. State ex rel. Utils. Comm'n. v. Edmisten, 291 N.C. 327, 230 S.E.2d 651 (1976). The Commission is charged with setting just and reasonable rates for public utilities. Chapter 62 authorizes the Commission to modify base rates in a general rate case. The purpose of this requirement is to allow the Commission and all parties to carefully scrutinize all components of cost of service. See G.S. 62-133. In this manner rates are set on an adjusted historic test year on the assumption that while rates are in effect the level of revenues, expenses, and investment will permit the appropriate level of earnings even though individual components will change over time. Single-item rate adjustments outside general rate cases throw the base rates out of balance. Historically, the Commission has, with a few limited exceptions, disallowed the use of single-factor rate riders or cost recovery adjustments outside of a general rate case because it is unlawful to do so. Indeed, the poster-child example of this fundamental principle is the very cost at issue here.

> The basic theory of utility rate making, pursuant to G.S. 62-133, is that rates should be fixed at a level which will recover the cost of the service to which the rate is applied, plus a fair return to the utility. A utility company may not properly be denied the right to charge such a rate, for the present use of its service, for the reason that, in a preceding month, the utility earned an excessive rate of return due to the fact than an expense which

> it was expected to incur in such previous month did not materialize. For example, rates for use of a utility's service are set at a level which will enable the company to pay, among other items, its anticipated tax expense. If, by virtue of some change in the tax law, it develops that the company did not incur the anticipated expense for the payment of which it collected revenues in prior months, its rates for present and future service may not be cut, on that account, below what it otherwise would be entitled to charge for the present or future service. Likewise, a failure of the utility, in a previous period, to earn the anticipated return over and above its then expenses does not authorize it to charge its present customers a rate higher than reasonable for present service in order to compensate for the past deficit. Prospective rate making to recover unexpected past expense, or to refund expected past expense which did not materialize, is as improper as is retroactive rate making.

State ex rel. Utils. Comm'n v. Edmisten, 291 N.C. 451, 469, 232 S.E.2d 184, 194-95 (1970) (emphasis added).

For most exceptions, statutory authorization is required. The annual fuel adjustment rider, Senate Bill 3 riders, and the Clean Smokestacks Act costs recovery are such examples. The gross receipts, sales, and franchise tax changes at issue here likewise fall into this category. Even more rarely, and under only closely circumscribed circumstances, single-factor base rate adjustments may occur in a rulemaking docket. Because the exceptions are rare, the Commission is obligated to construe any case law granting an exception narrowly and to only sparingly and under extraordinary circumstances grant any exception to this general rule. No such extraordinary circumstances are present here.

The North Carolina Supreme Court has allowed a change in rates using a rulemaking proceeding only in limited instances, based upon compelling circumstances, such as a substantial decrease to the federal corporate income tax rate, a rate many multiples higher than the state corporate income tax rate. See State ex rel. Utils. Comm'n v. Nantahala Power & Light Co., 326 N.C. 190, 198, 388 S.E.2d 118, 122-23 (1990). See also State ex rel. Utils. Comm'n v. Edmisten, 294 N.C. 598, 242 S.E.2d 862 (1978) (affirming Commission adoption of a natural gas rule allowing a surcharge for gas exploration expenses upon evidence showing that an emergency gas shortage existed in North Carolina).

The majority cites Nantahala as authority to consider the state corporate income tax changes in the present rulemaking. However, the state corporate income tax changes in the present case are vastly different from the federal tax changes involved in Nantahala. Review of the tests required in Nantahala and the Commission's consistent interpretation of them makes clear that the majority's reliance is misplaced. Historically, federal tax rates are many magnitudes higher than state tax rates, so a change from 48% to 46% to the federal tax rate, for example, affects utility tax expense to a far greater degree than a change in state tax rates from 8% to 6%. In addition, state

corporate tax expense is deductible in calculating federal tax expense, so changes to the state tax rate are offset by countervailing changes to federal income tax expense. Moreover, tax expense, both state and federal, actually paid to taxing authorities differs from test year income tax expense used to set rates. The difference is accounted for in Accumulated Deferred Investment Tax Credit (ADITC), a rate base offset. This offset affects utility rates.

The North Carolina Supreme Court (in defense of its decision and as part of its reasoning in Nantahala) cited to how the Federal Energy Regulatory Commission (FERC) dealt with the same Tax Reform Act of 1986 (TRA-86).

> FERC explained in the Notice that the last corporate tax change had been in 1978 when the rates were decreased from 48% to 46%. At that time FERC did not issue … a final rule. It merely considered [the] tax change on a case by case basis. The Commission explained that the situation was different in this case because the TRA-86 represents a dramatic decrease in the corporate income tax rates … that may result in significant overcollections by a public utility if rates are not adjusted to reflect the decrease.

Nantahala, 326 N.C. at 202, 388 S.E.2d at 125. Prior to the majority's decision in this docket, this "material and substantial" test for adjusting rates in a rulemaking outside of a general rate case has been consistently applied by this Commission. The test is necessary or the proscription against single-item ratemaking goes out the window.

The Commission, in its October 23, 1991 Order in Docket No. M-100, Sub 122, where more than income tax changes were at issue, while recognizing its limited authority to direct single-issue ratemaking action through a rulemaking, listed criteria for exercising such authority. The adjustments are appropriate only where: (1) the tax reduction affects all utilities uniformly; (2) a large number of utilities are affected, making individual hearings for all inappropriate; (3) no adjudicative-type facts are in dispute as to require a trial-type hearing for each individual utility; and (4) the increase or decrease to public utility rates are **clearly substantial and material**." Order Denying Application for Rate Adjustment and/or Institution of a Rulemaking Investigation, Docket No. M-100, Sub 122 (Oct. 23, 1991) (emphasis added). The majority opinion runs afoul of nearly all of these requirements. The changes are not substantial or material. Moreover, utilities are affected differently, and adjudicative facts are in dispute.

The Commission held in Docket No. M-100, Sub 122 that an increase in the state corporate income tax rate from 7.0% to 7.75%, plus a staggered four-year surtax, an increase in the sales and use tax, and the imposition of the regulatory fee, did not represent substantial and material changes necessitating a single-issue adjustment to rates. The Commission stated that the .75 percentage point increase in the state corporate income tax rate paled in comparison to the 1986 federal rate reduction of 12 percentage points. More importantly, the Commission stated, "Simply put, federal income taxes compose a much larger and more significant part of the cost of service for

all regulated utilities in North Carolina than state corporate income taxes." Order Denying Application for Rate Adjustment and/or Institution of a Rulemaking Investigation, Docket No. M-100, Sub 122 (Oct. 23, 1991).

In the Order, the Commission further noted that it had previously not required rate reductions when the federal corporate income tax rate decreased from 48% to 46% in 1978. Order Denying Application for Rate Adjustment and/or Institution of a Rulemaking Investigation, Docket No. M-100, Sub 122 (Oct. 23, 1991). And, the Commission did not order rate reductions in 1996 when the state corporate income tax rate was changed from 7.75% to 6.9% due to Session Law 1996-13-es2, Section 2.1.

The majority cites no case law for its determination that the Commission may adjust rates based upon a change in an isolated component of the cost of service absent a determination of whether or not the change is significant and material just because there is an open rulemaking and taxes other than state corporate income taxes are at issue. A review of case law and Commission precedent suggests otherwise. See Order Denying Application for Rate Adjustment and/or Institution of a Rulemaking Investigation, Docket No. M-100, Sub 122 (Oct. 23, 1991). See also State ex rel. Utils. Comm'n v. Edmisten, 291 NC 327, 230 S.E.2d 651 (1976). In Edmisten, the North Carolina Supreme Court in discussing the historical test period concept, quotes State ex rel. Utils. Comm'n v. Virginia Electric and Power Co., 285 N.C. 398, 417, 206 S.E.2d 283, 297 (1974) (upholding the Commission's decision to refuse to consider salary, wage, and federal social security tax increases known in the test period to be forthcoming but not taking effect until after the end of the test period) as follows:

> Adjustments for post-test period increases in certain categories of expenses may well give a distorted picture of the need for revenue since post-test period expenses in other categories of expense is not known and the possibility of offsetting adjustments is not precluded.

State ex rel. Utils. Comm'n v. Edmisten, 291 NC at 343, 230 S.E.2d 661.

The majority's order circumvents the material and substantial test here on the theory that other tax changes are at issue. The fact that other tax changes besides state corporate income taxes are at issue does not change the result. In the present case, a strict review of HB 998 indicates that the General Assembly displayed no intent to depart from this basic ratemaking tenet by limiting its mandate to the Commission to modify utility rates as a result of the repeal of the gross receipts tax and the resulting liability under the general franchise tax, and the changes to the sales tax located in Part IV of the bill. See HB 998, Part IV, Section 4.2.(a). The pertinent provisions of Part IV expressly address gas and electric utility taxes and expressly require the Commission to adjust base rates to flow through the required changes. The state corporate income tax changes are located in Part II of HB 998 and address all C Corporation taxpayers. There is no mention of public utilities or any direction to this Commission to take any action whatsoever. The tax changes mandated for flow through to utility customer rates causing the institution of this rulemaking proceeding are located only in Part IV.

Indeed, the majority concedes that the changes to the corporate income tax rate are located in a different Part of HB 998. Because the state corporate income tax changes are located in a different Part of HB 998, with entirely different requirements, the Commission's determination as to how or whether to adjust base rates should not be rolled into and lumped together with the bill's tax changes mandated for base rate changes. No basis exists to speculate, as the majority does, as to the General Assembly's intent. The language is clear and unambiguous. No flow through mandate exists in Part II. Speculation over intent is impermissible. "A long-standing rule of statutory construction declares that a facially clear and unambiguous statute requires no interpretation." Taylor v. City of Lenoir, 129 N.C.App. 174, 179, 497 S.E.2d 715, 719 (1998), citing Peele v. Finch, 284 N.C. 375, 382, 200 S.E.2d 635, 640 (1973). "The primary goal of a statutory construction is to give effect to the legislature's intent." State v. Hart, 287 N.C. 76, 80, 213 S.E.2d 291, 294 (1975). "To that end, a statute clear on its face must be enforced as written." Bowers v. City of High Point, 339 N.C. 413, 419-20, 451 S.E.2d 284, 289 (1994), citing Peele v. Finch, 284 N.C. 375, 382, 200 S.E.2d 635, 640 (1973).

No authority is cited for the proposition that because utility rate changes are required for franchise taxes and gross receipts taxes in one provision of an omnibus tax bill, the longstanding precedent addressing flow through of changes in corporate income tax should be discarded. Gross receipts and franchise taxes bear little resemblance to income taxes, other than the fact that they are taxes. For sales taxes, the utility simply acts as a tax bill collector. The majority cites no authority for its departure from case law and precedent.

General Assembly leaders, apparently believing that changes to gross receipt taxes, franchise taxes and sales taxes will result in lower consumer bills, have written the Commission in a letter dated March 25, 2014 to be assured the changes will be flowed through on July 1, 2014. No mention is made of the already effective changes to state corporate income taxes.

This is not the first case where taxes other than corporate income taxes have been at issue. In Docket No. M-100, Sub 122, besides the corporate income tax rate, a staggered surtax, sales and use tax and regulatory fee were at issue. This did not result in an abandonment of the substantial and material test to determine whether to flow through changes to the corporate income tax rates. It should not do so here. In the present case, besides being in a different Part of the bill, the changes to the state corporate income tax rate in Part II take effect over the course of two years[1] as opposed to the mandated tax changes spelled out in Part IV which take effect on July 1, 2014. See HB 998, Part IV Section 4.1.(f). Therefore, unlike the majority's conclusion that HB 998 should be construed as a package, using historic ratemaking principles of limiting exceptions to the rule, the Commission's decision regarding whether to modify utility

[1] The corporate income tax rate is reduced from 6.9% to 6.0% for taxable years beginning on or after January 1, 2014 and such rate is further reduced to 5.0% effective for taxable years beginning on or after January 1, 2015. See HB 998, Part II, Section 2.1.(c) and 2.2.(c).

rates based upon the decrease in the state corporate income tax rate should be determined separately from the bill's mandated flow through modifications. Standing alone, the changes to the state corporate income tax rate by any legitimate standard are not substantial and material to justify changing rates outside of a general rate case. Moreover, even if the rate impact of all the tax changes could be considered, as some cancel the others out, the impact on rates still is not substantial and material.

Besides failing the material and substantial test, the majority order fails others as well. The proposed changes to rates do not affect the utilities uniformly. Exceptions are made for Toccoa, Frontier, Pineville, CWS NC, Aqua, Piedmont, and Ellerbe, and all water and sewer utilities. Gas LDCs never have been subject to GRT and adjudicative hearings are necessary to resolve issues.

In this proceeding, Dominion disagrees with the Public Staff's representation of the revenue requirement impact of the changes in state corporate income tax rates outlined in HB 998. Specifically, Dominion asserted in its responsive comments that ordering a state income tax rulemaking adjustment is not as straightforward as suggested by the Public Staff and the Attorney General. Dominion maintained that the accumulated deferred income tax (ADIT) impact to rate base resulting from the state corporate income tax change to the electric utilities' tax liability is materially different and more complex than simply directing the GRT and the general franchise tax changes mandated by HB 998, Subsection 4.2. As noted by Dominion, the state corporate income tax change affects the utility's rate base by requiring adjustments to the ADIT component. Dominion argued that, unlike the state corporate income tax rate change, the GRT and the general franchise tax changes do not affect this element of the utilities' cost of service.

Dominion further maintained in its responsive comments that the Public Staff does not explain why it has chosen to make incomplete adjustments in the development of its position on the revenue requirement associated with the reduction in the state corporate income tax rate. Dominion stated that it specifically disagrees with the Public Staff's Table 1 characterization of the revenue requirement effects of HB 998 on each of the electric utilities for tax year 2015. Dominion asserted that the Company's calculation of the revenue requirement in Attachment 1 to Dominion's initial comments includes an offset to the change in revenue requirement associated with the reduction in the state corporate income tax rate for the effect of the elimination of the liability for ADIT from the cost of service and the resulting increase in federal income taxes.

In Dominion's opinion, insufficient information exists in the current record for the Commission to implement the Public Staff's state corporate income tax and excess deferred income tax recommendations. Dominion argued that it is clear that additional information and evidence, and possibly additional adjudicative proceedings, would be required to reconcile Dominion's detailed analysis of the state corporate income tax change with the Public Staff's comments. Dominion stated that, moreover, given the complexity of such an undertaking, it would no longer be a ministerial adjustment to

rates and basic fairness would dictate that Dominion should be permitted to broaden the scope of such a proceeding beyond such single-issue.

Based on these specific comments provided by Dominion, adjudicative-type facts are clearly in dispute in this proceeding and such dispute may necessitate a trial-type hearing for one or more individual public utilities. Based on the Commission's October 23, 1991 Order Denying Application for Rate Adjustment and/or Institution of a Rulemaking Investigation in Docket No. M-100, Sub 122, the Commission's authority to direct single-issue ratemaking action through a rulemaking versus through a general rate case proceeding is limited, among other criteria, to where no adjudicative-type facts are in dispute as to require a trial-type hearing for each individual utility. This proceeding clearly does not meet this criterion and trial-type hearings may very well be required to reconcile the numbers presented by Dominion and the numbers presented by the Public Staff.

The majority rejects the application of the Commission's strict standards for adjusting rates outside of a general rate case to the state corporate income tax changes, stating that the Commission does not need to apply the "substantial and material" test separately to this change because in the present case a "rulemaking has already been initiated to consider several tax changes." The majority's rationale does little to justify its result-oriented decision. It suggests that because the Commission initiated a rulemaking rather than simply declining to do so, this somehow foreordained the result. I, as the Chairman, initiated the rulemaking. Rest assured my intent was not to then go through the motions, waste the parties' time in seeking comments only to say the outcome had already been determined because the rulemaking proceeding had been instituted. Likewise, the majority supports its conclusion by arguing that the Chairman's order making the collection of corporate state income tax under the pre-changed rate provisional somehow foreordained a result. This was certainly not my intent. The Chairman order, as obvious from this dissent, was not intended to limit the Commission's ability to decline to flow through the income tax reduction to rates or to bind the full Commission. The Chairman's order preserved options; it did not eliminate them. Here, like the majority's speculation as to the Legislature's intent, the majority's speculation as to the Chairman's intent is wrong.

The majority cites the caption of HB 998 as implying that this expresses a legislative intent to pass through a reduction in the corporate state income tax rate by utilities to their customers. As addressed above, speculation as to the legislature's intent is impermissible. Moreover, this argument lacks logic. No question exists that the General Assembly intended to reduce the level of corporate income taxes assessed to the taxpayers that pay them. However, the legislature said nothing about how corporate taxpayers should price their products and services upon receiving a tax break. Most corporate tax payers are not regulated, so there is no way they can be forced to price their products or services to flow through a tax decrease. In this respect the legislature's intent as expressed by its clear pronouncements differs strikingly with respect to its changes to utility franchise and gross receipt taxes.

The majority asserts no party has presented evidence that not reducing rates in this rulemaking would cause the utilities' rates to exceed returns authorized in the most recent rate case. This assertion graphically demonstrates how misguided the majority opinion is. First, rates may be adjusted in rulemaking dockets only where evidentiary inquiry is unnecessary. Second, the only way to demonstrate that single-issue ratemaking will not affect earnings is to conduct a general rate case. The premise of single-issue ratemaking is that it is appropriate because it will not affect the overall rate of return. See G.S. 62-137. The party resisting single-item rate adjustments bears no responsibility to show this. Rather, the shoe is on the other foot. Failure to demonstrate the absence of an adjustment to earnings should result in disapproval of the change, not vice versa. Moreover, in the seminal case on this issue, Nantahala, the Company sought to resist a rate reduction to flow through a decrease in federal income tax rates because its earnings were far below a reasonable return. The Court determined this evidence was inappropriate to consider in a rulemaking case. Nantahala, 326 N.C. at 194, 388 S.E.2d at 120.

Further, the majority, in this proceeding, has no knowledge or evidence to determine if other expenses in the cost of service of each utility have risen since each utility's last general rate case that may offset any reduction of cost of service caused by the state corporate income tax change. This is the purpose of a general rate case, to consider all of the possible changes to cost of service, both increases and decreases, in their totality. No party to this proceeding has presented evidence that, were the Commission not to address the state corporate income tax change through the current rulemaking, the resulting rates would be unreasonable or cause the utilities to exceed the returns authorized in each utility's most recent rate case. See Southwestern Pub. Serv. Co. v. FERC, 952 F.2d 555, 560 (D.C. Cir. 1992). Any argument or concern that a public utility may earn in excess of its authorized rate of return based upon the state corporate income tax changes is unfounded. In fact, using Duke Energy Carolinas (DEC) as an example, the existing economic conditions make it extremely difficult for utilities to earn their authorized return. As recently as October 23, 2013, the Commission addressed these factors. See Order on Remand. Docket No. E-7, Sub 989, pp. 29-31 (Oct. 23, 2013).

Due to the economic recession, recent experience shows a substantial slowdown in revenue growth. Moreover, DEC is in a significant construction mode – adding new coal and gas-fired plants, retrofitting nuclear units, and investing in transmission and distribution facilities. Much of this investment is responsive to environmental regulatory requirements (as to which the Company has no choice but to comply). New gas and coal units will replace older, less efficient, higher polluting coal units. These units do little to meet new growth.

When costs and expenses grow at a faster pace than revenues during the period when rates will be in effect, the utility will experience a decline in its realized rate of return on investment. DEC's 2009 rate case, Docket No. E-7, Sub 909, was based on a 2008 test year. In that case, for ratemaking purposes, the test-year rate of return on investment under rates then in effect was 6.44%, and rate of return on equity was

7.00%. The Commission approved a 10.7% rate of return on equity. In the subsequent case (Sub 989), for ratemaking purposes, the test-year rate of return on investment was 6.4% and rate of return on equity was 7.29%, well below the 10.7%.

DEC's 2012 general rate case (Sub 1026) was based on a June 2012 test year and submitted to recover added costs and expenses incurred subsequent to the 2010 test year in Sub 989. The stipulation entered between the Public Staff and DEC (and approved by Commission order dated September 24, 2013) showed that, for ratemaking purposes, the rate of return on investment under rates then in effect was only 6.68%, and the earned or realized rate of return on equity was 7.94%, a substantial decline from the authorized 10.5% rate of return on equity.

The majority rejects Dominion's arguments that corporate income tax reductions should not be flowed through to rates because the tax changes, including the franchise and gross receipt taxes, do not affect all utilities uniformly as required by Nantahala on the proposition that the dissimilarities are restricted to franchise, sales, and gross receipt taxes. This is puzzling because the only way the majority can circumvent the required substantial and material test is to claim that more tax changes are at issue in this docket than state corporate income taxes. If the disregard of the substantial and material test is to be justified because gross receipts, franchise and sales taxes are at issue, like M-100, Sub 122, then the fact that these taxes are at issue must be regarded in applying the "similarly situated test."

In the instant case, as all of the parties, except the majority, have conceded, the magnitude of the HB 998 changes to state corporate income taxes is on a much smaller scale than those of the Tax Reform Act of 1986. Neither the Public Staff nor the Attorney General argues that the change is substantial or material. Pursuant to HB 998, the corporate income tax rate decreased from 6.9% to 6.0% for taxable years beginning on or after January 1, 2014 and then decreases again to 5.0% effective for taxable years beginning on or after January 1, 2015, making the total percentage point reduction over two years 1.9%. The majority attempts to distinguish this small percentage point reduction of 1.9% from the .75% increase which was found to be insubstantial in Docket No. M-100, Sub 122, by stating the current percentage change is more than double the .75%. This distinction is facially feckless. This is a completely misleading way to represent the impact of any change on the revenue requirement. A dime is 200% of a nickel, but on a $100 monthly bill, based on years of precedent on this issue, $0.10 is not material and substantial. The percentage point change of 1.9% in state corporate income taxes in the present case, when measured by its impact on consumer bills, is far more analogous to the .75% increase that the Commission found not material in Docket No. M-100, Sub 122, the .85% decrease in the state corporate income tax rate in 1996 which the Commission did not find significant enough to order rate reductions, and the 2 percentage points reduction in the federal corporate income tax rate in 1978 where again the Commission took no action versus the significant and large federal rate reduction of 12 percentage points in TRA-86 that met the clearly substantial and material test.

The majority engages in some mathematical calculations on page 28 of its order. It asserts that a 27.5% change, by combining the two step decrease into one, in state corporate income tax rate from 6.9% to 5.0% exceeds "the percentage change in rate (26.1%) effectuated by the 1986 Tax Reform Act." While math is not my strong suit, the validity of these number comparisons escapes me. When the federal corporate tax rate dropped from 46% to 34%, its effect on utility cost of service was many multiples of the effect of a drop in the state rate from 6.9% to 5.0%. If the utility's taxable income is $5,000,000, the decrease in the tax rate from 46% to 34% reduces tax expense from $2,300,000 to $1,700,000, a difference of $600,000, or 26%. If the tax rate on the same income drops from 6.9% to 5%, tax expenses drops from $345,000 to $250,000, a difference of $95,000 or 27.5%. However, from the ratepayer's perspective, $600,000 is more than 6 times $95,000. And this fails to take into account the fact that state taxes are deductible for federal tax purposes, so the gap widens. The majority's math completely undercuts the validity of its conclusions.

On the same page the majority asserts that a $0.25 per month reduction on a customer's bill is "not insignificant." If by this the majority means that a $0.25 per month change meets the substantial and material test, whether up or down, the majority has discarded the test and from now on any change in a corporate income tax rate, up or down, should be flowed through to rates. To this I cannot and do not agree.

The parties provided further support that the changes to the state corporate income tax rate here do not meet the clearly substantial and material test. DEC/DEP stated that the benefit to customers of the HB 998 changes to the corporate state income tax rate is small, and would amount to approximately $0.25 per month for DEC customers and $0.15 per month for DEP customers based on a typical residential customer's monthly bill. Dominion noted that each staggered state corporate income tax rate reduction would approximate a 0.1% change to Dominion's cost of service. PSNC Energy noted that the reduction in expenses associated with HB 998's enactment, disregarding the increased expense associated with taxes other than income taxes, would amount to approximately 0.12% of PSNC Energy's test-year revenues. As comparison, in Docket No. M-100, Sub 122, in support of its conclusion that the .75% change was insignificant, the Commission found that the .75% change would only amount to 0.53% of the Company's test year revenues which is larger than PSNC's 0.12% amount in the instant case.

Based on these numbers, the impact of the change in the corporate state income tax rate on the rates of public utilities clearly is not substantial and material, and no amount of "funny math" can demonstrate otherwise. Therefore, the change does not meet the test to allow for a single-issue ratemaking adjustment to rates in a rulemaking proceeding. The more appropriate proceeding to consider this change is in a general rate case where all of the components of cost of service are considered pursuant to G.S. 62-133. In fact, the HB 998 corporate state income tax changes have been reflected in the rates of Piedmont, Aqua, and CWSNC within the context of a general rate case proceeding, simply due to the fact that each of these utilities had a general rate case proceeding pending between the initiation of this proceeding (October 2013)

and the date of the Commission's decision in this docket. Under the majority's decision, the other utilities that simply due to unfortunate timing did not have a pending rate case proceeding open, must make the rate changes associated with the decrease in the state corporate income tax rate as a single-issue adjustment in a rulemaking proceeding without consideration of any of the utilities' other costs of service.

In conclusion, the Commission should only engage in single-issue ratemaking in the context of a rulemaking when a change is clearly substantial and material enough that to not address the change would result in unreasonable rates. No party to this proceeding has presented evidence that failure to address the state corporate income tax change in this proceeding would result in higher returns than those approved by the Commission. Sufficient justification has not been provided to treat this solitary ratemaking element differently from other elements. The fact that there is an open rulemaking is irrelevant to whether the Commission should make an exception to the general rule against single-issue ratemaking. Thus, immediately adjusting the rates of the utilities to reflect the HB 998 changes to the state corporate income tax rate through rulemaking is inappropriate. The change in the state corporate income tax rate is most properly implemented in the context of each utility's next general rate case where all items of the cost of service are under comprehensive review.

For the above-stated reasons, I dissent from this portion of the Commission's ruling.

/s/ Edward S. Finley, Jr.
Edward S. Finley, Jr.