Pa. PUC Converts Commission-Approved Rates into Temporary Rates in Wake of Tax Act

On March 15, 2018, the Pennsylvania Public Utility Commission (PUC) entered a temporary rates order that converted commission-approved rates of most large Pennsylvania public utilities into “temporary rates” for a period of six months, with a possible extension for an additional six months.¹ This action was taken in response to the federal Tax Cuts and Jobs Act (TCJA) that became effective on January 1, 2018.

Federal taxes and state taxes are reflected in the rates that public utilities charge to customers. The TCJA reduced the corporate federal income tax rate from 35 percent to 21 percent. This change will also impact public utilities’ reserves for deferred income tax liabilities. In addition, if the implementation of the TCJA results in lower federal taxable income amounts for public utilities, it may reduce the state taxes paid by public utilities.

Consequently, in January 2018, the PUC opened a proceeding to consider whether utilities’ existing rates are no longer “just and reasonable,” as required by Pennsylvania law. In February, 2018, the PUC issued a secretarial letter requesting detailed information from large public utilities and inviting interested parties to submit comments addressing such topics as “whether the Commission should adjust current customer rates to reflect the reduced annual state and federal income tax expenses of public utilities due to the tax rate changes in the TCJA.”

The PUC is in the process of reviewing the data and comments submitted in response to the secretarial letter. Due to the complexity of the tax law changes and the numerous public utilities involved, the PUC has stated that it is unable to determine when it will complete its review and resolve the issues presented. Consequently, the PUC issued the temporary rates order, which establishes the current, commission-approved rates and riders of most large public utilities as temporary rates for an initial period of six months, but the commission can extend the temporary rates for another six month period.² It ordered each affected public utility to file a tariff supplement designating its existing rates and riders as temporary rates, effective March 15, 2018.

According to the PUC, one reason for this approach is that it is consistent with the PUC’s response to the Tax Reform Act of 1986. At that time, the PUC set temporary rates for a large group of utilities and then determined the effects of the tax changes on each individual public utility. The PUC ultimately flowed tax savings back to ratepayers by directing utilities, on a case-by-case basis, to file temporary rates in the form of a negative surcharge (credit) or, voluntary, permanent rates reflecting a similar reduction.

The practical effect of the instant order is that the PUC has arguably preserved its authority to order refunds dating back to March 15, 2018, on the portion (if any) of the temporary rates that it ultimately determines to be unjust or unreasonable. Although some commenters suggested alternative approaches for dealing with the TCJA (such as reinvestment of capital in the systems), there is language in the PUC’s order that suggests that the PUC may be predisposed to directing refunds. Temporary Rates Order, p. 5 (“Lastly, in terms of procedure, the Commission anticipates that, after further review and analysis of the responses to data requests, financial information and public comments, the Commission will direct utilities to file appropriate tariffs to account for the tax rate reductions that became effective on January 1, 2018.”) (emphasis added). It is unclear why, at this early stage of its review, the PUC felt compelled to make an affirmative statement regarding its anticipated outcome.

The PUC suggests that its order is interlocutory in nature; so an appeal is not appropriate at this time. Nevertheless, if the PUC — in the future — does attempt to order refunds dating back to
March 15, 2018, that decision would no longer be interlocutory and could be appealed. Utilities would have a sound legal basis to argue that the PUC’s approach violates the long-standing prohibitions against retroactive ratemaking and single-issue ratemaking.

It remains to be seen whether the appellate courts will permit the commission to modify rates, retroactively and on the basis of a single issue, simply by dictating that commission-approved rates — which have the force and effect of law — are now temporary rates on an across-the-board basis. Such action by the PUC could have significant financial consequences on the utilities and could, among other things, constitute a regulatory taking.

Additionally, because a utility is constitutionally entitled to a fair opportunity to earn a fair return on the fair value of its investment, see Fed. Power Comm’n v. Hope Natural Gas Co., 320 U.S. 591 (1944), the PUC likely cannot direct a broad-brush mechanism for refunds that are generally applicable to all utilities. The circumstances of each utility must be taken into consideration in individual cases in which the PUC, as the adjudicator, has no predisposition.

If you would like to learn more about this order or the commission’s ratemaking process, please contact the Utility, Environmental & Energy Practice Group at Cozen O’Connor. The Utility, Environmental & Energy Practice Group guides clients through complex regulatory approvals by state public utility commissions and departments of environmental protection. It also represents clients in transactions, litigation, enforcement actions, and federal regulatory proceedings.

1 The commission’s order, and its two attachments, can be found by clicking here and searching for Docket No. M-2018-2641242.

2 Some large public utilities were exempted, such as those currently involved in rate cases. The PUC stated that, for these utilities, it expects the parties to address the effect of the TCJA on the justness and reasonableness of rates charged during the suspension period.