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APPLICATION OF CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC FOR AUTHORITY TO CHANGE RATES	§ § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

PUBLIC

WORKPAPERS

TO THE

DIRECT TESTIMONY

OF

JUNE M. DIVELY, CPA, CFF, CRFAC, DABFA

ON BEHALF OF THE

OFFICE OF PUBLIC UTILITY COUNSEL

JUNE 7, 2019

445

DOCKET NO. 45747

APPLICATION OF CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC FOR APPROVAL TO AMEND ITS DISTRIBUTION COST RECOVERY FACTOR PURSUANT TO 16 TEX ADMIN. CODE §25.243 AND TO RECONCILE DOCKET NO. 44572 REVENUES	§ § § § § § § §	PUBLIC UTILITY COMMISSION OF TEXAS

DIRECT TESTIMONY OF

MARY A. KIRK

FOR

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC

April 04, 2016

> period of the calendar year in which the payment is made and the report is due, regardless of when the accounting accrual for the cost occurs."

At page 19, the PFD notes,

> "The evidence further demonstrates that it is not unusual for a franchise to have a period for the tax base that is different than the service period, as is the case with SFT[52]."

The privilege year/service period decision in Docket No. 38339 is critical when calculating the correct incremental margin tax number in this case. As the Company explained in Docket No. 38339, its Texas margin tax payment on May 15 of any given year relates to the service provided during that calendar year (*i.e.*, the May 15, 2009 test year payment in Docket No. 38339 relates to the 2009 privilege or service period). The ***tax base*** is the taxable entity's margin on the year prior to the service period year. Therefore, the payment on May 15 of any given year relates to the tax base from the prior calendar year (*i.e.*, in Docket No. 38339, the May 15, 2009 test year payment relates to 2009 service, but is based on the tax base from 2008).

In Docket No. 38339, the Commission approved this methodology for calculating Texas margin tax and, thus, Company's current rates were set using this formula.[7]

Q. APPLYING THE DOCKET NO. 38339 METHODOLOGY, WHAT IS THE CORRECT SERVICE PERIOD AND TAX BASE TO USE IN THE DCRF TEXAS MARGIN TAX CALCULATION?

A. As discussed previously, the rule specifically states to use the methodology from the last comprehensive base-rate proceeding. The application of the Docket No.

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[7] Commission Docket No. 38339, Order on Rehearing, June 23, 2011, FOF 161-165.

38339 methodology results in the use of a 2015 service period based on the tax base from 2014.

Q. WHAT IS THE CORRECT TAX RATE FOR THIS DCRF PROCEEDING CONSIDERING THE PRIVILEGE YEAR AND TAX BASE AS NOTED ABOVE?

A. 16 TAC §25.243(d), requires the use of the current tax rate. The current tax rate for the 2015 payment is 0.95%. The calculation of the Texas margin tax uses the tax base margin from the prior year (2014) to calculate the amount due in the service period (2015). The tax rate applicable to the service period is the correct tax rate to be used in the DCRF filing. Thus for the 2015 service period, the applicable tax rate was 0.95%.

Q. LEGISLATION WAS PASSED IN 2015 THAT ADJUSTED THE TAX RATE FOR THE MARGIN TAX CALCULATION. SHOULD THE MARGIN TAX CALCULATION BE ADJUSTED TO REFLECT THE NEW LEGISLATION?

A. No. House Bill No. 32 of the 2015 Texas Legislature set the rate of franchise tax at 0.75% for returns filed *after* January 1, 2016. This change in the tax rate is for a future service period, not the service period that is applicable to this DCRF filing. Consequently, this tax rate cannot and should not be used to calculate the Texas margin tax because doing so will result in a mismatch between the actual amount that will be owed and that recovered in the DCRF rates. The Company acknowledges that under current law the 0.75% tax rate would be used in its DCRF application filed in 2017 for the 2016 service year.

Q. WAS THE TEMPORARY PERMISSIVE ALTERNATIVE RATE FOR TEXAS MARGIN TAX REPORTS FILED IN 2015 USED BY THE COMPANY IN ITS MARGIN TAX CALCULATION?

A. Yes. The temporary permissive rate is the rate applicable in the year the Texas margin tax is paid (*e.g.*, the service period). The payment made in 2015 was at the temporary permissive rate of 0.95% as authorized under Chapter 171 of the Tax Code[8] and House Bill 500 of the 2013 Texas Legislature.[9]

Q. WHAT IS THE CORRECT TOTAL REVENUE FOR THIS DCRF PROCEEDING CONSIDERING THE PRIVILEGE YEAR AND TAX BASE AS NOTED ABOVE?

A. 16 TAC §25.243(d), requires the use of the methodology from the last comprehensive base-rate proceeding. The methodology from the Company's last base-rate proceeding requires that the total revenues be used in the calculation of the DCRF Margin Tax. The calculation of the Texas margin tax uses the tax base margin from the prior year (2014) to calculate the amount due in the service period (2015). The total revenue from the tax base year of 2014 is the appropriate total revenue to use in this DCRF filing. Thus for the 2015 service period, the applicable total revenue is $2.264 billion as shown on WP/Schedule E-2.2/1.

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[8] Texas Tax Code Title 2 Subtitle F Chapter 171 Subchapter A §171.0023.
[9] Texas Legislature by Acts 213, Leg., R.S., Ch. 1232 (H.B. 500), Sec 2

Q. USING THE CALCULATION AS OUTLINED BY 16 TAC §25.243(d), WHAT ARE THE CORRECT AMOUNTS FOR TEXAS MARGIN TAX TAKING INTO CONSIDERATION THE CURRENT METHODOLOGY FROM DOCKET NO. 38339 (SERVICE PERIOD AND TAX BASE) AND CURRENT RATE AS NOTED ABOVE?

A. As shown in W/P E-2.2/1, the Company's Texas Margin Tax reflects the methodology approved in Docket No. 38339. The correct current tax margin rate used for 2015 service year is 0.95%, which is the tax rate for 2014 revenues when margin tax payment is made in 2015. The correct total revenue used for the 2015 service year is $2.264 billion, which is the tax base for 2014. An apportionment factor is applied to total revenues in the Margin Tax calculation to eliminate any revenues not subject to Texas Margin Tax. The current tax rate for the 2015 service year of 0.95% is then applied to calculate the Texas Margin Tax before adjustments. Adjustments are then made to remove any tax related to capital not related to distribution invested capital as stated in 16 TAC §25.243(b)(3). As shown on WP/Schedule E-2.2/1, the Texas Margin Tax in 2015 related to distribution invested capital is $14,396,368, or an incremental increase compared to Docket No. 38339 of $3,037,718.

Q. HOW DOES THE COMPANY ACCOUNT FOR TEXAS MARGIN TAX ON ITS BOOKS AND RECORDS?

A. The Company carries a regulatory asset reflecting the one year lag between the taxable year and the payment year. This accounting practice and regulatory asset was approved as filed in Docket No. 38339 and dates back to Docket No. 29526[10].

Q. WOULD THERE BE AN ACCOUNTING IMPACT TO THE COMPANY IF A DIFFERENT METHODOLOGY FROM THAT USED IN DOCKET NO. 38339 WAS USED TO CALCULATE TEXAS MARGIN TAX IN THIS DCRF FILING?

A. Yes. Because the Company carries a regulatory asset reflecting the one year lag between the taxable year and the payment year, any change to this approved methodology would strand this regulatory asset. This is contrary to the intent of the Commission given the approval of the deferral in Docket No. 29526, Findings of Fact 227-237. *See* Exhibit MAK-04 for illustrative purposes.

Q. PLEASE SUMMARIZE THE COMPANY'S POSITION WITH REGARD TO THE TEXAS MARGIN TAX CALCULATION?

A. The Texas margin tax should be calculated in accordance with the DCRF Statues, which support the use of total revenues. With regard to the methodology used to calculate Texas Margin Tax, the Commission's Rule clearly requires the use of the same methodology approved in Docket No. 38339 – that methodology dictates that ***tax base*** is the taxable entity's margin on the year prior to the service period year.

[10] *Application of CenterPoint Energy Houston Electric LLC., Texas Genco, LP, and Reliant Energy Retail Services, LLC to Determine Stranded Costs and Other Balances*, Order on Rehearing, December 17, 2004.

SOAH DOCKET NO. 473-16-3581
PUC DOCKET NO. 45747

APPLICATION OF CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC TO AMEND ITS DISTRIBUTION COST RECOVERY FACTOR AND TO RECONCILE DOCKET NO. 44572 REVENUES	§ § § § § § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

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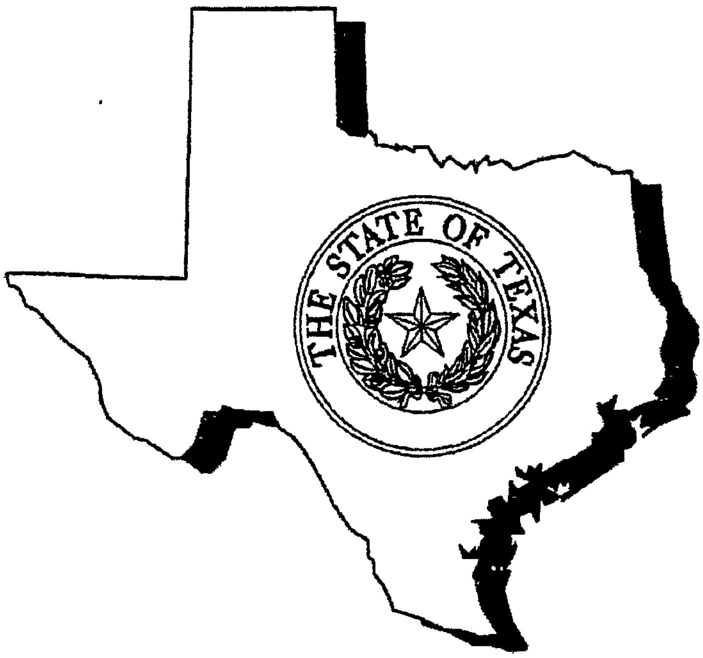

DIRECT TESTIMONY OF

RUTH STARK

RATE REGULATION DIVISION

PUBLIC UTILITY COMMISSION OF TEXAS

JUNE 3, 2016

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Company's request. Staff witness Grant Gervais utilizes this revenue requirement to develop Staff's revenue requirement adjusted for load growth.

Q. Are you sponsoring any of the adjustments to CenterPoint's requested distribution revenue requirement?

A. Yes. Based on my review of 16 TAC § 25.243, the Company's application and responses to RFIs, I am proposing an adjustment to the Texas gross margins tax expense. I also propose adjustments to distribution invested capital and depreciation expense, as well as an adjustment to federal income taxes that are an attendant impact of the adjustment to invested capital and its associated return.

V. ADJUSTMENTS TO CENTERPOINT'S REQUEST

A. Taxes Other Than Income Taxes – Texas Margins Tax

Q. Please explain CenterPoint's request related to the Texas margins tax.

A. According to Schedule E-2, the Company is requesting an increase of $3,037,718 to the $11,358,650 in Texas margins tax approved in Docket No. 38339 for a total requested margins tax amount of $14,396,368. According to CenterPoint witness Mary Kirk, the Company's request is based on 16 TAC § 25.243(d) which requires other taxes to be calculated using current tax rates and the methodology from its last comprehensive base rate case.[3] Ms. Kirk explains that CenterPoint uses the cost of goods sold ("COGS") method.[4] In CenterPoint's last base rate case, the amount included in its calendar year 2009 test year revenue requirement for the Texas margins tax using the COGS method

[3] Direct Testimony of Mary Kirk at 23:7-18.

was based on a tax base of 2008 revenues for the 2009 privilege or service period. As explained by the testimony of Ms. Kirk, "in Docket No. 38339, the May 15, 2009 test year payment related to 2009 service, but is based on the tax base from 2008."[5]

Q. Please continue.

A. CenterPoint's Ms. Kirk asserts that this means that the Texas margins tax for purposes of this DCRF proceeding must use the amount of the tax paid during calendar year 2015 that was based on revenues received in calendar year 2014. Ms. Kirk goes on to say that not only must the Commission use 2014 revenues to determine the Texas margins tax, but that it must also use the tax rate of .95% because "the current tax rate for the 2015 payment is 0.95%."[6] Finally, Ms. Kirk testifies that total revenues must be used to determine the DCRF because that is consistent with the methodology used in Docket No. 38339[7].

Q. Do you agree with CenterPoint's interpretation of 16 TAC § 243(d)?

A. No, I do not for several reasons. First, 16 TAC § 243(d) defines OT_C as Current Other Taxes as related to Current Net Distribution Invested Capital, calculated using current tax rates and the methodology from the last comprehensive base-rate proceeding. The testimony of Ms. Kirk describes the methodology used in its last comprehensive base-rate case:

> **Q. WHAT <u>METHOD</u> DOES THE COMPANY UTILIZE FOR THE MARGIN TAX?**

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[4] Kirk at 12:16.
[5] Kirk at 24:14-16.
[6] Kirk at 25: 6-7.
[7] Kirk at 14: 3-5.

> A. Under the Texas Margin Tax statutes, an entity is allowed to reduce its taxable revenues by the greater of: (1) its allowable Cost of Goods Sold ("COGS") deduction under Texas Margin Tax statutes; (2) certain employee compensation; or (3) 30% of total revenues. The Company utilizes the COGS **<u>method</u>**.
>
> **Q. WHY DID THE COMPANY CHOOSE THE COGS <u>METHODOLOGY</u> IN THE CALCULATION OF ITS MARGIN TAX?**
>
> A. Under the Texas Margin Tax statutes, the Company is required to be included in the consolidated Texas Margin Tax return with its parent and other member companies of the affiliated group. Each member company included in the consolidated group is required to use the same **<u>method</u>** of reducing its taxable revenues. CNP, the parent, elected to reduce its consolidated taxable revenues by COGS. This annual election was the most beneficial **<u>method</u>** for the CNP affiliated group and was, therefore, applied to all companies in the affiliated group, as required by statute.[8] (emphasis added)

Thus, the Cost of Goods Sold method is the methodology used by the Company in its last rate case and I concur that that is the method that should be used in this proceeding. I do not agree that the Company has used the correct taxable margin (revenues) in applying that method in this case nor do I agree that it has used the current tax rate as required by the rule.

Q. Please explain.

A. Ms. Kirk maintains that because the Commission used the amount of Texas Margin tax paid by the Company during the test year of its last rate case (calendar year 2009) which was based on revenues from the previous year (calendar year 2008), that the Commission must now use revenues from calendar year 2014 to determine the amount of margin tax included in the DCRF rates determined in this proceeding for rates to be collected starting in late 2016. CenterPoint filed a DCRF case in April of 2015 in order to update its

[8] Kirk at 12:11-23 and 13:1-3.

distribution investment for the period 2010 through the end of 2014. The present proceeding, filed in April of 2016, requests inclusion of distribution investment for the period January 1, 2015 through December 31, 2015. As noted above, TAC § 243(d) defines OT_C as Current Other Taxes as **related to Current Net Distribution Invested Capital.** It is illogical that a tax calculated using revenues from 2014 can be deemed **related** to the distribution invested capital added during the subsequent year, calendar year 2015, which is the subject of this proceeding. The DCRF proceeding is not a comprehensive base-rate proceeding and does not serve the same purpose as a full rate case. The purpose of the DCRF proceeding is to avoid having to file a full rate case with a full test year cost of service in order for the Company to be able to begin recovering incremental distribution investment. It, therefore, makes sense that using the same methodology to determine Texas margin tax from the last comprehensive base-rate proceeding (COGS) applied to a tax base (revenues) **related to Current Net Distribution Invested Capital** at the current tax rate is the appropriate manner to determine the margin tax for DCRF purposes.

Q. You indicated that there are several reasons you disagree with the Company's interpretation of 16 TAC § 243(d). What are the other reasons for your disagreement?

A. As noted above, CenterPoint is interpreting "current tax rate" to mean "the current tax rate for the 2015 payment" which is a distortion the meaning of "current tax rate." According to the Oxford dictionary, the definition of current is "belonging to the present time; happening or **being used or done now**." Merriam-Webster defines "current" in a similar fashion, "presently elapsing; occurring in or existing at the present time; most recent." According to the Texas Comptroller of Public Accounts, the rate applicable to CenterPoint for report years 2016 and 2017 is 0.75%.[9] This is the rate **being used now** and the rate that will be applied to the revenues collected under the DCRF approved in this proceeding. As Commissioner Anderson noted in his memo dated May 3, 2016 related to the Texas margins tax rate that should be used in determining Entergy Texas Inc.'s TCRF, "application of the reduced tax rate is appropriate because the TCRF rule contemplates use of the tax rates that apply during the period when revenues from the TCRF will be recovered."[10]

Q. Commissioner Anderson's memo relates to a different rule, 16 TAC § 25.239. Why are you using it as support for use of the 0.75% current tax rate in this proceeding?

A. I am relying on his reasoning from application of that rule because the DCRF rule, 16 TAC § 25.243(d) is even clearer and more proscriptive in its language than the TCRF rule that the current rate (the rate in effect when the DCRF revenues are collected) is to be used. The rate of 0.75% is the current rate that will be in effect when the revenues from CenterPoint's DCRF will be recovered.

Q. Ms. Kirk indicates, "The Company acknowledges that under current law, the .75% tax rate would be used in its DCRF application filed in 2017 for the 2016 service year."[11] Do you have any comments on this assertion?

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[9] Texas Comptroller of Public Accounts: http://www.cpa.texas.gov/taxinfo/franchise/rates.html. Please note that the term "Texas Franchise Tax" is used interchangeably with the term "Texas Margin Tax."

[10] *Application of Entergy Texas, Inc. for Approval of a Transmission Cost Recovery Factor,* Docket No. 45084, May 3, 2016 Memo of Commissioner Anderson.

[11] Kirk at 25:21-23.

A. Yes. The Company may choose not to file or may be prohibited from filing a DCRF in 2017 due to excess earnings. Given that the Commission may deny the use of the DCRF mechanism in future years, it makes no sense that it would allow a utility to collect an amount of margin tax in the DCRF that would contribute to excess earnings. Additionally, two Commissioners have recently expressed concerns about utilities collecting amounts for taxes in rates that are in excess of what the utility is expected to pay.[12]

Q. What is your recommendation for the appropriate amount of Texas margin tax to include in this proceeding?

A. The appropriate amount of Texas margin tax is $12,236,219 which represents a decrease of $2,160,149 to the Company's request of $14,396,368. My calculation is shown on Attachment RS-3.

Q. Please explain how you arrived at your recommended Texas margin tax.

A. As noted above, the amount of current other taxes to be included in the DCRF is the amount **related to the current net distribution** invested capital using **current tax rates** and the methodology from the last comprehensive base-rate proceeding. The revenues collected in 2015 are more appropriate to use in this proceeding because they are more closely related to the current net distribution invested capital at December 31, 2015 than are the 2014 revenues. A review of the Company's estimated Texas margin tax due in calendar year 2016 based on 2015 revenues shows that of the $18,191,355 tax accrued on

[12] *Joint Report and Application of Oncor Electric Delivery Company, LLC, Ovation Acquisition I, LLC, Ovation Acquisition II, LLC, and Shary Holdings, LLC for Regulatory Approvals Pursuant to PURA §§ 14.101, 37.154, 39.262(l)-(m) and 39.915*, Docket No, 45188 (Mar. 24, 2016).

its books at the end of 2015, the total revenue amount of $2,365,217,619 used in the calculation ties to the earnings monitoring report submitted in this proceeding.[13] The Company then adds other revenues and book/tax adjustments to that amount in reaching the total taxable margin amount of $2,433,852,513 prior to application of the **0.75% current tax rate.** I used the same $2,433,852,513 taxable margin amount that the Company used in accruing its December 31, 2015 margin tax expense. As explained previously, the current Texas margin tax rate is 0.75% and is the rate that is required to be used pursuant to 16 TAC § 25.243. My calculation follows the same methodology used by CenterPoint with the exception of the revenue amount and the tax rate applied.

Q. How do you address CenterPoint's contention that using a method that is different from its requested method will cause an accounting impact to the Company?

A. Ms. Kirk testifies,

> "Because the Company carries a regulatory asset reflecting the one year lag between the taxable year and the payment year, any change to this approved methodology would strand this regulatory asset. This is contrary to the intent of the Commission given the approval of the deferral in Docket No. 29526, Findings of Fact 227-237."[14]

First, I would note that it was the Company's choice to account for the margin tax in the manner that it does and that it is the only Texas TDU that I am aware of that carries a regulatory asset on its books related to the tax. Second, I have reviewed the findings of fact from Docket No. 29526[15] noted above and believe that not only did the Commission

[13] CenterPoint's Response to Staff's Second Request for Information, Question Staff 2-3, Attachment RS-4.

[14] Kirk at 28:7-11.

[15] *Application of CenterPoint Energy Houston Electric LLC, Reliant Energy Retail Services, LLC and Texas Genco, LP to Determine Stranded Costs and Other Balances Pursuant to PURA § 39.262,* Docket No. 29526, Findings of Fact Nos. 227-237 (Dec. 17, 2004).

not "approve" any deferrals for the regulated CenterPoint TDU going forward in that proceeding, I believe that it is presumptuous and incorrect to testify as to the Commission's intent based on the discussion in the order and language of the cited findings of fact. A review of the Order on Rehearing in that proceeding reveals that the Commission was approving stranded cost recovery of a margin tax deferred debit related to the generation portion of the Company's operations recorded during regulation that it would not be able to recover post-regulation. The Commission noted that "the state franchise taxes are properly considered a deferred debit related to the discontinuance of the application of SFAS No. 71."[16] The Findings of Fact cited by Ms. Kirk discuss deferred debits in the context of discontinuance of SFAS 71 and stranded cost recovery pursuant to PURA § 39.251(7). The Findings of Fact discuss how the joint applicants' predecessor accounted for state franchise taxes as a deferred debit **prior to deregulation.** The Findings of Fact do not address how the margin tax is to be accounted for by CenterPoint going forward, as Ms. Kirk suggests.

Q. Do you have any other comments regarding Ms. Kirk's contention that the Company will have a stranded regulatory asset related to the margin tax if the tax in this proceeding is not determined consistent with its request?

A. Yes. The Company's Texas margin tax calculation in this proceeding appears at WP/Schedule E-2.2/1 and indicates that it is calculating its request based on the $21.5 million regulatory asset it recorded at the end of 2014. (See Attachment RS-5 which is a page from the Company's 2014 FERC Form 1 reflecting this regulatory asset). A review of CenterPoint's FERC Form 1 for the year ending December 31, 2015 as well as the

[16] Docket No. 29526 at 46-67.

earnings monitoring report included in its application in this proceeding shows that the Company currently has an amount of deferred Texas margin tax on its books of only \$18.2 million.[17] CenterPoint has already reduced the amount of Texas margin tax recorded on its books, yet alleges that it will have stranded costs if not allowed to recover the \$21.5 million amount on its books **at the end of 2014**. Additionally, as seen on Attachment RS-8 (a compilation of Texas margin tax amounts reported on CenterPoint's FERC Form 1s for the period 2002 through 2015), it is not unusual for the Company to make adjustments to the margin tax amounts carried on its books.

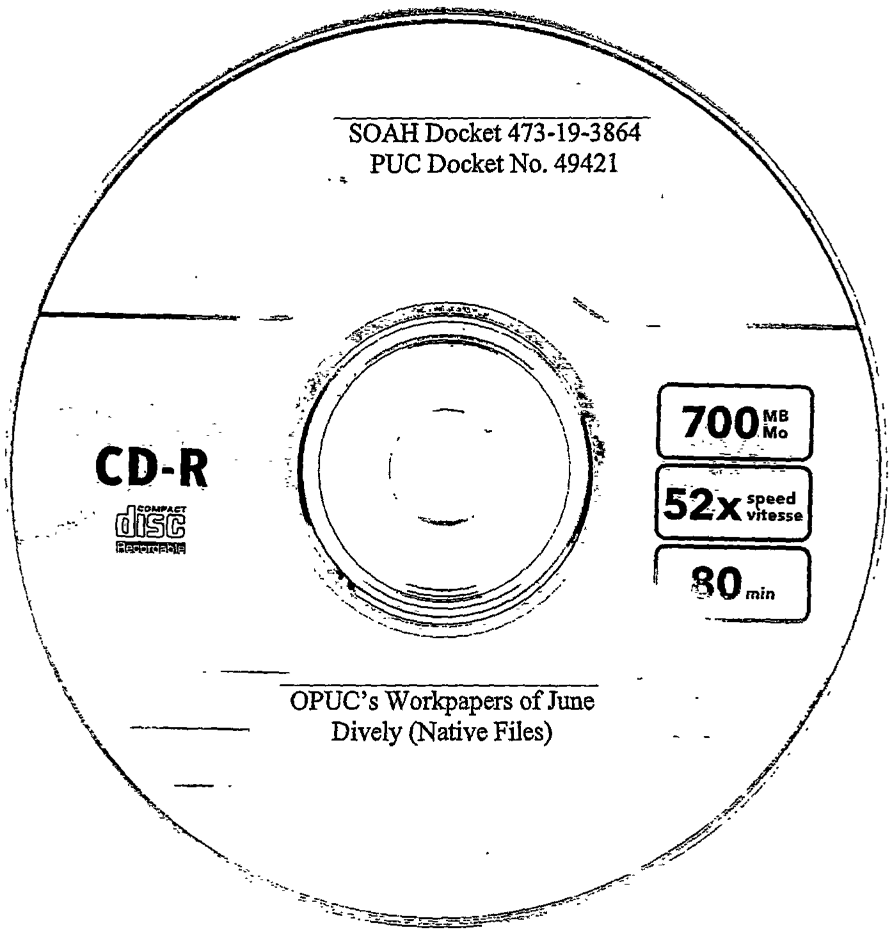
Q. Do you have an alternative recommendation should the Commission determine that the 2014 revenues should be used to determine the Texas margins tax?

A. Yes. If the Commission determines that it is appropriate to use the 2014 revenues to determine the amount of Texas margin tax related to rates going into effect at the end of 2016, the rule (16 TAC § 25.243) still requires the use of the current tax rate in the calculation. The result of using the 2014 revenues and the 0.75% current tax rate is shown on Attachment RS-9 and results in a total margin tax of \$11,393,254 which is a decrease of \$3,003,114 to the Company's request.

B. Distribution Invested Capital and Depreciation Expense

Q. Do you have a recommendation regarding CenterPoint's requested distribution invested capital and depreciation expense?

[17] CenterPoint's 2015 FERC Form 1, Other Regulatory Assets at 232 and CenterPoint's 2015 Earnings Monitoring Report, Supplemental Schedule III-1. Please see Attachments RS-6 and RS-7, respectively.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