

**IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE**

IN RE:

**PETITION OF PIEDMONT NATURAL
GAS COMPANY, INC. FOR APPROVAL
OF ITS 2024 ANNUAL REVIEW OF
RATES MECHANISM PURSUANT TO
TENN. CODE ANN. § 65-5-103(d)(6)**

Electronically Filed in TPUC Docket
Room on August 9, 2024 at 1:49 p.m.

DOCKET NO. 24-00036

DIRECT TESTIMONY

OF

DAVID N. DITTEMORE

August 9, 2024

I. Background

Q1. PLEASE STATE YOUR NAME AND OCCUPATION FOR THE RECORD.

A1. My name is David N. Dittmore. I am a self-employed consultant working in the utility regulatory sector.

Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND PROFESSIONAL EXPERIENCE.

A2. I received a Bachelor of Science Degree in Business Administration from the University of Central Missouri in 1982. I am a Certified Public Accountant licensed in Oklahoma (#7562). I was previously employed by the Kansas Corporation Commission (“KCC”) in various capacities, including Managing Auditor, Chief Auditor, and Director of the Utilities Division. I was self-employed as a utility regulatory consultant for approximately four years, primarily representing the KCC staff in regulatory issues. I also participated in proceedings in Georgia and Vermont, evaluating issues involving electricity and telecommunications regulatory matters.

Additionally, during this time frame, I performed a consulting engagement for Kansas Gas Service (“KGS”), my subsequent employer. For eleven years, I served as Manager and subsequently Director of Regulatory Affairs for KGS, the largest natural gas utility in Kansas, serving approximately 625,000 customers. KGS is a division of One Gas, a natural gas utility serving about two million customers in Kansas, Oklahoma, and Texas. I joined the Tennessee Attorney General's Office in September 2017 as a Financial Analyst. In July 2021, I began my consulting practice.

1 I have been a Board Member of the Financial Research Institute (University of Missouri).
2 I have also been a member of the NARUC Subcommittee on Accounting, the Vice-Chair
3 of the Accounting Committee of the National Association of State of Utility Consumer
4 Advocates (“NASUCA”), and an active participant in NASUCAs’ Natural Gas and Water
5 Committees.

6 Overall, I have thirty years of experience in public utility regulation and have presented
7 testimony as an expert witness on many occasions. A detailed overview of my background
8 is attached as Exhibit DND-1.

9 **Q3. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE**
10 **TENNESSEE PUBLIC UTILITY COMMISSION (“TPUC” OR THE**
11 **“COMMISSION”)?**

12 **A3.** Yes. I have submitted testimony in many TPUC dockets.

13 **Q4. ON WHOSE BEHALF ARE YOU APPEARING?**

14 **A4.** I am appearing on behalf of the Consumer Advocate Division of the Tennessee Attorney
15 General’s Office (“Consumer Advocate”).

16 **II. Purpose of Testimony**

17 **Q5. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

18 **A5.** The purpose of my testimony is to present the Consumer Advocate’s position on the
19 Company’s tax proposals supported by its witness John Panizza.

20 **Q6. WHAT IS THE COMPANY PROPOSING WITH REGARD TO THE USE OF THE**
21 **STATE TAX RATE IN THIS PROCEEDING?**

A6. The Company is requesting a modification to its ARRM methodologies to switch from using a composite tax rate within its State Income Tax calculation to the Tennessee statutory excise tax rate for purposes of calculating Income Tax Expense and the Company's balance of Accumulated Deferred Income Taxes ("ADIT").

III. History of State Tax Rate Issue

Q7. HOW IS THE STATE TAX RATE USED WITHIN THE RATEMAKING FORMULA?

A7. The state tax rate, regardless of whether it is a composite state tax rate or the Tennessee statutory rate is used to calculate both Income Tax Expense and ADIT. The balance of ADIT represents a source of cost-free capital provided by ratepayers to the Company and is used to reduce Rate Base. In simple terms ADIT is the prepayment of Income Taxes by ratepayers, that the Company will theoretically pay later.¹

Q8. WHAT IS MEANT BY THE TERM "COMPOSITE STATE TAX RATE"?

A8. The composite state tax rate represents the weighted average state tax rate in which Piedmont operates, driven by the North Carolina corporate state tax rate.²

Q9. WHAT IS THE COMPOSITE STATE TAX RATE PROVIDED BY PIEDMONT?

A9. 3.52%.

Q10. WHAT IS THE TENNESSEE STATUTORY EXCISE TAX RATE?

¹ The term "theoretical" is being used because of the ever-increasing capital expenditures of utilities tend to ensure significant accelerated tax depreciation and repair deductions that may be used to offset future taxable income.

² *Petition Of Piedmont Natural Gas Company, Inc. For Approval Of Its 2024 Annual Review Of Rates Mechanism Pursuant To Tenn. Code Ann. § 65-5-103(D)(6), Schedule 52W, TPUC Docket No. 24-00036 (May 20, 2024).*

1 **A10.** 6.5%.

2 **Q11. CAN YOU SUMMARIZE HOW THE STATE TAX RATE HAS BEEN**
3 **DETERMINED IN PAST PIEDMONT REGULATORY PROCEEDINGS?**

4 **A11.** Yes. Attached as Exhibit DND-2 is the Company's Response to Consumer Advocate DR
5 No. 1-28. This response identifies the Company's dockets in which the state tax rate has
6 impacted ratemaking determinations by the Commission. As noted on lines 4-6 of Exhibit
7 DND-2, the Company's composite rate was adopted for purposes of defining its Income
8 Tax Expense beginning with its more recent base rate case, while the Tennessee statutory
9 rate was used in its 2011 general rate case, and its Tax Cuts and Jobs Act ("TCJA") docket,
10 TPUC Docket No. 18-00040. The Commission has adopted Piedmont's composite tax rate
11 to calculate its ADIT balance consistently over the past two rate cases and the TCJA
12 proceeding.

13 **Q12. HOW WAS THIS ISSUE RESOLVED WITHIN THE COMPANY'S ARRM**
14 **MECHANISM?**

15 **A12.** The Company's current tariff, attached as Exhibit DND-3, clearly specifies that the
16 composite tax rate should be used within the ARRM calculation.³ The Commission
17 adopted these terms in its Order Approving Amended Annual Review of Rates Mechanism
18 in TPUC Docket No. 21-00135.⁴

19 **Q13. HAVE YOU WEIGHED IN ON THIS ISSUE IN PAST PROCEEDINGS?**

³ Exhibit DND-3, Piedmont Natural Gas Company, Inc. Tennessee Service Schedule No. 318, Original Page 7 of 18 at ¶25.

⁴ Order Approving Amended Annual Review of Rates Mechanism, TPUC Docket No. 21-000135 (November 1, 2022).

1 **A13.** Yes. I supported the use of the Tennessee state excise rate to determine Income Tax
 2 Expense and the applicable ADIT balance in the Company's TCJA TPUC Docket No. 18-
 3 00040. The purpose of this docket was to measure the implications of the federal tax rate
 4 change on Piedmont's revenue requirement, impacting both Income Tax Expense and
 5 ADIT.

6 **Q14. WHAT WAS THE OUTCOME OF THAT ISSUE IN THE TCJA DOCKET?**

7 **A14.** The Commission rejected my recommendation that the state tax rate should be adopted in
 8 the TCJA docket, TPUC Docket No. 18-00040, for both the Income Tax Expense
 9 component and the balance of ADIT. Instead, the Commission adopted the Company's
 10 recommendation to use the composite rate to determine the value of excess ADIT.⁵

11 **Q15. BEFORE THIS CASE, DID YOU BELIEVE THE USE OF THE COMPOSITE**
 12 **RATE WAS A SETTLED ISSUE IN DETERMINING PIEDMONT'S REVENUE**
 13 **REQUIREMENT?**

14 **A15.** Yes.

15 **IV. Piedmont ARM - TPUC Docket No. 23-00035**

16 **Q16. COULD YOU EXPAND ON THE TAX ISSUE YOU IDENTIFIED IN PIEDMONT'S**
 17 **LAST ARM PROCEEDING, TPUC DOCKET NO. 23-00035?**

18 **A16.** Yes. in TPUC Docket No. 23-00035, I discussed the implications of the Company's
 19 balance of ADIT on an upcoming change in the North Carolina corporate state tax rate. In
 20 my review, I determined that the Company had recorded a reduction in the ADIT liability

⁵ *Order Approving Stipulation and Partial Settlement Agreement and Adjudicating Contested Issues Presented by the Parties* at 15, TPUC Docket No. 18-00040 (Aug. 6, 2019).

1 account to reflect the impact of the reduction in the North Carolina corporate tax rate.
2 Exhibit DND-4 is a summary of the North Carolina state rate reductions written by the
3 accounting firm, Ernst and Young (“EY”). The ongoing reductions in North Carolina’s
4 corporate tax rate produce excess ADIT on a smaller scale than the excess ADIT that
5 resulted from the TCJA. This reduction in the ADIT liability increases Rate Base and
6 reflects the cancellation of future tax payments for which the Company had collected
7 deferred taxes from ratepayers.

8 **Q17. WHY SHOULD PIEDMONT’S TENNESSEE RATEPAYERS BE IMPACTED BY A**
9 **REDUCTION IN THE NORTH CAROLINA STATE INCOME TAX RATE?**

10 **A17.** Once the Commission adopted a composite state tax rate for ratemaking purposes, the
11 Company’s Tennessee jurisdictional customers gained a vested interest in any
12 modifications in the individual state tax rates comprising the composite rate, including
13 those tax rates applicable outside Tennessee. The North Carolina state tax rate comprises
14 72.5% of the makeup of the composite rate; thus, changes to the North Carolina state tax
15 rate have a material impact on the Company’s revenue requirement. The implication of the
16 North Carolina state tax rate change on the Company’s Tennessee revenue requirements is
17 an outgrowth of the Commission’s decision to rely upon a composite state tax rate in setting
18 rates in TCJA docket, TPUC Docket No. 18-00040.

19 **Q18. HOW WERE THE IMPLICATIONS OF THE EXCESS ADIT RESOLVED IN THE**
20 **LAST PROCEEDING?**

21 **A18.** The Parties agreed in last year’s ARRM Settlement Agreement that the Company should
22 address the implications of the state tax rate change on the Tennessee jurisdictional ADIT

1 balance and that Tennessee customers should be held harmless from any accounting entries
2 made in 2022 and 2023 associated with this tax issue.⁶

3 **Q19. DID YOU VIEW THIS LANGUAGE TO REQUIRE THE PARTIES TO CONSIDER**
4 **THE USE OF A TENNESSEE STATE TAX RATE IN FUTURE FILINGS?**

5 **A19.** No. The language required the Parties to consider the appropriate regulatory treatment of
6 the excess ADIT resulting from the North Carolina tax rate change. My intent in the
7 development of the language in the Settlement Agreement from last year's ARRM, in
8 TPUC Docket No. 23-00035, was not to re-litigate the state tax rate issue, but rather to
9 discuss its treatment for regulatory purposes.

10 **Q20. DID YOU SUPPORT THE USE OF THE TENNESSEE STATUTORY RATE IN**
11 **TPUC DOCKET NO. 23-00035?**

12 **A20.** No. I believe the state tax rate issue was resolved in favor of the Company's position in
13 TPUC Docket No. 18-00040 and was a settled issue as set forth in the Company's ARRM
14 tariff.

15 **V. RECOMMENDATIONS**

16 **Q21. AS A GENERAL RULE, DO YOU BELIEVE TENNESSEE UTILITY RATES**
17 **SHOULD BE DETERMINED BASED ON THE TENNESSEE EXCISE TAX RATE**
18 **OF 6.5%?**

⁶ Piedmont Natural Gas Company Inc. and the Consumer Advocate Division of the Office of the Tennessee Attorney General Settlement Agreement, at 7 ¶23, TPUC Docket No. 23-00035 (August 21, 2023).

1 **A21.** Yes. As a general matter, I believe that Tennessee jurisdictional revenue requirements
2 should be determined using the statutory Tennessee tax rate. However, the history of this
3 issue and its implications for future revenue requirements cannot be ignored.

4 **Q22. WHAT IS YOUR POSITION REGARDING THE APPROPRIATE STATE TAX**
5 **RATE TO USE WITHIN PIEDMONT'S ARRMs FILING?**

6 **A22.** I oppose the application of the Tennessee statutory tax rate as applied to the 2023 Historic
7 Base Period ("HBP") because it contradicts the clear requirement in the Company's tariff
8 that the composite state rate shall be used. I oppose the application of the Tennessee
9 statutory tax rate in 2024 because the Company has not addressed the implication of this
10 change on the sufficiency of its ADIT balance and has not committed that it will not claim
11 a future ADIT deficit associated with its proposed state tax rate methodology.

12 **Q23. GIVEN YOUR GENERAL SUPPORT FOR THE USE OF THE TENNESSEE**
13 **SPECIFIC TAX RATE IN DETERMINING BOTH THE INCOME TAX EXPENSE**
14 **COMPONENT AND THE ACCUMULATED DEFERRED TAX EXPENSE, WHY**
15 **ARE YOU OPPOSING THE COMPANY'S PROPOSAL TO ADOPT THE**
16 **TENNESSEE STATE TAX RATE AT THIS TIME?**

17 **A23.** Applying the Tennessee state tax rate to 2023 HBP results would represent an example of
18 retroactive ratemaking. However, I could support applying the Company's proposal to
19 2024 results if the Company was willing to affirm that it will not seek recovery from
20 ratepayers from any claim that its ADIT balance is deficient due to the tax change. Absent
21 this commitment from Piedmont, the Commission should continue to use the composite
22 state tax rate and Piedmont should refund the jurisdictional pro-rata portion of its excess
23 ADIT balances associated with the North Carolina state tax change.

1 **Q24. DO YOU BELIEVE THE FACT THAT THE PRIOR TARIFF IN EFFECT**
2 **THROUGHOUT 2023, REQUIRING THE USE OF THE COMPOSITE STATE TAX**
3 **RATE REQUIRES THAT THE 2023 HISTORIC BASE PERIOD REFLECT THE**
4 **SAME COMPOSITE STATE TAX RATE?**

5 **A24.** Yes. The tariff provisions in effect today cover the 2023 HBP. I question the validity of
6 modifying the terms of a tariff and applying them retroactively to a prior period. Such
7 tariff changes can be applied to the current year's results but should not be applied to a
8 prior period without running afoul of retroactive ratemaking.

9 **Q25. HAVE YOU TAKEN A SIMILAR POSITION REGARDING THE RETROACTIVE**
10 **APPLICATION OF A TARIFF PROVISION?**

11 **A25.** Yes. Piedmont filed its initial ARRM application in November 2021 in TPUC Docket No.
12 21-00135. The Company requested an effective date of 2021 on its proposed tariff which
13 would have guaranteed it to earn its authorized rate of return effective as of January 1,
14 2021. The Consumer Advocate opposed the 2021 implementation date requested by the
15 Company because the effective date requested by the Company was an example of
16 retroactive ratemaking.⁷ On February 18, 2022, the Parties submitted a "No Outstanding
17 Issues" letter with the Commission which identified January 1, 2022, as the effective date
18 of the ARRM calculation.

19 While applying a retroactive rate is not a direct issue in this proceeding, the current
20 situation represents a request to retroactively apply tariff provisions that directly conflict
21 with the currently stated tariff provisions that have been approved throughout the HBP.

⁷ *Direct Testimony of David N. Dittemore* at 6:16 – 10:3, TPUC Docket No. 21-00135, (Jan. 26, 2022).

Q26. DO YOU BELIEVE THERE IS ANY PRINCIPLE PROHIBITION AGAINST MODIFYING THE ARRM TARIFF TO INCORPORATE THE TENNESSEE STATUTORY TAX RATE FOR 2024?

A26. No.

Q27. DO YOU BELIEVE IT IS ACCEPTABLE TO REVISIT SPECIFIC ARRM PROVISIONS AS TIME PASSES DUE TO CHANGING CIRCUMSTANCES OR AS NEW INFORMATION BECOMES AVAILABLE?

A27. Yes. I also believe ARRM provisions may need to be reviewed if utility bills become less affordable.

Q28. PLEASE DISCUSS YOUR SECOND POINT RELATED TO THE IMPLICATIONS OF SWITCHING TO A TENNESSEE SPECIFIC RATE ON THE COMPANY'S ADIT BALANCES.

A28. The Company implemented interim base rates on January 2, 2021.⁸ These rates incorporated the Company's composite state tax rate and as set forth in Exhibit DND-2, and the use of the composite state tax rate has not changed since that time. Therefore, deferred taxes collected in rates have been reflective of the lower composite rate. Accounting theory suggests that when the deferred taxes collected from ratepayers comes due, they would be paid to the Tennessee Department of Revenue at a rate of 6.5%.⁹ The switch from using the composite rate to the Tennessee statutory rate suggests that the

⁸ *Order Imposing Conditions and Refund Requirements Regarding Piedmont Natural Gas Company, Inc's Intention to Implement New and Temporary Rates Pursuant to Tenn. Code Ann. § 65-5-103(B)*, TPUC Docket No. 20-00086 (Feb. 26, 2021).

⁹ The reality is the Company's ever-increasing level of new capital expenditures coupled with liberalized tax depreciation and the repair deduction will likely mean that the Company will continue to experience negative state taxable income in the future, and as a result state income tax payments may not occur.

1 imputed Tennessee ADIT balances, computed using the 6.5% rate, may result in a deficient
2 ADIT balance for ratemaking purposes applicable to the 2021-2024 period when the lower
3 composite state tax rate was in effect. In theory, if the Company pays the Tennessee state
4 excise tax in the future, it collected deferred Income Tax expenses at the rate of 3.52% but
5 would be required to pay the tax at the rate of 6.5% eventually.

6 **Q29. DO YOU BELIEVE THE COMPANY'S RATEPAYERS SHOULD BE REQUIRED**
7 **TO FUND ANY DEFICIENT ADIT BALANCES RESULTING FROM THE**
8 **COMPANY'S PROPOSED STATE INCOME TAX RATE CHANGE?**

9 **A29.** No. Any ADIT deficiency because of this tax rate change is due to the Company's historic
10 position on this issue. Ratepayers should not be burdened with additional costs because
11 the Company now seeks to modify what was a clearly settled issue.

12 **Q30. DOES THE COMPANY ACTUALLY PAY STATE EXCISE TAXES?**

13 **A30.** No. The Company's 2022 Franchise and Excise Tax Return is the most recent tax return
14 available. This return indicated that the Company [REDACTED]
15 [REDACTED]. It is doubtful that the Company will be required to pay state Excise Taxes in the
16 near future.

17 **Q31. GIVEN YOUR OPINION THAT IT IS UNLIKELY THE COMPANY WILL PAY**
18 **EXCISE TAX EXPENSE, WHY IS AN ACCRUED EXPENSE COMPUTED AND**
19 **INCLUDED IN THE COMPANY'S REVENUE REQUIREMENT?**

20 **A31.** The Commission has traditionally adopted a "normalization" tax methodology which
21 aligns Income Tax Expense in rates with the calculation of accrued Income Tax Expense
22 recorded pursuant to Generally Accepted Accounting Principles. The other tax

1 computation methodology is called the “flow-through” method. The flow-through
2 methodology of computing Income Tax Expense in rates more closely aligns Tax Expense
3 in rates with taxes paid to taxing jurisdictions.

4 **Q32. DO YOU BELIEVE THE NORMALIZATION VERSUS FLOW-THROUGH**
5 **METHODOLOGY IS AN ISSUE THAT SHOULD BE EXAMINED FURTHER IN**
6 **THE NEXT PIEDMONT ARRM FILING?**

7 **A32.** Yes. The more consumer-friendly flow-through methodology is worth further study given
8 the magnitude of annual rate increases Piedmont customers have faced since the
9 Company’s last rate case and the likelihood that the Company will not make excise tax
10 payments to the state of Tennessee in the near future.

11 **Q33. PLEASE SUMMARIZE YOUR POSITION ON THE COMPANY’S PROPOSAL TO**
12 **IMPLEMENT THE STATE TAX RATE CHANGE.**

13 **A33.** The Commission should reject the proposed tax rate change for the HPB because it directly
14 conflicts with the clear tariff provisions in effect during that period. The Commission
15 should reject the proposed tax rate change for the 2024 attrition period unless the Company
16 is willing to commit that it will not seek recovery of any claimed ADIT deficiencies as a
17 result of this voluntary tax rate change.

18 The ADIT balances adopted in this case should be those calculated using the composite
19 state tax rate as adjusted by Mr. Novak and referenced within the schedules he is
20 sponsoring.

21 **Q34. DOES THIS CONCLUDE YOUR TESTIMONY?**

1 **A34.** Yes. However, I reserve the right to modify my testimony if new information becomes
2 available.

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AT NASHVILLE, TENNESSEE**

IN RE:

**PETITION OF PIEDMONT NATURAL
GAS COMPANY, INC. FOR APPROVAL
OF ITS 2024 ANNUAL REVIEW OF
RATES MECHANISM PURSUANT TO
TENN. CODE ANN. § 65-5-103(d)(6)**

DOCKET NO. 24-00036

AFFIDAVIT

I, David Dittmore, on behalf of the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.


DAVID N. DITTEMORE

Sworn to and subscribed before me
this 5th day of August, 2024.



NOTARY PUBLIC



My commission expires: 1/31/2027.

David Dittamore

Experience

Areas of Specialization

Approximately thirty-years experience in evaluating and preparing regulatory analysis, including revenue requirements, mergers and acquisitions, utility accounting and finance issues and public policy aspects of utility regulation. Presented testimony on behalf of my employers and clients in natural gas, electric, telecommunication and transportation matters covering a variety of issues.

Self-Employed; **Consultant July 1 - Current**; Responsible for providing evaluation of utility ratemaking issues on behalf of clients. Prepare analysis and expert witness testimony.

Tennessee Attorney General's Office; **Financial Analyst September, 2017 – June 2021**; Responsible for evaluation of utility proposals on behalf of the Attorney General's office including water, wastewater and natural gas utility filings. Prepare analysis and expert witness testimony documenting findings and recommendations.

Kansas Gas Service; **Director Regulatory Affairs 2014 - 2017; Manager Regulatory Affairs, 2007 - 2014**

Responsible for directing the regulatory activity of Kansas Gas Service (KOS), a division of ONE Gas, serving approximately 625,000 customers throughout central and eastern Kansas. In this capacity I have formulated strategic regulatory objectives for KOS, formulated strategic legislative options for KOS and led a Kansas inter-utility task force to discuss those options, participated in ONE Gas financial planning meetings, hired and trained new employees and provided recommendations on operational procedures designed to reduce regulatory risk. Responsible for the overall management and processing of base rate cases (2012 and 2016). I also played an active role, including leading negotiations on behalf of ONE Gas in its Separation application from its former parent, ONEOK, before the Kansas Corporation Commission. I have monitored regulatory earnings, and continually determine potential ratemaking outcomes in the event of a rate case filing. I ensure that all required regulatory filings, including surcharges are submitted on a timely and accurate basis, I also am responsible for monitoring all electric utility rate filings to evaluate competitive impacts from rate design proposals.

Strategic Regulatory Solutions; 2003 -2007

Principal; Serving clients regarding revenue requirement and regulatory policy issues in the natural gas, electric and telecommunication sectors

Williams Energy Marketing and Trading; 2000-2003

Manager Regulatory Affairs; Monitored and researched a variety of state and federal electric regulatory issues. Participated in due diligence efforts in targeting investor owned electric utilities for full requirement power contracts. Researched key state and federal rules to identify potential advantages/disadvantages of entering a given market.

MCI WorldCom; 1999 - 2000

Manager, Wholesale Billing Resolution; Manage a group of professionals responsible for resolving Wholesale Billing Disputes greater than \$50K. During my tenure, completed disputes increased by over 100%, rising to \$150M per year.

Kansas Corporation Commission; 1984- 1999

Utilities Division Director - 1997 - 1999; Responsible for managing employees with the goal of providing timely, quality recommendations to the Commission covering all aspects of natural gas, telecommunications and electric utility regulation; respond to legislative inquiries as requested; sponsor expert witness testimony before the Commission on selected key regulatory issues; provide testimony before the Kansas legislature on behalf of the KCC regarding proposed utility legislation; manage a budget in excess of \$2 Million; recruit professional staff; monitor trends, current issues and new legislation in all three major industries; address personnel issues as necessary to ensure that the goals of the agency are being met; negotiate and reach agreement where possible with utility personnel on major issues pending before the Commission including mergers and acquisitions; consult with attorneys on a daily basis to ensure that Utilities Division objectives are being met.

Asst. Division Director - 1996 - 1997; Perform duties as assigned by Division Director.

Chief of Accounting 1990 - 1995; Responsible for the direct supervision of 9 employees within the accounting section; areas of responsibility included providing expert witness testimony on a variety of revenue requirement topics; hired and provided hands-on training for new employees; coordinated and managed consulting contracts on major staff projects such as merger requests and rate increase proposals;

Managing Regulatory Auditor, Senior Auditor, Regulatory Auditor 1984 - 1990; Performed audits and analysis as directed; provided expert witness testimony on numerous occasions before the KCC; trained and directed less experienced auditors on-site during regulatory reviews.

Amoco Production Company 1982 - 1984

Accountant Responsible for revenue reporting and royalty payments for natural gas liquids at several large processing plants.

Education

- B.S.B.A. (Accounting) Central Missouri State University
- Passed CPA exam; (Oklahoma certificate # 7562) - Not a license to practice

Response to Consumer Advocate Request 1-28
Piedmont Natural Gas Company
2024 ARM Annual Filing
Docket No. 24-00036
Historical Base Period Ending 12/31/2023

Exhibit DND-2

CA DR 1-28 Attachment

Description: Type of Tax Rates Utilized for each Docket

			State Income Tax Expense	Accumulated Deferred Income Tax Liability (ADIT)
Line No.	Docket Number	Docket Description		
1	11-00144	General Rate Case	Statutory TN Excise Tax Rate	Piedmont's Composite State Tax Rate
2	14-00017	Excess ADIT Refund	Statutory TN Excise Tax Rate	Piedmont's Composite State Tax Rate
3	18-00040	Federal Tax Reform Compliance Filing	Statutory TN Excise Tax Rate	Piedmont's Composite State Tax Rate
4	20-00086	General Rate Case	Piedmont's Composite State Tax Rate	Piedmont's Composite State Tax Rate
5	21-00135	Annual Review of Rates Mechanism	Piedmont's Composite State Tax Rate	Piedmont's Composite State Tax Rate
6	23-00035	2023 ARM Filing	Piedmont's Composite State Tax Rate	Piedmont's Composite State Tax Rate

SERVICE SCHEDULE NO. 318

Annual Review Mechanism (ARM)

I. OVERVIEW

Applicable

To service provided to customers under all Rate Schedules, including service provided to customers under approved special contracts.

Purpose

This Annual Review Mechanism (“ARM”) is implemented under the provisions of Tennessee Code Annotated Section 65-5-103(d)(6), which authorizes the Company to elect to opt into an annual review of the Company's rates. Pursuant to this ARM and the annual filings described herein, the Company's rates shall be adjusted to provide that the Company earns its Authorized Return on Equity on prudently incurred costs as defined by the Tennessee Public Utility Commission (“TPUC” or the “Commission”). The rate adjustments implemented under the ARM, which are to the Company's Base Margin Rates and its ARM Rider Rates, will reflect changes in the Company's jurisdictional operating revenues, cost of service, and rate base. Jurisdictional operating revenues and expenses exclude gains or losses related to gas supply hedging activities, off system sales, other gas supply and capacity secondary marketing activities, and other non-jurisdictional transactions as determined by the Commission. The ARM may be terminated or modified as provided under of Tennessee Code Annotated Section 65-5-103(d)(6)(D).

Piedmont's Base Margin Rates and ARM Rider Rates shall be reset on an annual basis pursuant to the procedures and information specified in this Tariff.

Nothing in this Tariff shall preclude intervenors or the Commission from identifying errors, omissions, or inconsistencies in the Company's ARM calculations, including adjusting such items within the determination of HBP results.

Global Definitions

- A. **Annual ARM Filing** shall consist of the components described below. The Company will simultaneously copy the Consumer Advocate on all Annual ARM Filings.
- B. **Annual ARM Filing Date** shall be the date the Company submits its Annual ARM Filing to the TPUC. The Annual ARM Filing Date shall be no later than May 20 of each year. The initial Annual ARM Filing shall be submitted by May 20, 2023 and shall include results for the Historical Base Period of calendar year 2022.

- C. **Annual ARM Proceeding** refers to the annual docketed proceedings in which the Company's Annual ARM Filings shall be reviewed.
- D. **Historic Base Period ("HBP")** is defined as the Company's most recently completed 12-month fiscal year ended December 31 prior to each ARM Annual Filing Date. The initial HBP shall be the 12-month fiscal year ended December 31, 2022.
- E. **Effective Date of ARM Rates** refers to the date that new ARM Rider Rates and new Base Margin Rates take effect. The Effective Date of ARM Rates shall be October 1 of each year pursuant to the Annual ARM Filing. As such, all bills rendered starting with October cycle 1 each year shall be billed under the new ARM Rider Rates and new Base Margin Rates.
- F. **2020 Rate Case Settlement** refers to the Stipulation and Settlement Agreement between Piedmont and the Consumer Advocate filed with the TPUC on February 2, 2021 in Docket No. 20-00086, which was subsequently approved by the TPUC.
- G. **Authorized Return on Equity** is defined as the 9.80% return on equity established in Docket No. 20-00086, or that which is established by the TPUC in any subsequent general rate case for the Company.
- H. **Overall Cost of Capital** is defined as the overall cost of capital for the applicable period, as stated on ARM Filing Schedule 10.
- I. **HBP Net Operating Income Deficiency (Sufficiency)** shall be computed as the difference between the net operating income for return in the HBP and the net operating income for return in the HBP that is required to produce the Authorized Return on Equity.
- J. **HBP Revenue Requirement Deficiency (Sufficiency)** shall be the HBP Net Operating Income Deficiency (Sufficiency) multiplied by the Revenue Conversion Factor.
- K. **Carrying Costs** are computed by applying an interest rate to the HBP Revenue Requirement Deficiency (Sufficiency) from the midpoint date of the HBP to the effective date of the ARM Rider Rates, which reflects a total of 15 months from July 1 of the HBP thru Sept 30 of the following year. The interest rate used shall be the net-of-tax Overall Cost of Capital rate including the Authorized Return on Equity, for the HBP.
- L. **ARM Reconciliation Deferred Account** shall be the interest-bearing regulatory asset or liability account to which the approved HBP Revenue Requirement Deficiency (Sufficiency) and Carrying Costs are recorded each October. The actual collections from customers (or refunds to customers) arising from the ARM Rider Rates shall be applied to the ARM Reconciliation Deferred Account each month in order to relieve its balance. Interest shall be accrued monthly to the ARM Reconciliation Deferred Account at a rate equivalent to the Company's net-of-tax Overall Cost of Capital under which Base Margin Rates were last established. Interest shall be applied to the average of the beginning and ending monthly balances. The ARM Reconciliation Deferred Account shall not be included in rate base for purposes of determining the HBP Net Operating Income Deficiency (Sufficiency) or the Annual Base Rate Reset Net Operating Income Deficiency (Sufficiency).
- M. **ARM Regulatory Asset** shall be the account(s) to which the Company records Interest Deferrals and Depreciation Expense Deferrals associated with plant in service that has not

yet been included in rate base. The Company shall be authorized to establish and include in rate base this ARM Regulatory Asset. The Company shall segregate its deferrals to the ARM Regulatory Asset by HBP. Upon the effective date of new Base Margin Rates each year, the Dec 31 balance of the ARM Regulatory Asset for the most recent HBP shall begin to be amortized evenly over a period of time equivalent to the depreciable life of its underlying plant assets.

- i. **Interest Deferrals:** On a monthly basis, the Company shall record deferred interest to the ARM Regulatory Asset. The rate for such deferred interest shall be the pretax Overall Cost of Capital under which Base Margin Rates were last established. Such deferred interest shall be calculated on all plant placed into service that is not yet included in rate base, and shall continue to accrue and be added to balance of the ARM Regulatory Asset during and after the HBP until such time that the underlying plant is included in rate base. The Company shall take care not to double count the application of Interest Deferrals and the recording of Allowance for Funds Used During Construction (AFUDC). The plant balance upon which the interest deferrals are calculated shall account for incremental plant additions net of a) incremental plant retirements; b) a provision adding or subtracting incremental deferred income taxes on plant assets not yet in rate base; c) a provision subtracting the increase in accumulated depreciation on assets already included in rate base; and d) a provision adding the depreciation expense deferred on assets not yet included in rate base.
 - ii. **Depreciation Expense Deferrals:** On a monthly basis, the Company shall record deferred depreciation expense to the ARM Regulatory Asset on plant not yet included in rate base. This accounting will result in a credit to depreciation expense and a debit to the ARM Regulatory Asset. The deferred depreciation expense shall be calculated on all plant placed into service that is not yet included in rate base, and shall continue to be added to the balance of the ARM Regulatory Asset during and after the HBP until such time that the underlying plant is included in rate base.
- N. **Annual Base Rate Reset Net Operating Income Deficiency (Sufficiency)** shall be computed as the difference in the net operating income for return for the Annual Base Rate Reset period under present Base Rates less the net operating income for return for the Annual Base Rate Reset period that is required to produce the Authorized Return on Equity.
- O. **Annual Base Rate Reset Revenue Requirement Deficiency (Sufficiency)** shall be the Annual Base Rate Reset Net Operating Income Deficiency (Sufficiency) multiplied by the Revenue Conversion Factor.
- P. **New Matters** refers to any issue, adjustment and/or ambiguity in or for any account, method of accounting or estimation, or ratemaking topic that would directly or indirectly affect the Annual ARM Filing for which there is no explicit prior determination by the TPUC regarding the Company since the 2020 Rate Case Settlement.
- Q. **ARM Rider Rates** refer to the customer billing rates per therm intended to relieve the ARM Reconciliation Deferred Account Balance over a 12-month period. The ARM Rider Rates will be updated each year on the Effective Date of ARM Rates. In each Annual ARM Filing, the Company shall propose new ARM Rider Rates based on the ARM

Deferred Account Balance at March 31 of the year after the HBP plus the current Annual ARM Proceeding's HBP Revenue Requirement Deficiency (Sufficiency) and Carrying Costs.

- R. **Base Rates** refer to those base rates per therm shown in Columns <1>, <2> and <3> of the Company's Tariff Sheet No. 1.
 - i. **Base Margin Rates** refer to those base rates per therm shown in Column <1> of the Company's Tariff Sheet No. 1. The Base Margin Rates will be adjusted each year on the Effective Date of ARM Rates in accordance with the approved Annual Base Rate Reset Revenue Requirement Deficiency (Sufficiency).
 - ii. **Base PGA Rates** refer to those base rates per therm shown in Columns <2> and <3> of the Company's Tariff Sheet No. 1, which are subject to adjustment caused by changes in the cost of purchased gas in accordance with Service Schedule No. 311, "Purchased Gas Adjustment (PGA) Rider".
- S. **Applicable Rate Schedules** are the Rate Schedules for which the ARM Rider Rates and the Base Margin Rates as updated under the ARM shall apply. The Applicable Rate Schedules are Rate Schedules 301, 302, 343, 352, 303, 304, 310, 313 and 314, which represent all of Piedmont's Rate Schedules.
- T. **Revenue Conversion** Factor shall be computed consistent with the paragraph 14.m. of the 2020 Rate Case Settlement.

Components of the Annual ARM Filing

On the Annual ARM Filing Date each year, the Company shall file with the TPUC schedules and workpapers that calculate the HBP Revenue Requirement Deficiency (Sufficiency) and the Annual Base Rate Reset Revenue Requirement Deficiency (Sufficiency) in accordance with this tariff. The Company's Annual ARM Filing shall specifically include the following:

1. ARM Filing Schedules, described in Section IV herein.
2. Workpapers supporting the ARM Filing Schedules (in electronic, native format with formulas intact).
3. Direct Testimony supporting the ARM Filing Schedules and requested rate adjustments, and also specifically including:
 - a. An explanation of the nature and extent of incremental deferred environmental expenses, pursuant to the requirements of para. 17.i. of the 2020 Rate Case Settlement; and
 - b. An explanation and support to demonstrate that incremental pension deferral amounts were prudently incurred to meet the Company's obligation to qualified employees and retirees, pursuant to the requirements of para. 17.b. of the 2020 Rate Case Settlement.¹

¹ Pursuant to Commission Order issued July 25, 2022 in Docket No. 21-00135, no additional regulatory asset for pension or OPEB above the amount that was authorized for recovery in Piedmont's last rate case shall be established for ratemaking purposes unless the Company first obtains express approval from the Commission.

4. Attestation from a Company officer, signed and notarized.
5. Proposed Tariff Changes.
6. Proposed Procedural Schedule.

II. HBP RECONCILIATION

The following methodologies shall be used in the ARM Filing Schedules, supporting workpapers and computations necessary to calculate the Company's HBP Revenue Requirement Deficiency (Sufficiency).

The HBP Revenue Requirement Deficiency (Sufficiency) and Carrying Costs shall be recovered through the ARM Rider Rates. The ARM Rider Rates shall be established for the Applicable Rate Schedules based on the amount of the ARM Reconciliation Deferred Account balance at March 31 of the year after the HBP plus the current Annual ARM Proceeding's HBP Revenue Requirement Deficiency (Sufficiency) and Carrying Costs.

The ARM Rider Rates shall be developed for each Applicable Rate Schedule based upon the respective customer billing determinants used in the computation of the Gas Sales and Transportation Revenues under Section III of this Tariff. In its Annual ARM Filing, Piedmont shall make a proposal for how to allocate any amount of HBP Revenue Requirement Deficiency (Sufficiency) among the Applicable Rate Schedules and the specific design for how the ARM Rider Rates are to be increased (decreased) for each Applicable Rate Schedule in accordance with the approved methodologies. Any intervenor party may make its own proposal for how the revenue deficiency (sufficiency) should be allocated to the Applicable Rate Schedules and the rate design for any increase (decrease) in the ARM Rider Rates. Based upon a final determination that the ARM Rider Rates need to be increased (decreased), the Commission shall order such increase (decrease) in the ARM Rider Rates be based upon the proposals of the parties or such other revenue allocation and rate design decision as it may find to be in the public interest.

Operating Revenues

- 1) **Gas Sales and Transportation Revenues** shall reflect such actual revenues from Base Rates billed for service provided to customers pursuant to the provisions of the Company's TPUC-approved rates and charges (including special contracts) and recorded during the HBP.
- 2) **Forfeited Discount Revenues** shall reflect such actual revenues related to service provided to customers pursuant to the provisions of Company's TPUC-approved rates and charges (including special contracts) and recorded during the HBP.
- 3) **Other Revenues** shall reflect such actual revenues related to service provided to customers pursuant to the provisions of Company's TPUC-approved rates and charges (including special contracts) and HomeServe Warranty Program revenues as recorded during the

HBP, exclusive of revenues related to off system sales, other gas supply and capacity secondary marketing activities, and customer cash-out activities.

- 4) **Margin Revenues** shall reflect the sum of the Gas Sales and Transportation Revenues, Forfeited Discount Revenues and Other Revenues described herein, less Purchased Gas Expenses [Cost of Gas].

Operating Expenses

- 5) **Purchased Gas Expenses [Cost of Gas]** shall be set equivalent to the PGA portion of the actual Gas Sales and Transportation Revenues during the HBP. Note that the actual purchased gas expenses are recorded to general ledger account 804, and are recovered by the Company through the PGA mechanism.
- 6) **Other Purchased Gas Expenses** shall reflect such actual expenses recorded during the HBP. Note that these are expenses not eligible for recovery by the Company through the PGA mechanism.
- 7) **Uncollectible & Bad Debt Expenses** shall reflect such actual expenses recorded during the HBP.
- 8) **Lobbying Expenses** recorded during the HBP shall be entirely excluded from the computation of Operating Expense.
- 9) **Employee Salaries & Wages Expenses** shall reflect such actual expenses recorded during the HBP, exclusive of any such expenses related to lobbying activities and any such costs deemed excessive or not otherwise in the public interest.
- 10) **Employee Incentive Compensation Expenses** shall reflect such actual expenses recorded during the HBP, exclusive of any such expenses related to lobbying activities. Also, fifty percent of the STIP expenses recorded during the HBP and one hundred percent of the LTIP expenses recorded during the HBP shall be excluded from the computation of Operating Expenses, consistent with paragraph 14.h. of the 2020 Rate Case Settlement.
- 11) **Amortization Expenses for Deferred Rate Case Expenses for Docket No. 20-00086** recorded during the HBP shall be entirely excluded from the computation of Operating Expense, consistent with paragraphs 14.k. and 17.f. of the 2020 Rate Case Settlement.
- 12) **Amortization Expenses for Deferred Environmental Costs** shall reflect the unamortized portion of previously-approved deferred environmental costs in accordance with the previously-approved amortization period. The Company may seek recovery of Environmental Costs incurred during the HBP, in accordance with Section III. Annual Base Rate Reset of this Tariff, upon a showing of prudence and that such costs are not recoverable through insurance policies.
- 13) **Amortization Expenses for Deferred Pension Costs** shall reflect the annual expense for unamortized balance of the pension regulatory asset included in the agreed-upon rate base in the Company's last rate case in accordance with the approved amortization period from the Company's last rate case.
- 14) **Other Pension Expenses and OPEB Expenses** shall be the Tennessee jurisdictional portion of the actuarially-determined minimum contribution requirement. Any Pension and

OPEB expenses computed and recorded in accordance with GAAP, including actual contributions, during the HBP shall be excluded.

- 15) **Expense for Allocated Return on DEBS Assets** shall reflect such actual expenses properly incurred, and charged to the Company's Tennessee jurisdiction during the HBP, adjusted to reflect a return based on the Authorized Return on Equity, and exclusive of any such expense related to return on DEBS pension assets. Such return shall be applied to the balance of DEBS assets net of Accumulated Depreciation and Accumulated Deferred Income Taxes (ADIT). Recoverable expenses shall exclude any such expense related to the return on DEBS pension assets.
- 16) **Expense for TPUC Fee** shall reflect such actual expenses recorded during the HBP.
- 17) **Other O&M Expenses** shall reflect such actual expenses recorded during the HBP including HomeServe Warranty Program expenses, as well as recoverable promotional and advertising expenses consistent with Commission Rule 1220-04-05-.45, exclusive of any such expenses related to lobbying activities, and shall reflect costs necessary in the provision of natural gas service.
- 18) **Other Expense Adjustments** shall reflect adjustments made by the Company to exclude any known expenses improperly recorded as an Operating Expense during the HBP.
- 19) **Depreciation Expenses** shall reflect such actual expenses recorded during the HBP, net of credits recorded during the HBP related to Depreciation Expense Deferrals.
- 20) **Amortization Expenses for ARM Regulatory Asset** shall reflect such actual expenses recorded during the HBP related to relieving the ARM Regulatory Asset pursuant to approvals granted in prior Annual ARM Proceedings.
- 21) **Payroll Tax Expenses** shall reflect such actual expenses recorded during HBP, adjusted to comport with the labor and other compensation expense adjustments described herein.
- 22) **Property Tax Expenses** shall reflect such actual expenses recorded during the HBP.
- 23) **Other General Tax Expense** shall reflect such actual expenses recorded during the HBP.
- 24) **Amortization of Investment Tax Credit** shall reflect such actual expenses recorded during the HBP.
- 25) **State Excise Tax Expense** shall be computed using the Company's composite state tax rate in effect December 31 of the HBP, and in alignment with the representation of the adjusted revenues and expenses herein including synchronized interest on debt. The Company shall notify the Commission and the Consumer Advocate of any change in the state tax rates which comprise the Company's composite state tax rate.
- 26) **Federal Income Tax Expense** shall be computed using the statutory federal tax rate in effect as of December 31 of the HBP, and in alignment with the representation of the adjusted revenues and expenses herein including synchronized interest on debt. Federal Income Tax Expense shall be further adjusted for the amortized return of protected federal excess accumulated deferred income taxes ("EDIT") resulting from the 2017 Tax Act.

Adjustments to Net Operating Income

- 27) **AFUDC** shall reflect the 13-month average CWIP balance during the HBP multiplied by the Overall Cost of Capital in the HBP including the Authorized Return on Equity.
- 28) **Interest on Customer Deposits** shall reflect such actuals recorded during the HBP.

Rate Base

- 29) **Utility Plant in Service** shall reflect the 13-month average of the actual end-of-month (“EOM”) balances for the HBP and the month prior to the HBP. Any amount recorded to plant in service that is not truly used in providing service to customers should be removed from general ledger account 101 and either written off or reclassified to an appropriate general ledger account. The Company has the burden to demonstrate the accuracy of recordings to plant in service.
- 30) **Accumulated Depreciation** shall reflect the 13-month average of the actual EOM balances for the HBP and the month prior to the HBP.
- 31) **CWIP** shall reflect the 13-month average of the actual EOM balances, exclusive of fifty percent of STIP costs and one hundred percent of LTIP costs recorded to CWIP during the HBP and the month prior to the HBP, consistent with paragraph 14.h. of the 2020 Rate Case Settlement. Pension and OPEB cost loadings to construction projects and accounted for in CWIP shall be accounted for consistent with how such expenses are recoverable in the HBP (see above item 14 – Other Pension and OPEB expenses).
- 32) **ARM Regulatory Asset** shall reflect the 13-month average of the actual EOM balances for the HBP, excluding the components of such balance associated with the Interest Deferrals.
- 33) **ADIT** shall reflect the 13-month average of the actual EOM balances for the HBP and the month prior to the HBP, exclusive of any amounts related to unprotected federal EDIT subject to refund to customers pursuant to the TPUC's August 6, 2019 Order in Docket No. 18-00040. Items included in ADIT should be determined consistent with the inclusion/exclusion of revenue and expense items represented in the HBP. The Company shall notify the Commission and the Consumer Advocate of any change in the state tax rates which comprise the Company's composite state tax rate. Any state tax rate change will result in an excess or deficient ADIT balance and that such excess or deficiency should be preserved on the Company's books for appropriate regulatory treatment within subsequent ARM filings.
- 34) **Cash Working Capital (Lead-Lag)** shall be computed in conformity with the lag days and categories of revenue and expense in the 2020 Rate Case Settlement.
- 35) **Other Working Capital** shall reflect the 13-month average of the actual EOM balances for the HBP and the month prior to the HBP, for the following:
- a. Material and Supplies
 - b. Gas Inventory
 - c. Prepaid Insurance
 - d. Fleets & Overheads
 - e. Accounts Payables applicable to CWIP

- f. Accounts Payables applicable to Materials and Supplies
- g. Customer Deposits
- h. Interest on Customer Deposits
- i. Accrued Vacation
- j. The Company may request recovery of any Deferred Debits for Environmental Costs. The Company shall bear the burden of proof that such costs are appropriately included in rate base.
- k. Pension Costs: Piedmont shall be allowed to recover through the ARM the unamortized balance of the pension regulatory asset included in the agreed-upon rate base in the Company's last rate case in Docket No. 20-00086 through annual expense amortizations over the remaining portion of the authorized eight-year amortization period. No additional regulatory asset for pensions or OPEBs above the amount that was authorized in Piedmont's last rate case shall be established for ratemaking purposes unless the Company first obtains express approval from the Commission.

Capitalization

- 36) **Capital Structure** shall reflect the actual long-term debt, short-term-debt and common equity (not including the impact of goodwill) each as a percentage of total average capitalization for the 13-month period ending December 31 of the HBP.
- 37) **Long Term Debt Cost** shall reflect the actual average embedded cost of long-term debt for the 13-month period ending December 31 of the HBP. The computation of the embedded cost of long-term debt shall include an adjustment for unamortized loss on reacquired debt and credit facility fees.
- 38) **Short Term Debt Cost** shall reflect the actual average cost rate of short-term debt borrowings (Piedmont's intercompany money pool borrowings) for the 13-month period ending December 31 of the HBP.
- 39) **Authorized Return on Equity** as defined in Section I of this Tariff.

III. ANNUAL BASE RATE RESET

The following methodologies shall be used in the ARM Filing Schedules, supporting workpapers and computations necessary to calculate the Company's Annual Base Rate Reset Revenue Requirement Deficiency (Sufficiency).

The updated Base Rates for each Applicable Rate Schedule shall be developed based upon the respective customer billing determinants the used in the computation of the Gas Sales and Transportation Revenues as set forth in Section III of this Tariff herein. In its Annual ARM Filing, Piedmont shall make a proposal for how to allocate any amount of Annual Base Rate Reset Revenue Requirement Deficiency (Sufficiency) among the Applicable Rate Schedules and the specific design for how the updated Base Rates are to be increased (decreased) for each Applicable

Rate Schedule in accordance with the approved methodologies. Any intervenor party may make its own proposal for how the revenue deficiency (sufficiency) should be allocated to the Applicable Rate Schedules and the rate design for any increase (decrease) in the Base Rates for the Annual Base Rate Reset. Based upon a final determination that the Base Rates need to be increased (decreased), the Commission shall order such increase (decrease) in the Base Rates be based upon the proposals of the parties or such other revenue allocation and rate design decision as it may find to be in the public interest.

Operating Revenues

- 1) **Gas Sales and Transportation Revenues** shall be computed, as follows:
 - a. For service rendered under Rate Schedules 301 (Residential), 302 (Small General) and 352 (Medium General) respectively, the actual usage during the 12-month period comprising the HBP shall be normalized for weather. For this purpose, Normal Heating Degree Days (NHDD) shall be the average of the actual daily heating degree days experienced in the 30-year period ending December 31 of each HBP. A simple linear regression analysis² using actual heating degree days for each month of the HBP, actual usage by rate schedule for each month of the HBP, and the monthly NHDD will be performed to derive the normalized base load usage and heat-sensitive usage per customer for each rate schedule. Such normalized base load usage and heat-sensitive usage per customer for each rate schedule shall then be aligned with the monthly NHDD and actual number of bills rendered each month of the HBP to establish the total normalized customer usage by month by rate schedule. Normalized revenues shall then be computed by applying the present Base Rates (clean rates, which are the rate components shown in columns <1>, <2> and <3> on the Company's Tariff Sheet No. 1, and excluding ARM Rider Rates and all other non-base rates) to the derived normalized monthly customer usage and associated monthly customer count for each rate schedule.
 - b. For service rendered under Rate Schedules 303 (Large General Sales - Firm), 304 (Large General Sales - Interruptible), 310 (Resale Service), 313 (Large General Transportation - Firm), 314 (Large General Transportation - Interruptible) and 343 (Motor Vehicle Fuel Service), revenues shall be computed by applying the present Base Rates (clean rates, which are the rate components shown in columns <1>, <2> and <3> on the Company's Tariff Sheet No. 1, and excluding ARM Rider Rates and all other non-base rates to the actual monthly customer usage and customer count for each rate schedule during the HBP.

² The methodology for computing and updating base load and heat sensitivity factors shall be the simple linear regression analysis methodology ordered by the Commission for Atmos Energy Corporation in Docket No. 14-00146 and Chattanooga Gas Company in Docket No. 18-00017. The updated base load and heat sensitivity factors shall be utilized for the Company's WNA for the applicable period of time immediately following the TPUC's decision on the Company's Annual ARM Filing.

- c. For service rendered under special contracts, revenues shall be the actuals recorded during the HBP. Should a special contract customer move to a tariff rate during or after the completion of the HBP, the revenue for that customer shall instead be computed pursuant to subpart a or b above, as warranted.
- 2) **Forfeited Discount Revenues** shall reflect such actual revenues related to service provided to customers pursuant to the provisions of Company's TPUC-approved rates and charges (including special contracts) and recorded during the HBP.
- 3) **Other Revenues** shall reflect such actual revenues related to service provided to customers pursuant to the provisions of Company's TPUC-approved rates and charges (including special contracts) and HomeServe Warranty revenues as recorded during the HBP, exclusive of revenues related to off system sales, other gas supply and capacity secondary marketing activities, and customer cash-out activities.
- 4) **Margin Revenues** shall reflect the sum of the Gas Sales and Transportation Revenues, Forfeited Discount Revenues and Other Revenues, net of the amount of Purchased Gas Expenses.

Operating Expenses

- 5) **Purchased Gas Expenses [Cost of Gas]** shall be set equivalent to the computed PGA portion of Gas Sales and Transportation Revenues.
- 6) **Other Purchased Gas Expenses** shall reflect such actual expenses recorded during the HBP. Note that these are expenses not recovered by the Company through the PGA mechanism.
- 7) **Uncollectible & Bad Debt Expenses** shall reflect such actual expenses recorded during the HBP.
- 8) **Lobbying Expenses** recorded during the HBP shall be entirely excluded from the computation of Operating Expense.
- 9) **Employee Salaries & Wages Expenses** shall reflect such actual expenses recorded during the HBP, exclusive of any such expenses related to lobbying activities and any such costs deemed excessive or not otherwise in the public interest.
- 10) **Employee Incentive Compensation Expenses** shall reflect such actual expenses recorded during the HBP, exclusive of any such expenses related to lobbying activities. Also, fifty percent of the STIP expenses recorded during the HBP and one hundred percent of the LTIP expenses recorded during the HBP shall be excluded from Operating Expenses, consistent with paragraph 14.h. of the 2020 Rate Case Settlement.
- 11) **Amortization Expenses for Deferred Rate Case Expenses for Docket No. 20-00086** recorded during the HBP shall be entirely excluded from the computation of Operating Expense, consistent with paragraphs 14.k. and 17.f. of the 2020 Rate Case Settlement.

- 12) **Amortization Expenses for Deferred Environmental Costs** shall reflect the unamortized portion of previously-approved deferred environmental costs in accordance with the previously-approved amortization period. The Company may also herein seek recovery of Environmental Costs incurred during the HBP upon a showing of prudence and that such costs are not recoverable through insurance policies, and such Environmental Costs shall be represented herein in accordance with the previously-approved amortization period.
- 13) **Amortization Expenses for Deferred Pension Costs** shall reflect the unamortized balance of the pension regulatory asset included in the agreed-upon rate base in the Company's last rate case in accordance with the approved amortization period from the Company's last rate case.
- 14) **Other Pension Expenses and OPEB Expenses** shall be the Tennessee jurisdictional portion of the actuarially-determined minimum contribution requirement. Any Pension and OPEB expenses computed and recorded in accordance with GAAP, including actual contributions, during the HBP shall be excluded.
- 15) **Expense for Allocated Return on DEBS Assets** shall reflect such actual expenses properly incurred, and charges to the Company's Tennessee jurisdiction during the HBP, adjusted to reflect a return based on the Authorized Return on Equity, and exclusive of any such expense related to return on DEBS pension assets. Such return shall apply to the balance of DEBS assets net of Accumulated Depreciation and Accumulated Deferred Income Taxes (ADIT). Recoverable expenses shall exclude any such expense related to the return on DEBS pension assets.
- 16) **Expense for TPUC Fee** shall reflect such actual expenses recorded during the HBP.
- 17) **Other O&M Expenses** shall reflect such actual expenses recorded during the HBP including HomeServe Warranty Program expenses, as well as recoverable promotional and advertising expenses consistent with Commission Rule 1220-04-05-.45, exclusive of any such expenses related to lobbying activities, and shall reflect costs necessary in the provision of natural gas service.
- 18) **Other Expense Adjustments** shall reflect adjustments made by the Company to exclude any known expenses improperly recorded as an Operating Expense during the HBP.
- 19) **Depreciation Expenses** shall be computed as annualized depreciation expense aligned with the actual December 31 HBP balance of Utility Plant in Service. Depreciation expenses shall be computed using the depreciation rates approved by the Commission in the Company's most recent general rate case or any subsequent approval.
- 20) **Amortization Expenses for ARM Regulatory Asset** shall be computed as annualized amortization expense aligned with the actual December 31 HBP balance of the ARM Regulatory Asset pursuant to approvals granted in prior Annual ARM Proceedings.
- 21) **Payroll Tax Expenses** shall reflect such actual expenses recorded during HBP, adjusted to comport with the labor and other compensation expense adjustments.
- 22) **Property Tax Expenses** shall reflect such actual expenses recorded during the HBP.

- 23) **Other General Tax Expense** shall reflect such actual expenses recorded during the HBP.
- 24) **Amortization of Investment Tax Credit** shall reflect such actual expenses recorded during the HBP.
- 25) **State Excise Tax Expense** shall be computed using the Company's composite state tax rate in effect as of December 31 of the HBP, and in alignment with the representation of the adjusted revenues and expenses as described including synchronized interest on debt. The Company shall notify the Commission and the Consumer Advocate of any change in the state tax rates which comprise the Company's composite state tax rate.
- 26) **Federal Income Tax Expense** shall be computed using the statutory federal tax rate in effect as of December 31 of the HBP, and in alignment with the representation of the adjusted revenues and expenses herein including synchronized interest on debt. Federal Income Tax Expense shall be further adjusted for the amortized return of protected federal excess accumulated deferred income taxes ("EDIT") resulting from the 2017 Tax Cuts and Jobs Act.

Adjustments to Net Operating Income

- 27) **AFUDC** shall be represented as the CWIP balance at December 31st of the HBP multiplied by the Overall Cost of Capital at December 31st of the HBP including the Authorized Return on Equity.
- 28) **Interest on Customer Deposits** shall reflect such actuals recorded during the HBP.

Rate Base

- 29) **Utility Plant in Service** shall reflect the actual December 31 HBP balance. Any amount recorded to plant in service that is not truly used in providing service to customers should be removed from Account 101 and either written off or reclassified to an appropriate account. The Company has the burden to demonstrate the accuracy of recordings to Plant in Service.
- 30) **Accumulated Depreciation** shall reflect the actual December 31 HBP balance.
- 31) **CWIP** shall reflect the actual December 31 HBP balance, exclusive of fifty percent of STIP costs and one hundred percent of LTIP costs recorded to CWIP during the HBP, consistent with paragraph 14.h. of the 2020 Rate Case Settlement. Pension and OPEB cost loadings to construction projects and accounted for in CWIP shall be accounted for consistent with how such expenses are recoverable in the HBP (see above item 14 – Other Pension and OPEB expenses).
- 32) **ARM Regulatory Asset** shall reflect the actual unamortized December 31 HBP balance.
- 33) **ADIT** shall reflect the actual December 31 HBP balance, exclusive of any amounts related to the unprotected federal EDIT subject to refund to customers pursuant to the TPUC's August 6, 2019 Order in Docket No. 18-00040. Items included in ADIT should

 Tax News Update  Email this document  Print this document

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North Carolina enacts significant tax law changes for businesses and individuals

On November 18, 2021, Governor Roy Cooper (D) signed into law the 2021 Appropriations Act (2021–2022 N.C. Sess. Laws, ch. SL 2021-180, [Senate Bill 105](#)) (Bill),¹ which affects various North Carolina taxes. The Bill (1) phases out the corporate income tax; (2) simplifies the franchise tax base; (3) establishes an elective tax on pass-through entities, such as partnerships, S corporations and limited liability companies (PTEs); (4) updates North Carolina's conformity to the Internal Revenue Code (IRC) and loan forgiveness under the Paycheck Protection Program (PPP); (5) reduces individual income tax rates; and (6) increases the individual standard deduction and child deduction, among other tax law changes.

The Bill enacts the state's \$52.9 billion general fund budget for each year of the fiscal biennium beginning July 1, 2021 through June 30, 2023.

Tax provisions in the Bill generally are effective for tax years beginning January 1, 2022, unless otherwise noted.

Corporate income tax changes

The Bill phases out the current 2.5% corporate income tax rate over five-years starting in 2025, reaching zero by 2030. The Bill lowers the corporate tax rate to 2.25% for tax years beginning on or after January 1, 2025. The rate decreases to 2% in 2026 and 2027; and to 1% in 2028 and 2029. After 2029, the rate decreases to 0%.²

For purposes of the state's addback provision for related-party interest expense, the Bill modifies the definition of "qualified interest expense" so that the state limitation on deductions for the proportional share of interest paid to a related member does not apply to the extent that the interest paid has already been disallowed under IRC Section 163(j).³ This change applies retroactively to tax years beginning on or after January 1, 2018.

The Bill also requires the revenue secretary (Secretary) to apply the standards in the regulations under IRC Sections 381 and 382 when determining the extent a loss survives a merger or acquisition. This change applies to tax years beginning on or after January 1, 2015. For mergers and acquisitions that occurred before January 1, 2015, the secretary must apply the standards under N.C.G.S. Section 105-130.8.⁴

North Carolina law authorizes the Secretary to adjust net income or require a combined return. North Carolina law also requires taxpayers to provide information to the secretary upon the secretary's request. The Bill expands the scope of information that can be requested to include (1) financial or tax documents the Secretary deems necessary to determine the appropriate adjustments to net income, or (2) a combined return. If such information is not timely provided, the secretary may propose any allowable adjustment.⁵ This change took effect when the Bill became law on November 18, 2021.

Corporate franchise tax simplification

The Bill simplifies the franchise tax calculation. Previously, North Carolina's franchise tax was levied on the largest of three bases: (1) a corporation's North Carolina apportioned net worth; (2) 55% of the appraised value of all a corporation's real and tangible personal property in North Carolina; or (3) a corporation's total investment in tangible property in North Carolina.⁶ Under all three bases, the tax applied at a rate of \$1.50 for every \$1,000 of the tax base, with a \$200 minimum and a \$150,000 maximum tax.⁷

The Bill eliminates the second and third property tax bases, so the franchise tax will only apply to the first tax base — a taxpayer's North Carolina apportioned net worth. This change is effective for a corporation's franchise tax calculated on its 2022 income tax returns filed in 2023.⁸

PTE provisions

Following similar legislation enacted by many other states this year, the Bill gives North Carolina individual taxpayers the ability to reduce the impact of the annual \$10,000 limit on the IRC Section 164(b)(6) deduction for state and local tax (SALT Cap) by allowing certain PTEs to elect to pay tax at the entity level.⁹ The election cannot be made by a publicly traded partnership, r



partnership that has, at any time during the tax year, a partner that is not an individual, an estate, a trust or an organization described in IRC Section 1361(c)(6).¹⁰ A PTE must elect to be taxed at the entity level on its timely filed annual return for tax periods covered by the return; the election may not be revoked after the return's due date (including extensions).¹¹ The Bill describes (1) how electing PTEs calculate their taxable income, (2) how they pay their tax, and (3) how tax credit partners or shareholders of electing PTEs can claim their share of paid PTE tax against their North Carolina personal state income taxes.¹²

IRC conformity, North Carolina treatment of PPP loans and conformity to IRC Section 163(j)

The Bill updates North Carolina's conformity to the IRC of 1986, as amended, to that in effect as of April 1, 2021 (from May 1, 2020).¹³ This change took effect when the Bill became law on November 18, 2021.

North Carolina law follows the federal exclusion from gross income for indebtedness forgiven on a PPP loan issued under the Coronavirus Aid, Relief and Economic Security Act (P.L. 116-136) (CARES Act) and any subsequent federal legislation. Before the Bill's enactment, North Carolina taxpayers had to add back to federal income any expense deducted under the IRC to the extent the expense was paid with forgiven PPP loan income excluded from gross income.¹⁴

The Bill modifies this addback provision in N.C.G.S. Section 105-153.5(c2)(20) by deleting the addback language for expenses paid with forgiven PPP loans. For tax years beginning on or after January 1, 2023, the Bill requires North Carolina taxpayers to add back any expense deducted under the IRC to the extent the expense is allocable to income that is either wholly excluded from gross income or is wholly exempt from North Carolina income tax. This provision conforms North Carolina law to the treatment of PPP loans under federal tax law, which allows expenses paid with forgiven PPP loans and other federal pandemic-assistance programs to be deducted through 2022. The Bill also clarifies, for North Carolina income tax purposes, the tax treatment of expenses paid with receipts from other federal pandemic relief programs.¹⁵

North Carolina previously decoupled from the modifications to the IRC Section 163(j) limitation on business interest expense allowed under Section 2306 of the CARES Act for tax years beginning in 2019 and 2020.¹⁶ The Bill allows taxpayers to deduct the addition modification resulting from that decoupling over five years beginning with tax year 2021.¹⁷

Personal income tax rate reductions and other changes

The Bill lowers the North Carolina personal income tax rate from 5.25% to 3.99% over six years beginning on or after January 1, 2022.¹⁸

The Bill also increases the North Carolina standard deduction for personal income taxes for each of the tax years beginning on or after January 1, 2022 as follows:

	North Carolina standard deduction for personal income taxes	
Filing status	Current law	New law (eff. 1/1/22)
Married, filing jointly/surviving spouse	\$21,500	\$25,500
Head of Household	\$16,125	\$19,125
Single	\$10,750	\$12,750
Married, filing separately	\$10,750	\$12,750

In addition, the Bill increases the North Carolina child deduction by \$500 for each qualifying child. The child deduction now ranges from \$500 per child up to \$3,000 per child based on filing status and income threshold. The Bill also expands the eligibility for the child deduction by increasing the income threshold at which taxpayers may claim the deduction.¹⁹

The Bill also creates a net operating loss (NOL) calculation for individual income tax purposes, effective for tax years beginning on or after January 1, 2022.²⁰ Under the Bill, a taxpayer's state NOL for a tax year generally equals the amount by which yearly business deductions exceed yearly gross business income, as determined under the IRC and adjusted under N.C.G.S. Sections 105-153.5 and 105-153.6. A state NOL would not, however, include the following:

- A state NOL deduction
- Deductible losses on sales or exchanges of capital assets, to the extent they exceed gains from those sales or exchanges
- The IRC Section 1202 small business stock gains exclusion
- A child deduction
- Deductions under IRC Section 199A

The Bill allows deductions not attributable to a taxpayer's trade or business to the extent the gross income is not derived from the trade or business.



Unused NOLs can be carried forward up to 15 years. The taxpayer's state NOL deduction cannot exceed the taxpayer's North Carolina taxable income determined without deducting the taxpayer's state NOLs. A taxpayer's federal NOL that was not used in tax years beginning before January 1, 2022, may be included in the taxpayer's state NOL in tax years beginning on or after January 1, 2022. Starting in 2022, federal NOLs carryforwards are only allowed as a state NOL to the extent they meet certain conditions.

The Bill includes other personal income tax-related provisions that:

- Conform to the lower threshold amount (7.5% of income) for the medical expense deduction
- Decouple North Carolina's personal income tax from the federal exclusion from income for unemployment compensation received in tax year 2020
- Exempt certain military retiree income from taxation, effective for tax years beginning on or after January 1, 2021
- Decouple from the federal modifications of limits on charitable contributions under the CARES Act and the Consolidated Appropriations Act, 2021 (CAA) by allowing taxpayers to carry forward charitable contributions from tax years 2020 and 2021 that exceed the federal limitation for those years
- Prohibit, through tax year 2021, mortgage insurance premiums that are treated as qualified residence interest from being treated as deductible interest paid or accrued during the tax year under IRC Section 163(h)
- Require through 2025 that taxpayers add back any gross income excluded under IRC Section 108 for the discharge of qualified principal residence indebtedness
- Decouple from the exclusion for certain employer payments of student loans under the CARES Act and the CAA and the exclusion from income for the discharge of a student loan under the American Rescue Plan Act of 2021
- Decouple from the increased deduction for business-related expenses for food and beverages provided by a restaurant under the CAA
- Extend through 2021 the deduction from adjusted gross income for amounts granted under the Extra Credit grant program (previously, the deduction was only available through 2020)

Other changes

The Bill makes other tax-related changes as follows:

- Reenacts and extends the mill rehabilitation credit
- Extends and expands the historic rehabilitation credit
- Authorizes the North Carolina Department of Revenue to create and administer the Business Recovery Grant Program for businesses that suffered economic damage from the COVID-19 pandemic²¹ (amounts received under the grant program are not taxed for North Carolina income tax purposes)²²
- Converts the flat 10% late-payment penalty to a graduated penalty that starts at 2% and increases an additional 2% for each month the failure continues, not to exceed 10% in aggregate
- Clarifies that taxpayers must request a refund of a tax overpayment involving a contingent event²³ within six months of the event's conclusion
- Modifies the use of fees collected on overdue taxes

The Bill also makes various changes to the state's property, sales/use, fuel and gross premiums taxes, as well as other administrative changes.

Implications

The Bill significantly changes North Carolina's personal income, corporate income and franchise and other business entity tax laws. North Carolina taxpayers should consult with their tax advisors and preparers on how the Bill's tax provisions and reporting requirements will affect past or future transactions.

The elective PTE tax effectively enables North Carolina PTE owners to exceed the SALT Cap when deducting, for federal income tax purposes, their share of North Carolina tax on their business income assigned to the state, consistent with IRS Notice 2020-75, which blessed these various state taxes imposed on PTEs (see Tax Alert [2020-2690](#)). North Carolina becomes the latest state to enact such a "workaround" to the SALT Cap by allowing a PTE to elect to pay income tax at the entity level.²⁴

Contact Information

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ENDNOTES

¹ The Bill is titled the North Carolina "2021 Appropriations Act."



- ² Bill, Section 42.2.(a) (amending N.C. Gen. Stat. (N.C.G.S.) Section 105-130.3).
- ³ Bill, Section 42.13B.(d) (amending N.C.G.S. Section 105-130.7B(b)(4)).
- ⁴ Bill, Section 42.13B.(e) (amending N.C.G.S. Section 105-130.8A(c)).
- ⁵ Bill, Section 42.13B.(f) (amending N.C.G.S. Section 105-251(a)).
- ⁶ See N.C.G.S. Section 105-122(d) (prior to amendment by the Bill).
- ⁷ N.C.G.S. Section 105-120(b).
- ⁸ Bill, Sections 42.3.(c) (amending N.C.G.S. Section 105-120.2(b)) and (d) (establishing the effective date of the provision).
- ⁹ Bill, Sections 42.5.(a) - (n) (amending and adding various provisions to North Carolina tax law addressing the taxation of S corporations and partnerships including N.C.G.S. Sections 105.131.1, 105.131A (new), 105.131.7, 105.131.8, 105-153.3, 105-154.1 (new), 105-153.5, 105-153.9(a), 105.160.4, 105-163.38 and 105-163.39.)
- ¹⁰ Bill, Section 42.5(h) (adding new section N.C.G.S. Sections 105-154.1(a)).
- ¹¹ Bill, Sections 42.5(c) (adding new subsection N.C.G.S. Sections 105-131A(a) (Taxed S Corporation Election)) and 42.5(h) (adding new subsection N.C.G.S. Sections 105-154.1(a) (Taxed Partnership Election)).
- ¹² Bill, Sections 42.5.(a) through (n).
- ¹³ Bill, Section 42.4.(a).
- ¹⁴ N.C.G.S. Section 105-153.5(c2)(20).
- ¹⁵ Bill, Section 42.4.(c).
- ¹⁶ N.C.G.S. Section 105-153.5(c2)(17).
- ¹⁷ Bill, Section 42.13A.(b).
- ¹⁸ Bill, Section 42.1.(a) and (b). The North Carolina personal income tax rate will be 4.99% in 2022, 4.75% in 2023, 4.6% in 2024, 4.5% in 2025 and 4.25% in 2026. For years thereafter, the rate will be 3.99%.
- ¹⁹ Bill, Section 42.1.(c).
- ²⁰ Bill, Section 42.6.(a) - (c).
- ²¹ Bill, Section 34.3A.(b).
- ²² Bill, Sections 34.3B.(a) and 34.3B.(b).
- ²³ A contingent event is one that prevents the taxpayer from filing an accurate and definite refund request for an overpayment of tax within the allowed period.
- ²⁴ The following states have already enacted a PTE tax as a workaround to the SALT Cap: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Georgia, Idaho, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oklahoma, Oregon, Rhode Island, South Carolina and Wisconsin. Michigan, Ohio and Pennsylvania have introduced legislation that would enact a similar PTE tax.



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