



**Feature Article:**  
**Hooray for Refunds!  
But, When?**  
**Tax Cuts and Jobs Act of 2017  
Impacts on Utilities**



With the passage of the Tax Cuts and Jobs Act of 2017 (TCJA), utility service companies and their respective regulators have scrambled to determine the best means to incorporate the new corporate tax rate of 21% into the current rates charged to customers, as well as what methodologies best preserve refunds that will be owed until rates are changed to reflect the new tax rate. Unlike non-regulated corporations, regulated utilities cannot easily change tariffed rates without approval by state or federal regulators. Therefore, state public utility commissions have started the first wave of required utility company filings to address rate reduction proposals.

**TCJA RATEPAYER IMPACTS**

- 1. MUST INCLUDE A 21% TAX RATE IN THE NEXT RATE CHANGE**
- 2. REFUND THE DIFFERENCE BETWEEN THE 35% TAX RATE AND THE 21% TAX RATE THAT WILL BE COLLECTED FROM RATEPAYERS FROM JANUARY 1, 2018 UNTIL RATES ARE CHANGED**
- 3. REFUND THE EXCESS DEFERRED INCOME TAXES THAT WERE ORIGINALLY PAID BY RATEPAYERS AT THE 35% CORPORATE INCOME TAX RATE OVER SOME PERIOD ORDERED BY REGULATORS**

The most important ratepayer impacts of the TCJA are that a utility company (1) must include a 21% tax rate in the next rate change; (2) refund the difference between the 35% tax rate and the 21% tax rate that will be collected from ratepayers from January 1, 2018 until rates are changed; and (3) refund the excess deferred income taxes (EDIT) that were originally paid by ratepayers at the 35% corporate income tax rate over some period ordered by regulators. It is this EDIT refund period that will likely be the most contentious component of the ratepayer refund.

So, how do regulators ensure that ratepayers receive the appropriate refunds? Based on the directives issued by many state utility regulatory commissions, the prevailing theme is for utilities to establish a deferred regulatory liability that computes the difference between the 21% and 35% tax rates built into current rates. (A deferred regulatory liability is a separate account established to reflect the balance of a utility's amount owed during a future period.) This deferred regulatory liability will continue to accrue the difference

between the 21% and 35% tax rates until the next general rate proceeding, or in some cases, until interim rate filings can be made to change the rates charged to customers. Generally, the commission directives also include a requirement that utilities provide an EDIT deferred liability computation with refund periods that comply with Internal Revenue Service (IRS) normalization rules.

How do the IRS normalization rules impact the computation of refunds to customers and the period of time that refunds will be made? Without attempting to summarize the IRS normalization rules, a next to impossible task, investor-owned utilities compute their utility rates' federal income

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tax rate at the corporate income tax rate. However, there is a portion of this amount that will not be paid to the IRS until a future period. This becomes the deferred income tax already paid by customers, but not yet paid in income taxes. Under the normalization rules, the tax computation that allows utilities to “defer” some of its full tax liability is the ability to deduct accelerated depreciation expenses when straight line depreciation is used for setting rates. Thus, even though customers have paid for a tax liability that includes straight line depreciation, the utility deducts a far greater amount as an expense when determining actual taxes in any given year. The idea is that at a future period when the assets are fully depreciated for tax purposes, the utility will pay the deferred portion of the taxes at that time, without any additional charge to customers.

Why is this important when determining a refund to customers? The amount of the income tax paid by customers that has been deferred will now be paid in a future period at 21% instead of 35%. This results in customers having paid more than will ever be remitted to the IRS. According to the normalization rules, any refunds on the amounts related to the timing differences for depreciation must be repaid over the life of the assets that gave rise to the differences, which is the normalization component of the EDIT refund.

To further confuse the issue (as if that is possible), there are other expenses that can give rise to deferred federal income tax calculations that are not related to the depreciation timing differences. These deferred taxes are not governed by the IRS normalization rules; as such, the refund period for the differences between the 21% and the 35% tax rates for these unrestricted deferred income taxes can be established by the regulators.

Therefore, a utility’s proposed methodology for refunding the entire amount of EDIT should be closely scrutinized to identify those periods governed by the normalization rules and those periods that can be set to ensure that ratepayers are receiving their refunds over a reasonable timeframe.

What should we look for in the days ahead? As customers, we should ensure that regulators are reviewing the proposals put forth by utilities considering what is clearly required under the normalization rules, and what is not, when developing the EDIT refunds.

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### Cryptocurrency Mining Impacts on Utilities

Regions of the country and utilities with access to low cost power supply markets, specifically in the Pacific Northwest, are facing dramatically increasing interest, and in some cases customer demand, from cryptocurrency (e.g., Bitcoin and Ethereum) mining facilities. These facilities are typically high load factor, large demand customers. In the case of mining cryptocurrency, bigger is better. Thus, the more computing power, the more cryptocurrency you can mine. This is leading to a

niche business of miners building scalable, shipping container type of mining “rigs” using 5 MW or more of power. While this may sound like the perfect customer to a utility, utilities should consider:

- How long will these miners be in business?
- Should we provide a marginal or embedded cost of power to them?
- Can they utilize the existing system and infrastructure or are there added infrastructure needs to serve them?
- What is the cost of the new infrastructure?
- How should the customer reimburse the utility for the infrastructure expansions (in rates, up front, or a mix)?

The answers to some of these questions have led some utilities to ban miners or institute a moratorium on new mining applications.

## Energy Insights cont.

In addition to these larger, professional miners, residential customers are also getting into the act with do-it-yourself mining rigs at home. These smaller rigs using scalable 1 kilowatt (kW) increments are widely available to purchase or build at home. A web or YouTube search for cryptocurrency mining rigs returns many options you can build yourself or buy directly through eBay, Etsy, or other sites. In addition to developing a rate strategy for larger cryptocurrency mining customers, utilities may begin monitoring their residential customers for do-it-yourself miners and consider new rates for them, in addition to evaluating potential localized infrastructure impacts due to the increased loads.

### ENERGY PROJECT HIGHLIGHT

#### **Preliminary Feasibility Study for Municipal Electric Utility**

##### *City of Decorah, Iowa*

In August 2017, NewGen and its subconsultants were retained by Decorah Power, a not for profit entity developed to investigate the feasibility of creating a municipal electric utility (MEU) in the City of Decorah, Iowa. Decorah Power advocated the development of an MEU for the purposes of local control; advancing renewable energy and energy efficiency programs; and creating an opportunity for a sound economic base for the City while providing reliable power to the citizens and businesses of Decorah.

The intent of the preliminary feasibility study was to provide a recommendation to the City based on an independent field assessment of the potentially acquired assets, as well as the development of a financial analysis of the costs to create and operate an MEU within the City. The preliminary financial analysis included an estimate of the Replacement Costs Less Depreciation (RCLD) value for the assets, as well as various power supply and transmission options. The benchmark for the preliminary feasibility analysis was the average retail rate for the estimated load within the area to be served by the MEU.

The preliminary results suggested a cost savings to the City under an MEU scenario. Therefore, the City has initiated a public referendum for May 1st to potentially support an application to the Iowa Utilities Board (IUB), which is the public utilities commission in Iowa, to allow for a municipal acquisition of the IPL assets and operations.



## WATER, WASTEWATER, AND STORMWATER INSIGHTS

### **Hurricane Harvey to Impact Municipal Utility District Credit Ratings**

In a recent report issued by Moody's Investor Services, the rating agency is beginning to anticipate the long-term impact to some Municipal Utility Districts (MUDs) that experienced significant damage from Hurricane Harvey. Residences still in disrepair will likely impact assessed valuations and may require some MUDs to raise their tax rates to meet their obligations. While some MUDs may choose to use existing reserves to fund cash-flow shortages, the speed with which payments are made through the Federal Emergency Management Agency or insurance policies could result in reserves being insufficient, thus challenging the financial capacity of the Districts as they seek to rebuild.

### **Deliberation Continues on the Waters of the U.S. Rule (WOTUS)**

While amendments to WOTUS, which was crafted under the Obama Administration, continue to be litigated, the United States Environmental Protection Agency (EPA) has delayed the effective date of the rule for another two years effective January 2018. Additionally, in late 2017, the EPA and Army Corps of Engineers received public comments on a potential replacement to the controversial language, which would re-codify the pre-existing rules.

### WATER, WASTEWATER, AND STORMWATER PROJECT HIGHLIGHT

#### **Non-Potable Water Rate Study**

##### *City of Thornton, Colorado*

NewGen was retained by the City of Thornton (City) to conduct a comprehensive Non-Potable Water Rate Study including the evaluation of the current water rate structure, benchmarking with water supply agencies in the Metro Denver area, and developing an alternative rate structure for consideration by the City.

Currently, the City's parks are the primary user of non-potable water for irrigation purposes. In the coming year, the parks department will add a significant facility, which will greatly enhance their

## Water, Wastewater, and Stormwater Insights cont.

use of non-potable water for irrigation. To ensure the parks department is paying an appropriate amount for service and that the water fund is properly compensated for services provided, the City has engaged NewGen to conduct a Non-Potable Water Rate Study to examine and determine the appropriate rates to be charged between departments.

The initial draft of the study was completed in December 2017 and finalized in March 2018 based upon internal City policy deliberations.



### Tax Reform Impacts on the Solid Waste Industry

One of the primary impacts from the Tax Cuts and Jobs Act, which was signed into law by the President on December 22, 2017, is the reduction in effective tax rates for some of the largest waste companies in the United States (U.S.). For instance, with both Waste Management and Republic Services having tax rates in the mid-30% range, it is estimated that the reduction in the corporate tax rate to 21% will represent a 40% reduction in their tax rate. Some Wall Street analysts have estimated this could improve their net income by 20% or more.

If your city or local government procures its solid waste and/or recycling services from a private hauler, you should ask them about the impact of the new tax law on their "cost of doing business" and whether your rates will be decreased. If you are about to go "out to bid" to procure solid waste services, consider calling NewGen to find out what questions you should be asking of your private solid waste vendors. For more information, call Dave Yanke (Austin, Texas; 512.649.1254) or Allison Trulock (Orlando, Florida; 407.247.2370).

### New Leader for the State of Texas Alliance for Recycling (STAR)

STAR has named Mr. Jordan Fengel as its new Executive Director. He started work in February 2018 and replaces Ms. Sara Nichols, who recently joined Keep America Beautiful. Mr. Fengel was formally with the City of Georgetown, Texas and served as its Environmental Services Manager. Mr. Fengel brings a passion for recycling and is expected to be able to successfully engage governmental, private sector, non-profits, and individuals in advancing

recycling in the State of Texas.

### Increased Usage of Paper Cups May Lead to Increased Recovery of These "Single-Use" Cups

It is estimated that 643,000 tons of paper beverage cups are used annually in the U.S. and Canada, with the vast majority of them being landfilled. However, a number of paper mills, material recovery facilities (MRFs), and manufacturers are looking at ways to capture this stream of material and re-use it. The majority of cups are coated with polyethylene (PE) and a lesser amount with polylactic acid (PLA). Those coatings serve as an insulation, prevent leaking, and maintain the cup's structure. However, the material creates a problem for paper mills to accept it as a recyclable material. Some mills are beginning to find a way to separate the poly coating from the cup. For instance, Sustana's Fox River Fiber Facility in De Pere, Wisconsin is one facility that has begun accepting these types of materials and is now generating 450 tons of de-inked recycled pulp every day. While this material has its challenges, and represents extra work for paper companies, these firms are being pushed to shift their operations as their stream of source material goes through significant changes. With the decline in newspaper circulation there has been an increased awareness that these fibers need to be captured in other markets (i.e., paper cups) to make many of the products we use. As a result, paper cups, which have long, white virgin fiber are increasingly attractive for mills that can process the material.

### SOLID WASTE AND RECYCLING PROJECT HIGHLIGHT

#### Collection Services Proposal Evaluation Assistance City of Murphy, Texas

NewGen was retained by the City of Murphy (City) to assist with the evaluation of proposals received resulting from the City's collection procurement process. The goal of this engagement was to provide the City with assistance in analyzing proposals received in response to their Request for Proposals (RFP), specifically relating to providing general guidance for the selection process including direction for the selection committee, evaluating the cost proposals, developing a questionnaire for reference checks, and assisting with a City Council work session once a recommendation was being considered.

The NewGen team's extensive background in collection procurement allowed us to provide these services in an efficient manner to accommodate an extremely tight timeline, while providing the

## Solid Waste and Recycling Insights cont.

City with sound advice along the way. Additional services included assistance with negotiations and review of a draft agreement for collection services. These efforts resulted in the successful completion of the selection committee meetings, reference checks, cost comparisons, the selection of a winning proposer, and ultimately the award of an agreement to the winning proposer.

NewGen provided the City with guidance and the tools for a proven and transparent approach to stepping through the evaluation and selection process. In the February 20, 2018 City Council Meeting where the contract was approved, some of the comments expressed by the Murphy City Council regarding the process included ***"I was really impressed with the way the RFP process was put together ...I'd like for this to be possibly a benchmark for seven years from now that we follow something very similar to this. ... I feel a lot more comfortable making the decision now based on the criteria we asked for and what we got back. So, I'm very happy with the way we handled it. Great job."*** The City Council unanimously approved the Exclusive Contract for Solid Waste and Recycling Service.



## CONFERENCES AND SEMINARS

### Government Finance Officers Association of Texas

Matthew Garrett and Chris Ekrut will be attending the Government Finance Officers Association of Texas Conference in Austin, April 15-17.

### TxSWANA Conference

NewGen is a Bronze Sponsor and will have a booth at the TxSWANA Conference in Denton, Texas, April 16-18. Dave Yanke will be presenting the findings from a study completed in October 2017 titled "A Municipal Solid Waste Generation and Diversion Forecast for the Houston-Galveston Area Council Planning Region." Come by the booth and introduce yourself to Dave or Allison Trulock (who is joining us from our Orlando office).

**NewGen  
Strategies & Solutions**

Have a question? Contact us at

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California | Colorado | Florida | Michigan | Tennessee | Texas | Washington

### Texas AWWA Conference

Chris Ekrut and Kim Bostik will be presenting at the Texas AWWA Conference April 25th and April 26th. Their presentations include:

- "Decimated by Data – Common Utility Billing Mistakes and the Impact on Water and Sewer Utilities," April 25th, 11:00 A.M.
- "That'll be the Day that Water Rates Change in Lubbock," April 26th, 9:30 A.M.

### Oklahoma SWANA Conference

NewGen is a Bronze Sponsor at the Oklahoma SWANA Conference in Catoosa, Oklahoma (Tulsa), May 1-3. Mr. Yanke will be presenting on "How to Develop a Cost Based Financial Plan to Safely Operate Your Solid Waste Utility."

### American Public Power Association National Conference

NewGen is a Platinum Sponsor of the APPA National Conference in New Orleans, LA in June 2018. Additionally, NewGen will hold a Preconference Seminar on "Distributed Energy Resources: Managing the Risk" on Sunday, June 17th (8:30 A.M. - 12:00 P.M.).



## NEWGEN HIGHLIGHTS

NewGen's Utility Service Officer training for the U.S. Army Corps of Engineers' Commercial Utilities Program was highlighted in the U.S. Army's April/May/June 2018 Public Works Digest.

Please visit NewGen's website for a link to the full article.

