ORAL ARGUMENT HAS NOT BEEN SCHEDULED

In the United States Court of Appeals for the District of Columbia Circuit

No. 18-1298

BALTIMORE GAS AND ELECTRIC COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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FINAL BRIEF: JUNE 11, 2019

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The Parties before this Court are identified in Petitioner's Rule 28(a)(1) certificate.

B. Rulings Under Review

1. *PJM Interconnection, L.L.C.*, Order Rejecting Proposed Tariff Revisions, 161 FERC ¶ 61,163 (2017) ("Initial Order"), R. 9, JA 87–96;

   and

2. *PJM Interconnection, L.L.C.*, Order on Rehearing and Clarification, 164 FERC ¶ 61,173 (2018) ("Rehearing Order"), R. 17, JA 202–22.

C. Related Cases

This case has not previously been before this Court or any other court. To counsel's knowledge, there are no related cases pending elsewhere.

/s/ Jared B. Fish
Jared B. Fish

June 11, 2019

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GLOSSARY

1993 Guidance	Accounting for Income Taxes, FERC Dkt. No. AI93-5-000 (Apr. 23, 1993)
2006 Settlement	Baltimore Gas and Electric Settlement Agreement and Offer of Settlement, FERC Dkt. No. ER05-515 (filed Mar. 20, 2006), JA 7–47
2014 Guidance	FERC Staff Guidance on Formula Rate Updates (July 17, 2014)
2018 Proposed Rule	*Pub. Util. Transmission Rate Changes to Address Accumulated Deferred Income Taxes*, 165 FERC ¶ 61,117 (2018) (notice of proposed rulemaking)
Construction Allowance Equity	The equity component of Allowance for Funds Used During Construction depreciation expense
Br.	Opening brief of Petitioner Baltimore Gas and Electric Company
Baltimore Gas	Petitioner Baltimore Gas and Electric Company
Commission or FERC	Respondent Federal Energy Regulatory Commission
Standard 109	Financial Accounting Standard 109
Initial Order	*PJM Interconnection, L.L.C.*, Order Rejecting Proposed Tariff Revisions, 161 FERC ¶ 61,163 (2017), R. 9, JA 87–96
P	Internal paragraph number in a FERC order
R.	Record item
Rehearing Order	*PJM Interconnection, L.L.C.*, Order on Rehearing and Clarification, 164 FERC ¶ 61,173 (2018), R. 17, JA 202–22

Rehearing Petition	Baltimore Gas and Electric Request for Clarification and Rehearing (filed Dec. 18, 2017), R. 12, JA 102–67
Response to Deficiency Letter	Baltimore Gas and Electric Response to FERC's Deficiency Letter (filed Mar. 13, 2017), R. 7, JA 64–86
Tax Rule or Rule	*Regulations Implementing Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes*, Order No. 144, FERC Stats. & Regs. ¶ 30,254 (1981), *on reh'g*, Order No. 144-A, FERC Stats. & Regs. ¶ 30,340 (1982)

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BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUE

This case involves a Federal Energy Regulatory Commission ("Commission" or "FERC") requirement that electric utilities make a timely rate filing to reflect accumulated deferred income taxes on their books. Deferred taxes accrue due to the different treatment accorded facility expenses by the Internal Revenue Service for tax purposes and by the Commission for ratemaking purposes. Deferred tax amounts are recorded according to Financial Accounting Standard No. 109 ("Standard 109").

Commission Order No. 144 ("Tax Rule" or "Rule"), enacted in 1981, requires utilities to address deferred taxes in their "next rate case," and to do so "within a reasonable period of time." The Rule's purpose is twofold: (1) to match the tax benefits of a facility expense with the ratepayers who pay for that expense through their electric rates; and (2) to do so expeditiously to ensure that such "matching" occurs.

In 1996 and 1997, Baltimore Gas and Electric Company ("Baltimore Gas") filed its first two wholesale rate cases with the Commission. Those cases were resolved through "black-box" settlements, meaning the Commission approved specific rates without considering whether the inputs reflected deferred tax amounts. While Baltimore Gas presumes the 1996 and 1997 rates addressed deferred taxes, it acknowledges that the rates produced by its "next rate case" in 2005 did not. Indeed, Baltimore Gas waited nearly 12 years thereafter before seeking a rate adjustment with the Commission to address deferred taxes. And it sought to do so not only on a going-forward basis, but also to recoup approximately $38 million in deferred taxes dating back to 2005. Those amounts had accumulated on Baltimore Gas's books because it did not account for them in its 2005 rates. To address this deficiency, Baltimore Gas proposed increasing its rates prospectively above what they would have been had it reflected deferred tax amounts in its rates since 2005.

The Commission rejected Baltimore Gas's proposed retrospective recovery. Because Baltimore Gas failed to address deferred tax amounts in its 2005 rate filing—i.e., in its "next rate case"—the Commission concluded that approving a rate increase on future ratepayers to make up a deficiency that had accumulated over the previous 12 years would violate the Tax Rule. At the same time, the Commission preserved Baltimore Gas's right to seek a rate adjustment on a going-forward basis through a separate filing.

The question presented is:

Whether the Commission reasonably concluded, in interpreting its 1981 Tax Rule, that Baltimore Gas is not entitled to recover from future ratepayers $38 million in deferred tax amounts it had accumulated over the preceding 12 years.

JURISDICTIONAL STATEMENT

The Commission agrees with Baltimore Gas's statement of jurisdiction.

STATUTORY AND REGULATORY PROVISIONS

Pertinent statutes and regulations are located in a separately filed Addendum.

STATEMENT OF FACTS

I. Background

A. Reflecting Tax Treatment of an Expense in a Utility's Rates: The Flow-Through Method Versus Tax Normalization

The Federal Power Act charges the Commission with setting "just and reasonable" wholesale rates for public utilities. 16 U.S.C. § 824d(a).

Traditionally, "[t]he rates [we]re based on cost of service, which comprises all expenses incurred, including income taxes, plus a reasonable return on capital." *Pub. Sys. v. FERC*, 709 F.2d 73, 75 (D.C. Cir. 1983) (internal quotations omitted).

One of the challenges involved in wholesale ratemaking is aligning income tax treatment of a facility expense with ratemaking treatment of that expense. *Id.* The issue is one of timing. Internal Revenue Service rules often allow for accelerated depreciation of a utility's facility expense. *See Town of Norwood v. FERC*, 53 F.3d 377, 381–82 (D.C. Cir. 1995). Accelerated depreciation differs from straight-line depreciation in that it allows a utility to deduct from its income the entire expense of a facility—e.g., a transmission line—sooner than the end of its useful life, e.g., in a single year. *See id.* Under straight-line depreciation, the facility expense is spread over the useful life of the facility. *Id.* at 382. The upshot is that accelerated depreciation results in a relatively large income tax break in the first year, but higher taxes in the back years, whereas straight-line depreciation means a relatively higher tax burden in the first year, but a relatively lower bill thereafter. *See id.* The utility ultimately pays the same amount in taxes; it is just a question of the time period over which it pays them. *See id.*

Accelerated depreciation raises the question of how to reflect such tax treatment in rates. One method is to lower rates only in the first year, thereby flowing through the utility's entire tax savings to ratepayers that same year. *Pub. Sys.*, 709 F.2d at 76. Ratepayers in later years will then pay the cost of a facility

expense without the benefit of the first-year deduction. *See id.* This "flow-through" method has the virtue of aligning rate accounting with tax accounting. *Id.*; *Regulations Implementing Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes*, Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,527–28 (1981), *on reh'g*, Order No. 144-A, FERC Stats. & Regs. ¶ 30,340 (1982) (collectively, the "Tax Rule" or "Rule") (excerpts appended in Addendum). But the flow-through method has a drawback: it fails to match the tax benefits of an expense with all ratepayers who bear the cost of that expense over time. *Id.* Only ratepayers in the first year will see a rate cut; ratepayers in the back years will shoulder a relative rate hike. *Norwood*, 53 F.3d at 382. Such a result violates the Commission's long-standing "matching principle," whereby "ratepayers are charged with the costs of [the utility] producing the service they receive." *Id.* at 380–81.

Tax normalization is an alternative ratemaking technique that solves the flow-through method's matching problem. *Pub. Sys.*, 709 F.2d at 76. Under tax normalization, all ratepayers who bear the cost of an expense—spread over the useful life of the facility—receive the benefit of the tax deduction that occurred in the first year under accelerated depreciation. *Id.* at 80; *Commonwealth Edison Co.*, 164 FERC ¶ 61,172, at P 122 (2018). In other words, the tax deduction is reflected in a rate decrease spread over many years, even though the utility received all of

the tax savings in the first year. *Norwood*, 53 F.3d at 382. Tax normalization thereby satisfies the "matching principle" because "the [ratepayers] who pay the expense receive the tax benefit associated with that expense," regardless of *when* the tax benefit is enjoyed by the utility. *Pub. Sys.*, 709 F.2d at 76, 80.

B. The Commission's 1981 Tax Rule and the Switch From the Flow-Through Method to Tax Normalization

In 1980, the Commission conducted a rulemaking to move the utility industry from the flow-through method to tax normalization, a process that resulted in the 1981 Tax Rule. *Pub. Sys.*, 709 F.2d at 78, 80. The change, however, created a transition problem: utilities previously operating under the flow-through method would have already passed on to ratepayers the full benefits of the front-end tax deduction resulting from accelerated depreciation. *See id.* at 84–85. But requiring utilities to switch to tax normalization would mean spreading the benefits of the deduction over the useful life of the expense, even though they had already flowed-through the entire deduction to their customers. *Id*.

Put another way, had the utility followed tax normalization since day one, it would have had a deferred tax account made up of a surplus that it held onto—rather than flowed-through to ratepayers—when it received a tax cut in the first year. *Norwood*, 53 F.3d at 382. It would have then spent down that surplus through its rates over the useful life of the facility. *Id*. But "[w]hen the [utility] *switches* from flow-through to tax normalization accounting, it does not have any

accumulated surplus in its deferred tax account." *Id*. (emphasis in original). This means the utility "owes more money in taxes than it can collect from its ratepayers under its new tax normalization procedure." *Id*. For its part, Baltimore Gas switched from the flow-through method to tax normalization in 1976 due to a Maryland state law requirement. Baltimore Gas Request for Clarification and Rehearing at 55 (filed Dec. 18, 2017) ("Rehearing Petition"), R. 12, JA 156; Baltimore Gas Response to FERC's Deficiency Letter at 21 (filed Mar. 13, 2017) ("Response To Deficiency Letter"), R. 7, JA 84.

The Tax Rule addresses the transition problem by requiring utilities to include a "make-up" provision in their rates. *Pub. Sys.*, 709 F.2d at 84. The provision operates as follows: for expenses already on the books—and which were subject to the flow-through method before—those normalized rates are adjusted so the utility is assured recovery through its rates of what it pays in taxes. *See id*. at 84–85. While the Tax Rule leaves it to utilities to fashion their "make-up" mechanism, the industry standard is the so-called *South Georgia* method. Under that method, the utility collects from future ratepayers the amount the utility would have collected had it used tax normalization all along. *See Norwood*, 53 F.3d at 382; *PJM Interconnection, L.L.C.*, Order on Rehearing and Clarification, 164 FERC ¶ 61,173, at P 3 n.3 (2018) ("Rehearing Order"), R. 17, JA 203 (citing *South Georgia Nat. Gas Co.*, FERC Dkt. No. RP77-32 (May 5, 1978) (delegated letter order)). In practice, this means that "future rates must be higher than they would

have been if normalization had always been used."[1] *Pub. Sys.*, 709 F.2d at 85. Baltimore Gas seeks to recover approximately $13 million (of a $38 million total) from ratepayers going forward due to its transition from the flow-through method to tax normalization in 1976. *PJM Interconnection, L.L.C.*, Order Rejecting Proposed Tariff Revisions, 161 FERC ¶ 61,163, at P 10 (2017) ("Initial Order"), R. 9, JA 91.

C. The Tax Rule and Addressing Changes to Tax Laws

In addition to addressing deferred tax amounts related to the switch from the flow-through method to tax normalization, the Commission's 1981 Tax Rule also targets deferred tax amounts that accrue due to changes in tax rates. Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,559–60. The issue and solution are largely the same as with Flow-Through Amounts, but the triggering event is different. For example, if the tax rate drops from 48% to 46%, the utility will begin paying less in taxes than reflected in its rates. *Id.* at 31,559. It will thus begin accumulating a surplus in its deferred tax account that the Tax Rule requires be returned to ratepayers through a rate adjustment. *Id.* Conversely, if a tax rate is increased, then the utility would begin collecting too little from ratepayers, thus requiring a rate adjustment in the other direction. Baltimore Gas seeks to return

[1] This brief refers to those deferred tax amounts resulting from the transition from the flow-through method to tax normalization as Flow-Through Amounts.

approximately $4 million to ratepayers due to tax law changes. Initial Order P 10, JA 91.

D. The Tax Rule and Addressing Construction Allowance Equity

Finally, in its order denying rehearing of its Tax Rule, the Commission indicated that utilities should also address a third trigger of accumulated deferred tax amounts: the equity component of Allowance for Funds Used During Construction depreciation expense ("Construction Allowance Equity"). Order No. 144-A, FERC Stats. & Regs. ¶ 30,340, at 30,136 (excerpts appended in Addendum); *see also Midcontinent Indep. Sys. Operator*, 163 FERC ¶ 61,163, at PP 59–60 (2018) ("[T]he Commission has held that the tax effect of the non-deductibility of [Construction Allowance] Equity should be treated as a temporary timing difference."); Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,557–58 ("The final rule … requires that rate base be adjusted for … accumulated deferred taxes arising from construction-related timing differences ….").

Construction Allowance Equity refers to the equity component of a utility's financing costs incurred during construction. *See* Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,557–58. Those costs are recorded as a depreciation expense that is reflected in the utility's rates. Initial Order P 7, JA 90. But unlike the facility's construction costs, federal tax rules do not allow a utility to deduct the equity component of construction funds from its income taxes. *Id.* This mis-match between rate treatment and tax treatment of Construction Allowance Equity results

in an under-collection from ratepayers: ratepayers pay a rate that reflects a full deduction for a utility's Construction Allowance Equity expense, when, for tax purposes, the utility may not deduct that expense. *See id*. The Tax Rule contemplates addressing this imbalance in a utility's rates. *See* Order No. 144-A, FERC Stats. & Regs. ¶ 30,340, at 30,136; *see also Midcontinent*, 163 FERC ¶ 61,163, at PP 59–60. Baltimore Gas seeks to recover approximately $29 million (of a $38 million total) from ratepayers related to Construction Allowance Equity. Initial Order P 10, JA 91.

E. Implementing the Commission's Tax Rule

In the interest of protecting ratepayers, and central to the dispute on review here, the Tax Rule imposes a temporal limitation on the period in which utilities may achieve full normalization by resolving excesses or deficiencies in their deferred tax accounts. Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519, 31,522, 31,560; *see also Pub. Sys.*, 709 F.2d at 84–85 ("The make-up provision, by spreading over time the liability for prior flow-through of tax benefits, prevents an undue hardship from falling upon a portion of future ratepayers."). It requires a utility to "develop[] *in its next rate case* a method for handling any excesses or deficiencies that might exist in the deferred tax reserves because of prior flow-through treatment of timing difference transactions or because of tax rate changes." Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519 (emphasis added); Rehearing Order P 18, JA 210–11.

The Commission also time-limited the period utilities had to file the requisite "next rate case." Its Tax Rule requires utilities "to begin the process of making up deficiencies in or eliminating excesses in their deferred tax reserves so that, *within a reasonable period of time to be determined on a case-by-case basis*, they will be operating under a full normalization policy." Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,560 (emphasis added). The "reasonable period of time" requirement works in conjunction with the "next rate case" requirement. Rehearing Order P 18, JA 210–11. Thus, if a new tax law increases a utility's tax rate, the utility must seek to recoup the adjusted amount from ratepayers in its "next rate case," and do so "within a reasonable period of time." *See id.*; Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519, 31,560.

Utilities make rate modifications either through a rate case filing under Federal Power Act section 205, or pursuant to a Commission-imposed rate case under section 206. *See Pub. Util. Transmission Rate Changes to Address Accumulated Deferred Income Taxes*, 165 FERC ¶ 61,117, at P 11 (2018) (notice of proposed rulemaking) ("2018 Proposed Rule") (citing 16 U.S.C. §§ 824d, 824e(a)). The Commission then decides whether the utility's proposed adjustment is "just and reasonable." *See* 16 U.S.C. §§ 824d(a), 824e(a). Thus, by requiring a utility to adjust its rates to reflect deferred taxes in a rate case, the Commission's Tax Rule necessarily requires the utility to secure Commission approval before doing so.

F. Financial Accounting Standard 109 and the Commission's Guidance on Deferred Taxes

In 1992, the Financial Accounting Standards Board issued Standard 109. Initial Order P 4, JA 88. Standard 109 requires utilities to track fluctuations in their deferred tax accounts based on the three triggering events discussed above: (1) the transition from flow-through accounting to tax normalization; (2) tax law changes; and (3) the incurrence of Construction Allowance Equity. *Id.* Standard 109 does not, however, mandate any corrective action to address those deferred tax amounts in a utility's rates. It is, instead, a recordkeeping requirement. *See id.*

In 1993, the Commission issued guidance on implementing Standard 109. *See id.* (citing Accounting for Income Taxes, FERC Dkt. No. AI93-5-000 (Apr. 23, 1993) ("1993 Guidance") (appended in Addendum)). Among other things, the 1993 Guidance explains how Standard 109's recordkeeping mandate works in conjunction with the Commission's 1981 Tax Rule. As relevant here, it reiterates the Rule's requirement that a utility receive Commission approval for a rate adjustment—i.e., in its "next rate case"—before addressing deferred tax amounts in its rates. 1993 Guidance § 13.

G. Baltimore Gas's 1996, 1997, and 2005 Rate Cases

In 1996, the Commission issued its landmark Order No. 888 open access rulemaking. *See Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1363

(D.C. Cir. 2004). That order required transmission-owning utilities like Baltimore Gas to "'functionally unbundle' their wholesale generation and transmission services by stating separate rates for each service in a single tariff …." *Id*. at 1364. Prior to 1996, utilities like Baltimore Gas charged customers through bundled *retail* rates, which were regulated by state public utility commissions. *See* Initial Order PP 12–13, JA 92. Thus, until 1996, Baltimore Gas had no need to file a wholesale rate case with the Commission. *See* Rehearing Petition at 24, JA 125.

Baltimore Gas filed its first rate case with the Commission in 1996, followed by a second one in 1997. Initial Order PP 12–13, JA 92; Rehearing Petition at 24, JA 125. Both filings were resolved through "black-box" settlements, meaning the Commission approved a specific rate without peering behind the curtain at the methodology for deriving the rate. *See* Letter Order, Dkt. No. ER97-3189-002 (Sept. 18, 1998); Letter Order, Dkt. No. ER96-894 (Nov. 13, 1997); *see also E. Shore Natural Gas Co.*, 122 FERC ¶ 61,076, at P 2 (2008) (explaining the nature of black-box settlements). It is therefore unclear whether the approved rates in 1996 and 1997 addressed deferred tax amounts accumulating on Baltimore Gas's books.

Baltimore Gas filed its next rate case in January 2005. That filing differed from the prior rate cases in that Baltimore Gas proposed switching from a stated rate to a formula rate. *See Baltimore Gas and Elec. Co.*, 115 FERC ¶ 61,066, at P 2 (2006); *see also* Rehearing Petition at 26, JA 127. A stated rate is the rate a utility charges its customers; it is modified through a formal rate case. *See* 2018

Proposed Rule P 15. A formula rate, by contrast, is made up of a formula into which a utility's costs are input, resulting in a numerical rate. *See id*. Those cost inputs and resulting rate are updated annually. *Id*. While the annual update does not require Commission review and approval, the initial formula rate filing—filed as a rate case under Federal Power Act section 205 or 206, 16 U.S.C. §§ 824d(a), 824e(a)—undergoes the same "just and reasonable" assessment as does a stated rate case filing. *See, e.g.*, *Xcel Energy Servs. Inc. v. FERC*, 815 F.3d 947, 949–51 (D.C. Cir. 2016); *Baltimore Gas*, 115 FERC ¶ 61,066, at P 2.

Baltimore Gas's 2005 rate case filing resulted in an offer of settlement, which the Commission approved in 2006 (the "2006 Settlement"). *Baltimore Gas*, 115 FERC ¶ 61,066, at PP 1–2 (citing Baltimore Gas Settlement Agreement and Offer of Settlement, FERC Dkt. No. ER05-515 (filed Mar. 20, 2006), JA 7–47). The new formula rate excluded deferred tax amounts, as indicated by line items explaining that the rate was "net of" or "less" "[Standard … 109]" amounts. Rehearing Order PP 16–17 & nn.32, 35, JA 208–10.

H. Baltimore Gas's 2016 Rate Case to Recover Approximately $38 Million in Deferred Tax Amounts That Had Accrued Since 2005

In December 2016, Baltimore Gas filed the Federal Power Act section 205 rate case on review here. Initial Order P 1, JA 87. It sought to modify its formula rate to address deferred taxes that had accumulated since 2005, and also to address

those amounts it had yet to incur going forward.[2] Initial Order PP 1, 13, JA 87, 92. In February 2017, the Commission issued a deficiency letter seeking information on Baltimore Gas's ratemaking history and the specific tax liabilities it proposed to recover. *Id*. at P 9, JA 91. In its March 2017 response, Baltimore Gas explained that it was seeking to recoup approximately $38 million from future ratepayers. *Id*. at P 10, JA 91. That amount nets out excesses and deficiencies related to the three categories of deferred income taxes discussed above: (1) a return of approximately $4 million to ratepayers related to tax law changes; (2) a collection of approximately $29 million from ratepayers related to Construction Allowance Equity; and (3) a collection of approximately $13 million from ratepayers related to Flow-Through amounts. *Id*.

II. The Commission Orders on Review

The Commission denied Baltimore Gas's application to recover approximately $38 from future ratepayers for already-accrued deferred tax amounts, while denying without prejudice a modification to its formula rate to address deferred taxes prospectively. Initial Order P 2, JA 87; Rehearing Order PP 37–38, JA 221–22. It explained that the 1981 Tax Rule requires a utility to address deferred taxes in its "'next rate case,'" and to do so "'within a reasonable

[2] Baltimore Gas did not seek to refund or recover amounts dating from the period before its 2005 rate case because it assumed it had recovered deferred tax amounts under its stated rates from that period. Initial Order P 13, JA 92.

period of time.'" Rehearing Order PP 16, 18 (quoting Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519, 31,560), JA 208–11. Because Baltimore Gas did not address deferred taxes in its 2005 rate case, the Commission held that it had failed to comply with the Rule's timing provisions. *Id.*

The Commission rejected Baltimore Gas's contrary interpretations of the Tax Rule. First, it found no merit in Baltimore Gas's argument that because the 2006 Settlement expressly excluded deferred taxes, it had effectively "'le[ft] the issue to be addressed in some later proceeding.'" Rehearing Order P 17 (quoting Rehearing Petition at 41, JA 142), JA 209–10. The Commission acknowledged that the Tax Rule includes an exception allowing parties to "'reach a settlement on any of the issues covered by the rule'"—namely, deferred taxes. *Id.* at P 17 n.41 (quoting Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519), JA 209–10. And it broadly interpreted that exception to allow a utility to postpone addressing deferred taxes to a future proceeding. *Id.* But it held that the 2006 Settlement neither addressed deferred taxes nor postponed consideration of them because it did no more than exclude those amounts from the formula rate. *Id.* at P 17, JA 209–10.

Second, the Commission rejected Baltimore Gas's argument that the term "reasonable period of time" refers to the time it takes a utility to achieve full normalization *after* a rate case is filed, rather than the time a utility has to file the requisite "next rate case" in the first place. Rehearing Order PP 19–20, JA 211–13;

Rehearing Petition at 47–51, JA 148–52. Baltimore Gas had argued that, because in its view its "next rate case" was the 2016—and not the 2005—filing, and because it believed the "reasonable period of time" test pertained to the period thereafter, the Commission erred in holding that it did not seek to address its deferred tax amounts in a "reasonable period of time." Rehearing Petition at 51, JA 152.

The Commission found that this reading contravened the Tax Rule's purpose of expeditiously achieving full normalization. Rehearing Order PP 19–20, JA 211–13. It explained that, under Baltimore Gas's construction, the amount of time a utility has to resolve excesses or deficiencies in its deferred tax accounts would be entirely open-ended. *Id.* And, in any event, it found that the 2005 rate case was Baltimore Gas's "next rate case," not the 2016 filing here on review.[3] *See* Rehearing Order PP 16, 18, 21, JA 208–11, 213–14. Thus, even if Baltimore Gas's interpretation of the Tax Rule's "reasonable period of time" requirement were correct, in the Commission's view it had still violated the rule's "next rate case" mandate by failing to address deferred taxes in 2005. *See id.*

Third, the Commission found that Baltimore Gas's proposal violated the matching principle by misaligning the tax effects of a facility expense with the ratepayers who pay for that expense. *Id.* at P 25, JA 215–16. Baltimore Gas's

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[3] Baltimore Gas agreed with the Commission that a utility must address its deferred taxes in its "next rate case." Rehearing Petition at 51, JA 152.

proposal would shift the entire burden of deferred tax amounts accrued from 2005 to 2017 to ratepayers beginning in 2018, amortized over the 28-year average remaining useful life of its facilities. *See id*. at PP 25–26, JA 215–16; Initial Order P 11, JA 91. Because Baltimore Gas proposed recouping its $38 million in deferred taxes over a compressed period, rather than the 40-year timeframe that would have applied had the clock started running in 2005, rates going forward would increase over what they *would have been* had Baltimore Gas addressed deferred taxes in its 2005 rates. *See id*.; Initial Order P 20, JA 95.

Fourth, the Commission found that four orders involving deferred taxes cited by Baltimore Gas were either non-binding or distinguishable. Rehearing Order PP 28–30, JA 217–18. It explained that three of the orders were delegated letter orders issued by staff, and thus did not establish precedent. *Id*. at P 28, JA 217. As for the one non-delegated order, the Commission found that the record there did not reflect a request for deferred amounts, and that, in any event, the order did not directly address the question of retrospective recovery of deferred taxes. *Id*. at P 30, JA 218.

Further, the Commission explained that the order involving the next-longest filing delay (seven years) was well short of Baltimore Gas's 12-year filing delay. *See id*. at PP 28–29, JA 217–18. Baltimore Gas had argued that because the 2006 Settlement imposed a rate moratorium until 2009, it could not have filed a rate case addressing deferred tax amounts until that time, and so its actual delay was seven

years, not 12. *Id*. at P 28, JA 217–18. The Commission rejected this argument, finding that Baltimore Gas failed to explain why its inability to make another rate filing until 2009 meant the period from 2006 to 2009 should be ignored for purposes of determining whether waiting until 2016 was reasonable. *Id*. at P 29, JA 218.

Finally, the Commission explained that, while it was rejecting Baltimore Gas's filing as a whole because it was presented as an integrated rate case, its decision was without prejudice to Baltimore Gas seeking recovery of deferred tax amounts on a going-forward basis. *Id*. at PP 36–37, JA 220–21. This includes amounts originating after the February 2017 effective date of its proposed rate modification, as well as amounts that would not have been fully recovered by that time even if Baltimore Gas had applied a mechanism to recover those amounts in its 2005 formula rate. *Id*. at P 37, JA 221.

Baltimore Gas petitioned for judicial review.

SUMMARY OF ARGUMENT

The Commission's 1981 Tax Rule requires utilities to address accrued deferred taxes in their "next rate case," and to do so "within a reasonable period of time." The Commission reasonably interpreted its Rule to mean that, if a utility is carrying deferred taxes on its books, it must expeditiously address those amounts in its "next rate case."

Baltimore Gas was accruing deferred taxes at the time it filed its rate case in 2005. It was therefore required to address those amounts in its rates in that filing. It failed to do so, and instead waited 12 years before seeking to recover $38 million from ratepayers that had accumulated since 2005. Based on these facts, and a reasonable interpretation of its Tax Rule, the Commission concluded that Baltimore Gas violated the Rule's "next rate case" requirement. Baltimore Gas's contrary argument rests on an untenable construction of the Rule, a manufactured distinction between stated rates and formula rates, a misreading of the Rule's narrow settlement exception, and a misplaced reliance on four non-precedential orders.

First, Baltimore Gas argues that it (presumably) addressed deferred taxes in its 1996 rate case—i.e., its first rate case after the Commission's Tax Rule took effect in 1981—and therefore did not need to account for those amounts in subsequent rate cases. Baltimore Gas did not advance this argument in its Rehearing Petition to the agency; it is therefore forfeited.

It is also wrong. Baltimore Gas's interpretation of the "next rate case" requirement—i.e., that it may avoid addressing deferred taxes in later rate cases so long as it did so in its first one—ignores the Rule's purpose of achieving "full normalization" "within a reasonable period of time." It also runs afoul of the matching principle by mis-aligning the tax effects of an expense with the ratepayers who pay for that expense.

Second, Baltimore Gas argues that switching from a stated rate to a formula rate in its 2005 rate case somehow "interrupted" its ability to address deferred tax amounts. As with its first argument, this one appears nowhere in its Rehearing Petition to the Commission and is therefore forfeited. It also fails on the merits. Baltimore Gas never explains *why* a utility cannot address deferred taxes in a formula rate case, while it can in a stated rate case. And its assertion that it was not until a 2018 proposed rule that the Commission clarified the process finds no support in the proposal itself. In fact, the proposal *confirms* the Tax Rule's requirement that utilities account for deferred taxes in their "next rate case"—whether the case involves a formula rate or a stated rate.

Third, Baltimore Gas argues that the 2006 Settlement, which resolved its 2005 rate case, allowed it to postpone addressing deferred taxes to some unspecified future date because the Settlement excluded those amounts from the formula rate. But the Commission's Tax Rule requires something more. It provides only a narrow exception to adjusting rates to reflect deferred taxes if a settlement agreement actually wrestles with the issue. The 2006 Settlement, however, merely acknowledges that the new formula rate does not reflect deferred taxes, without resolving the issue or postponing such resolution to a later date.

Baltimore Gas next argues that none of this matters anyway because the 2006 Settlement includes a reservation provision preserving its right to adjust its rates through a future rate filing. As with two of its other arguments, Baltimore

Gas did not raise this one in its Rehearing Petition and so it is forfeited. And it too fails on the merits. The reservation provision merely preserves Baltimore Gas's right to do what it did here: make a rate filing seeking a change to its formula rate. It does not guarantee the Commission will deem that change to be just and reasonable. Indeed, because the Commission found that Baltimore Gas's application on review violated the Tax Rule, it concluded the change was *not* just and reasonable.

Finally, Baltimore Gas refreshes its reliance on four orders where the Commission approved retrospective recoupment of deferred taxes. None of those orders, however, compels the outcome Baltimore Gas seeks here. First, none of the cited cases involved protests or resulted in orders in which the Commission resolved the issue disputed here—i.e., a utility's right to recoup deferred taxes retrospectively where it failed to do so in its "next rate case." Thus, those orders cannot establish Commission policy or precedent on that issue. Second, three of the decisions are unreasoned delegated letter orders issued by Commission staff; they therefore do not establish Commission policy or precedent. And third, the lone non-delegated order involved a utility that *did* seek to recover deferred tax amounts in its "next rate case" after the triggering event of a tax law change. Thus, that utility—unlike Baltimore Gas—complied with the Commission's Tax Rule.

ARGUMENT

I. Standard of Review

This Court reviews Commission orders under the Administrative Procedure Act's deferential "arbitrary and capricious" standard. 5 U.S.C. § 706(2)(A); *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760, 782 (2016). Review under this standard is narrow. *Elec. Power Supply Ass'n*, 136 S. Ct. at 782. "A court is not to ask whether a regulatory decision is the best one possible or even whether it is better than the alternatives." *Id.* "Rather, the court must uphold a[n] [order] if the agency has 'examine[d] the relevant [considerations] and articulate[d] a satisfactory explanation for its action[,] including a rational connection between the facts found and the choice made.'" *Id.* (quoting *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)) (alterations added and in original). Further, the Court "owe[s] deference to reasonable FERC interpretations of [its own] orders." *Ala. Mun. Elec. Auth. v. FERC*, 662 F.3d 571, 573 (D.C. Cir. 2011).

Where, as here, a utility seeks approval of rates through a Federal Power Act section 205 rate case, the Commission must determine whether the utility's proposal will result in "just and reasonable" rates. 16 U.S.C. § 824d(a). Judicial review of Commission rate decisions is particularly deferential, as "'just and reasonable' is obviously incapable of precise judicial definition," *NextEra Energy Res., LLC v. FERC*, 898 F.3d 14, 20 (D.C. Cir. 2018) (quoting *Morgan Stanley*

Capital Grp. Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., 554 U.S. 527, 532 (2008)), and "issues of rate design are fairly technical and, insofar as they are not technical, involve policy judgments that lie at the core of the regulatory mission," *PJM Power Providers Grp. v. FERC*, 880 F.3d 559, 562 (D.C. Cir. 2018) (internal quotations omitted).

In addition, the Commission's "construction of language" in a settlement agreement deserves *Chevron* deference. *Nat'l Fuel Gas Supply Corp. v. FERC*, 811 F.2d 1563, 1569 (D.C. Cir. 1987)); *see also Transcon. Gas Pipe Line Corp. v. FERC*, 485 F.3d 1172, 1178 (D.C. Cir. 2007)) (explaining that courts give "the Commission's interpretation of a settlement agreement" a "high degree of deference" (internal quotations omitted)); *see also* Br. 32 n.5. Baltimore Gas argues the Commission does not enjoy deference for its interpretation of the 2006 Settlement because, it asserts, the agency "did not interpret the language of the settlement." Br. 32. That is incorrect. The Commission *did* interpret the language of the 2006 Settlement, specifically those provisions Baltimore Gas raised in the administrative proceeding below that exclude deferred tax amounts from the formula rate. Rehearing Order P 17, JA 209–10.

To the extent Baltimore Gas argues—and its standard of review discussion is unclear on this point—that FERC deserves no deference because it did not interpret a particular provision of the 2006 Settlement, that argument is forfeited. Baltimore Gas observes the Commission's orders do not address a Settlement provision

preserving Baltimore Gas's right to file a future rate case. Br. 47–48. It reads that provision as allowing it to recover deferred tax amounts in its current filing dating back to 2005. *See* Br. 47–48 (quoting 2006 Settlement § 6.16, JA 25–26). But Baltimore Gas never made this argument below; indeed, its prior filings make no mention of section 6.16. And because it failed to raise the applicability of section 6.16 in its Rehearing Petition to the agency, judicial review of this first-time argument on appeal is foreclosed. *See, e.g.*, *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520, 535 (D.C. Cir. 2010) ("'No objection to [an] order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do.'" ((quoting 16 U.S.C. § 825*l*(b)) (alternation in original)). Accordingly, the Court's review here on all matters over which it has jurisdiction is controlled by the deferential "arbitrary and capricious" standard. *Elec. Power Supply Ass'n*, 136 S. Ct. at 782.

II. The Commission's Tax Rule Required Baltimore Gas To Address Accumulating Deferred Taxes in Its 2005 Rate Case

The Commission's 1981 Tax Rule requires rate applicants to "begin the process of making up deficiencies in or eliminating excesses in their deferred tax account reserves so that, within a reasonable period of time to be determined on a case-by-case basis, they will be operating under a full normalization policy." Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,560. To that end, the Tax Rule

requires a utility to "develop[] in its *next rate case* a method for handling any excesses or deficiencies that might exist in the deferred tax reserves because of prior flow-through treatment of timing difference transactions or because of tax rate changes." *Id*. at 31,519 (emphasis added); *see also id.* ("[T]he [Tax Rule] requires an adjustment to be made in the applicant's *next rate case* following the applicability of the rule." (emphasis added)); Rehearing Order PP 16, 18, JA 208–11.

The Tax Rule's implementing regulations similarly require a utility to address deferred tax amounts in its rates. Section 35.24(c) provides that "[t]he public utility must compute the income tax component in its cost of service by making provision for any excess or deficiency in deferred taxes," and that it "must use some ratemaking method for making such provision, and the appropriateness of this method will be subject to case-by-case determination." 18 C.F.R. § 35.24(c)(2)–(3).

A. The Commission's Rejection of Baltimore Gas's Application is Based on a Reasonable Interpretation of the Tax Rule

Interpreting its own Tax Rule, the Commission reasonably determined that, if a utility has accumulating deferred taxes on its books, it must address them in its "next rate case," and do so "within a reasonable period of time." Rehearing Order PP 16 & n.31, 18, JA 208–11. That interpretation is controlling for two mutually reinforcing reasons: (1) the Commission deserves deference for its reasonable

interpretations of its own orders—here, the Tax Rule, *Ala. Mun. Elec.*, 662 F.3d at 573; and (2) the Commission deserves deference for its reasonable policy judgments in deciding whether a rate is "just and reasonable," *NextEra Energy*, 898 F.3d at 20; *PJM Power Providers*, 880 F.3d at 562.

The Commission's interpretation of the Tax Rule is reasonable because it gives effect to all provisions of the Rule and implementing regulations, while also executing the Rule's goal of expeditiously achieving full normalization. *See Mac's Shell Serv., Inc. v. Shell Oil Prod. Co. LLC*, 559 U.S. 175, 188 (2010) (explaining that statutes should be interpreted "in a manner that gives effect to all of their provisions" (internal quotations omitted)). The Rule and implementing regulations require a utility to, in its (1) "next rate case," (2) "handl[e] any excesses or deficiencies" in its deferred tax accounts, (3) "use some ratemaking method" for doing so, and accomplish the task (4) "within a reasonable period of time." 18 C.F.R § 35.24(c); Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519, 31,560. By reconciling its deferred tax account with customers' rates in its next rate case sooner rather than later, a utility will better ensure that "[ratepayers] who pay an expense" of a facility will also be the ratepayers who "get the tax benefit that accompanies the expense," thereby satisfying the Commission's matching principle. *Pub. Sys.* 709 F.2d at 80. As a result, a utility "prevents an undue hardship from falling upon a portion of future ratepayers" that might occur if it

delayed seeking to "make-up" in its rates what it was accruing on its deferred income tax balance sheet. *See id*. at 84–85.

The Commission reasonably concluded that Baltimore Gas failed to satisfy these requirements. Rehearing Order PP 16, 18, 20, JA 208–13. As Baltimore Gas acknowledges, at the time it filed its 2005 rate case, it was accruing deferred tax amounts. *See* Br. 16; *see also* Initial Order PP 10–11, JA 91. Those amounts accumulated due to (1) tax law changes in 1987, 1988, and 1993, (2) a growing Construction Allowance Equity balance sheet, and (3) Flow-Through items dating back to 1976. Initial Order PP 10–11, JA 91; Baltimore Gas Rate Application at 5–12, FERC Dkt. No. ER17-528 (filed Dec. 13, 2016), R. 2, JA 52–59. In order to resolve its existing—and growing—deferred tax account balance, Baltimore Gas was required to address these amounts in its rates through its "next rate case," which occurred in 2005. Rehearing Order PP 16, 18, JA 208–11; *see also* Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519; 18 C.F.R. § 35.24(c). It did not do so.

Further, because Baltimore Gas failed to satisfy the "next rate case" requirement, the Commission did not need to decide whether it sought to address its deferred tax account balance "within a reasonable period of time." Rehearing Order P 18, JA 210–11. As the Commission explained—and Baltimore Gas does not disagree, Br. 33—the "reasonable period of time" requirement refers to the time in which a utility must file the requisite "next rate case"; it is not an

alternative to addressing deferred taxes in the "next rate case." *Id*. Nor does "reasonable period of time" define the period in which a utility has to achieve full normalization *after* its "next rate case," while leaving unconstrained the period the utility has to file the rate case itself. *Id*. at PP 19–20, JA 211–13. The latter interpretation, advanced by Baltimore Gas below though abandoned on appeal, would leave open-ended the time a utility has to file its "next rate case," thereby deferring full normalization indefinitely and contravening the purpose of the Tax Rule. *Id*.

B. Baltimore Gas's Contrary Interpretation of the Tax Rule Would Allow Utilities to Delay Addressing Accumulated Deferred Taxes Indefinitely

Baltimore Gas offers two counter-arguments based on a contrary reading of the Commission's Tax Rule (Br. 32–51), neither of which is reasonable. First, it asserts that it did, in fact, comply with the Rule's "next rate case" requirement by (presumably) addressing deferred taxes in its 1996 rate settlement. Second, it insists that switching to formula rates in 2005 somehow "interrupted" its ability to reflect deferred tax amounts in its rates, and that it cannot be faulted for waiting 12 years to remedy the error. Baltimore Gas's two-pronged argument fails because it misconstrues the Tax Rule's text and intent and manufactures a distinction between stated rates and formula rates that does not exist.

1. Baltimore Gas Could Not Avoid Addressing Deferred Taxes in Its 2005 Rate Case Simply Because It (Presumably) Addressed Them in a Prior Rate Case

Baltimore Gas argues that because its 1996 rate case was its "next rate case" after the Tax Rule took effect, and because it (presumably) addressed deferred taxes in that rate case, it *did* comply with the Rule's "next rate case" requirement, and thus was not required to address deferred taxes in its 2005 rate proceeding. Br. 32–33.

Baltimore Gas failed to advance this particular objection—that "[it] *did* comply with [the Tax Rule's] requirement to begin recovering [Standard] 109 amounts in its 'next rate case'" with the 1996 filing, Br. 33 (emphasis in original)—in its Rehearing Petition to the agency. It is therefore forfeited. *See, e.g.*, *Sacramento Mun. Util. Dist.*, 616 F.3d at 535 (quoting 16 U.S.C. § 825*l*(b)). In fact, Baltimore Gas does one worse, as its argument on appeal *contradicts* statements it made in its Rehearing Petition. There, it argued that "[the 2016 filing] "is 'the next rate case'" under the Tax Rule, not the 1996 filing. Rehearing Petition at 51, JA 152.

In any event, Baltimore Gas's interpretation of the Commission's Tax Rule is untenable because it undermines the Rule's text and intent. As discussed (*see supra* at 5–7), by switching from the flow-through method to tax normalization, the Tax Rule sought to ensure that the same customers who pay for a facility expense receive the tax benefits of that expense. *Pub. Sys.*, 709 F.2d at 80. It would thwart

this goal if Baltimore Gas could preserve the option of accumulating more deferred tax amounts in later rate cases—thereby abandoning normalization—so long as it addressed them in its 1996 rate case. *See id*. at 84 (explaining the Rule's goal of achieving full normalization).

Moreover, Baltimore Gas's reading could incentivize disfavored conduct: utilities could seek to collect deferred taxes when the outstanding balance benefitted them, while omitting those amounts in subsequent rate cases when the balance benefitted ratepayers. Such a maneuver, if allowed, would promote the very type of "gamesmanship" that Baltimore Gas acknowledges the Commission's Tax Rule was meant to prevent. *See* Br. 13. This Court avoids interpretations that could lead to such anomalous results. *Validus Reinsurance, Ltd. v. United States*, 786 F.3d 1039, 1045–46 (D.C. Cir. 2015) (courts "must … avoid statutory interpretations that bring about an anomalous result when other interpretations are available" (internal quotations omitted)).

2. Switching to Formula Rates in 2005 Did Not "Interrupt[]" Baltimore Gas's Ability to Address Deferred Taxes

Having argued that it complied with the Tax Rule's "next rate case" requirement, Baltimore Gas then shifts gears, asserting that something about switching to a formula rate "interrupt[ed]" its ability to address deferred taxes. Br. 34. It reads into the Commission's guidance a policy that utilities must make two separate filings before reflecting deferred tax amounts in *formula* rates

specifically: a rate filing (like Baltimore Gas's 2005 rate case) establishing the formula rate itself, followed by a subsequent filing—to be submitted at some unspecified future date—modifying the formula rate to reflect already-accrued deferred tax amounts. Br. 17, 36–37. Because the Commission did not limit the time in which to make the second filing, Baltimore Gas argues it cannot be faulted for waiting 12 years to file the rate case on review. *See* Br. 37.

Like its prior argument, this one—that switching to formula rates "interrupt[s]" recovery of deferred taxes and also necessitates multiple filings—appears nowhere in Baltimore Gas's Rehearing Petition and is therefore forfeited. *See, e.g.*, *Sacramento Mun. Util. Dist.*, 616 F.3d at 535 (quoting 16 U.S.C. § 825*l*(b)).

It is also wrong. Baltimore Gas's authorities provide no support for the core premise grounding its entire argument: that a stated rate case—like Baltimore Gas's 1996 and 1997 rate cases—can address deferred taxes, but a formula rate case cannot. Its leading authorities are two Commission guidance documents, issued in 1993 and 2014, but they offer no support. While Baltimore Gas is correct that those documents require a utility to obtain Commission approval before a rate may reflect deferred taxes, Br. 36; 1993 Guidance § 13, they say nothing about requiring *multiple* filings, or suggest that a utility cannot seek approval for addressing deferred taxes in its rates at the same time it seeks approval for the formula rate itself.

For its part, the 1993 Guidance states that, as concerns deferred taxes, a utility "shall make a filing with the proper rate regulatory authorities prior to implementing the change for tariff billing purposes." 1993 Guidance § 13. But that is true for stated and formula rates alike. Indeed, while Baltimore Gas relies on the 1993 Guidance for its assertion that utilities must make a "separate filing" for purposes of formula rates specifically (Br. 36), the 1993 Guidance has nothing to do with formula rates *at all*. Nor does the 1981 Tax Rule—enacted in an era of stated rates—which also explicitly requires a utility to obtain Commission approval before passing through deferred tax amounts to ratepayers. Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519 (requiring that the requisite rate modification be submitted through the utility's "next rate case," which necessarily requires Commission review and approval); *see also* 18 C.F.R. § 35.24(c) (explaining that the "appropriateness" of a chosen ratemaking method for addressing deferred taxes is "subject to case-by-case determination").

In short, nothing about a *formula* rate case prevents a utility from seeking to recover deferred taxes *in that filing*. *See* Rehearing Order P 16, JA 208–09. Baltimore Gas could have sought to recover its deferred taxes in its 2005 formula rate case, just as it presumes it did in its 1996 and 1997 *stated* rate cases. It simply failed to do so.

To be sure, the 2014 Guidance—issued after the industry began transitioning to formula rates, *see* 2018 Proposed Rule P 15—discusses a variety of topics

related specifically to formula rates, including deferred taxes. Staff's Guidance on Formula Rate Updates at 2 (July 17, 2014) ("2014 Guidance") (appended in Addendum). But like its 1993 predecessor, the 2014 Guidance does not even suggest that formula rates trigger a different procedure. It explains only that, consistent with the 1993 directive and the Tax Rule itself, utilities may not reflect deferred tax amounts in their formula rates absent Commission approval. 2014 Guidance at 2 & n.3 (explaining that "accounting guidance … restrict[s] the inclusion of [deferred taxes] from the development of rates without Commission authorization").

Baltimore Gas's reference to a recent proposed rule is similarly misplaced. First, Baltimore Gas cannot invoke the 2018 Proposed Rule—which post-dates the close of the record on review here—because the Court "will not reach out to examine a decision made after the one actually under review." *Brooklyn Union Gas Co. v. FERC*, 409 F.3d 404, 406 (D.C. Cir. 2005) (internal quotations omitted).

Second, contrary to Baltimore Gas's argument (Br. 37), the 2018 proposal announces no new policy. Its purpose is, instead, to bring utilities into compliance with a policy that already exists: the Tax Rule's requirement that utilities "reflect any excess or deficient [accumulated deferred income taxes] as a result of any changes in tax rates in their next rate case." 2018 Proposed Rule P 26 (citing 18 C.F.R. § 35.24). In the course of studying the effects of the Tax Cuts and Jobs Act of 2017 on utilities' deferred tax accounts, the Commission discovered that "many,

if not most" utilities' formula rates were non-compliant with its Tax Rule. *Id*. at PP 14, 16. The 2018 proposal sets forth a corrective measure whereby utilities must adjust their formula rates to address deferred taxes resulting from the 2017 tax law and going forward. *Id*. at PP 16, 26, 27 (discussing such rate case filings by International Transmission Companies and Ameren).

To be sure, the 2018 proposal identifies a distinction between stated rates and formula rates, *id*. at P 15, but it is a distinction that is irrelevant here. In the days of stated rates, a utility adjusted its rates by filing a new rate case. *Id*. at PP 10, 15. But as utilities transitioned to formula rates, new rate cases became less frequent. *See id*. at P 15. That is because once a utility establishes a formula for calculating a rate through an initial formula rate case, it thereafter updates the actual rates annually by adjusting cost inputs that plug into the formula. *Id*. at PP 10, 15. And those updates do not trigger a new rate case. *Id*.

Confronted with an environment in which many utilities operating under formula rates were non-compliant with its Tax Rule, the Commission had a choice: it could either wait for those utilities to voluntarily file new rate cases that may never occur, or it could impose on utilities a requirement that they modify their formula rates to reflect deferred tax amounts. *See id*. at P 15 (explaining that, because utilities operating under formula rates no longer adjust their rates through new rate cases, the Tax Rule's "contemplat[ion]" of a utility's next rate case filing as the proper vehicle for addressing deferred taxes no longer applies); PP 26, 36

(requiring utilities to address deferred taxes in their formula rates). The Commission's 2018 proposal goes with the second option, expressly requiring utilities to comply with 18 C.F.R. § 35.24, which—consistent with the Tax Rule's "next rate case" requirement—triggers a rate case filing for purposes of modifying rates to account for deferred taxes. *Id.* at PP 26, 36; 18 C.F.R. § 35.24(c)(3), (d)(3); *see also* 2018 Proposed Rule P 11 (explaining that formula rates may only be adjusted through a rate case filing under Federal Power Act section 205 (if done voluntarily by the utility) or section 206 (if imposed by the Commission) (citing 16 U.S.C. §§ 824d(a), 824e(a)). Nothing in the Commission's proposal, however, evinces a new policy, or suggests that Baltimore Gas was not required to address deferred taxes *when it filed its formula rate case in 2005*.[4]

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[4] To the extent the Commission has announced a new policy regarding its interpretation of its Tax Rule, that policy does not implicate the instant matter. In a recent order—issued approximately two months before the 2018 proposed rulemaking—the Commission added numerical teeth to the "reasonable period of time" requirement. Specifically, it announced its "expectation that public utilities will make [Federal Power Act] section 205 filings to recover … [accumulated deferred income tax] amounts within two years after they are incurred." *Commonwealth*, 164 FERC ¶ 61,172, at P 133. In other words, a utility must file a rate case within two years of, say, a tax law change, in which it addresses the effects of that change in its rates (stated or formula). The issue here, however, is not whether Baltimore Gas timely filed its 2005 rate case; it is whether it could, consistent with the Commission's Tax Rule, avoid addressing deferred taxes *in that rate case*.

*   *   *

Baltimore Gas argues the purpose of the Commission's Tax Rule is to "*require* utilities to adopt some mechanism" to address deferred taxes, and thus "ensur[e] the accuracy of rates." Br. 35 (emphasis in original). That is correct, but tells only part of the story: utilities must do so in their "next rate case" and "within a reasonable period of time." Rehearing Order PP 16, 18, JA 208–11. By reading out of the Rule its temporal dimension, Baltimore Gas's interpretation violates the basic precept of statutory interpretation that all of a rule's provisions be given effect, *see Mac's Shell*, 559 U.S. at 188, and would result in inequities for ratepayers by mis-matching the tax treatment of a utility's facility expense with the ratepayers who pay for that expense, *see Pub. Sys.*, 709 F.2d at 80, 84–85; Initial Order P 20, JA 95; Rehearing Order PP 16, 18, 19–20, JA 208–13. That is precisely the problem the Commission's Tax Rule sought to address. Accordingly, the Commission's conclusion that Baltimore Gas failed to comply with its Tax Rule's "next rate case" requirement, based on a reasonable interpretation of the Rule, deserves deference. *Ala. Mun. Elec.*, 662 F.3d at 573; *NextEra Energy*, 898 F.3d at 20; *PJM Power Providers*, 880 F.3d at 562.

III. The 2006 Settlement Did Not Comply With the Tax Rule's Narrow Exception to Achieving Full Normalization

While the Commission's Tax Rule requires a utility to address deferred taxes in its "next rate case" to achieve full normalization, it also provides a narrow

exception: "'The rule, of course, leaves undisturbed the ability of the parties to reach a settlement on any of the issues covered by the rule.'" Rehearing Order P 17 n.41 (quoting Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519), JA 210. In other words, the Commission and a utility may enter into a settlement agreement allowing the utility to avoid achieving "fully normalized rates" through its "next rate case," as otherwise required by Order No. 144. *Stingray Pipeline Co.*, 49 FERC ¶ 61,240, at 61,859 n.22 (1989), *on reh'g*, 50 FERC ¶ 61,159 (1990).

A. The 2006 Settlement Did Not "Reach a Settlement On" Deferred Tax Amounts; It Simply Omitted Them

Baltimore Gas entered into a settlement agreement with the Commission—the 2006 Settlement—to resolve its 2005 rate case. That Settlement did not, however, address deferred taxes, or otherwise postpone the issue for future consideration. It simply made clear that the new formula rate excluded them, stating that the settlement rates are "net of" and "less" deferred tax amounts. Rehearing Order P 17, JA 209–10; *see also* Response to Deficiency Letter at 11 (explaining that the "formula rate expressly excluded [deferred tax] amounts from [accumulated deferred income tax] calculations, and made no provision for recovery of amounts that had been recorded under [Standard] 109"), JA 74. Because the 2006 Settlement neither addressed how to reflect deferred taxes in Baltimore Gas's formula rate, nor postponed the issue for future resolution, the

Commission reasonably concluded that the Tax Rule's settlement exception did not apply. Rehearing Order PP 17–18, JA 209–11.

Baltimore Gas insists the 2006 Settlement, by not addressing deferred taxes, somehow qualifies for the settlement exception anyway. It cites a FERC order outside the context of the Tax Rule for support, in which the Commission permitted a rate change because the particular issue raised in the applicant's filing was not addressed in a prior settlement. Br. 44–45.

Context, however, matters. Baltimore Gas does not simply seek a change to its rates on an issue not addressed by the 2006 Settlement. It seeks to do so in a manner inconsistent with the Tax Rule. *See Nat'l Fuel*, 811 F.2d at 1572 (explaining that a settlement agreement must comply with governing regulations). By requiring parties to "reach a settlement *on*" deferred taxes, the Rule mandates more than simply excluding them from a utility's rates, as the 2006 Settlement does; the settlement must actually address the issue. *See* Rehearing Order P 17 & n.41 (quoting Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519 (emphasis added)), JA 209–10.

Without a textual anchor to moor its analysis, Baltimore Gas instead argues that the Commission's orders on review announce a new approach to the Tax Rule's exception by requiring a settlement to "expressly"—rather than implicitly—postpone addressing deferred taxes. Br. 42. But the Commission has said just the opposite, finding in another case that a settlement agreement did not "reach[] a

settlement on the issue of tax normalization," as required by the Tax Rule, because it did not expressly "mention … the extent of normalization in the settlement." *Stingray*, 49 FERC ¶ 61,240, at 61,859; *cf. El Paso Natural Gas Co.*, 120 FERC ¶ 61,208, at 61,897 (2007) (approving a settlement that expressly resolved the issue of deferred taxes). And, more fundamentally, Baltimore Gas's suggestion that a utility can postpone addressing deferred taxes *sub silentio* reads out of the Rule its requirement that a utility "'reach a settlement *on* any of the issues covered by [the Tax R]ule.'" *See* Rehearing Order P 17 n.41 (quoting Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519 (emphasis added)), JA 210; *see also Mac's Shell*, 559 U.S. at 188.

* * *

The Commission reasonably determined that, under the 2006 Settlement's terms, "[Baltimore Gas] did not intend to pursue recovery of [deferred tax] amounts," and had not preserved the issue for future resolution as the Tax Rule required it to do. Rehearing Order P 17 & n.41, JA 209–10. That conclusion, based on the Commission's reasonable interpretation of its Tax Rule and a settlement agreement it reviewed and approved, deserves a "high degree of deference." *Transcon. Gas Pipe Line*, 485 F.3d at 1178 (internal quotations omitted); *Ala. Mun. Elec.*, 662 F.3d at 573.

B. Baltimore Gas's Argument That FERC Did Not Consider the Language of the 2006 Settlement is Both Forfeited and Wrong

Baltimore Gas next observes that the 2006 Settlement includes a reservation provision, which it argues allows it to address deferred taxes at some unspecified future date. Br. 47–51. That provision, Section 6.16, provides that the Settlement does not "restrict in any way the rights of [Baltimore Gas] … to file and implement changes to any of [its] respective rates, terms and conditions of service pursuant to Section 205 of the [Federal Power Act] …." 2006 Settlement § 6.16, JA 25–26. Baltimore Gas faults the Commission for not addressing this particular provision in the orders on review. Br. 47.

This argument is not properly before the Court because Baltimore Gas did not press any objection related to Section 6.16 of the 2006 Settlement in the administrative proceeding below—including in its Rehearing Petition.[5] *See, e.g.*, *Sacramento Mun. Util. Dist.*, 616 F.3d at 535 (quoting 16 U.S.C. § 825*l*(b)). In any event, the argument fails on the merits.

First, as discussed above, the Tax Rule required Baltimore Gas to address deferred taxes in the 2006 Settlement to avoid that Rule's requirements. *See supra* at 39–40. Section 6.16 does not do so. Second, Section 6.16 merely allows Baltimore Gas to seek an adjustment to its formula rate at some future date through

[5] This provides a plausible reason why the Commission did not address Section 6.16 in its Rehearing Order.

a conventional Federal Power Act section 205 rate case. *See* 2006 Settlement § 6.16, JA 25–26. Baltimore Gas availed itself of that option here with the rate filing on review. But preserving a utility's prerogative to seek a rate adjustment does not guarantee the Commission will *accept* the proposed change. Indeed, section 205 confers on the applicant the burden of showing that its proposal is "just and reasonable." *Ala. Power Co. v. FERC*, 993 F.2d 1557, 1571 (D.C. Cir. 1993) (citing 16 U.S.C. § 824d(e)). In evaluating Baltimore Gas's filing on review, the Commission determined that, consistent with the Tax Rule, its regulations, and the matching principle, Baltimore Gas's proposal failed to meet the "just and reasonable" standard. *See* Initial Order P 2, JA 87.

Baltimore Gas discusses *National Fuel* (Br. 48–51), but that case is inapposite. There, a natural gas company sought to make a retroactive adjustment to its rates, notwithstanding a settlement agreement that established those rates. 811 F.2d at 1572–73. This Court affirmed the Commission's decision denying the rate modification. *Id*. at 1564.

Baltimore Gas draws a distinction between *National Fuel* and the instant matter. It observes that the *National Fuel* settlement resolved the very issue the utility there sought to revisit in a later rate filing, whereas here the 2006 Settlement did not address the issue of deferred taxes at all. Br. 49. But that factual difference—assuming it is correct—says nothing about the dispositive issue here: whether the 2006 Settlement satisfied the Tax Rule's narrow exception to

addressing deferred taxes in the utility's "next rate case." As discussed above, it did not.

To the extent *National Fuel can* be analogized to the instant matter, it hurts rather than helps Baltimore Gas's case. The *National Fuel* settlement included a "general disclaimer" that preserved the parties' rights "with respect to any matters not expressly provided for herein." *Nat'l Fuel*, 811 F.2d at 1573 (internal quotations omitted). The Court deemed such a general reservation to be "insufficient to constitute an express reservation of a right to make retroactive adjustments in these rates." *Id*. Same here. Baltimore Gas's general reservation of a right to file a future rate case says nothing about whether it has the specific right to collect deferred tax amounts in its rates.

Further, the disclaimer in *National Fuel* preserved only those rights the gas company "may otherwise have." *Id*. (internal quotations omitted). Baltimore Gas seizes on this language for support (Br. 50–51) but draws the wrong conclusion. Baltimore Gas did not "otherwise have" the right to delay addressing a deferred tax account balance of $38 million until sometime *after* it filed its "next rate case." To the contrary, the Tax Rule required it to address those amounts "*in* its next rate case." Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,519 (emphasis added).

IV. Baltimore Gas Cites Commission Orders That Do Not Establish Agency Policy or Precedent

Baltimore Gas refreshes its argument on appeal that, notwithstanding the language of the Commission's 1981 Tax Rule and implementing regulations, the Commission is compelled to grant its application because it has done so before in the cases of four other utilities. Br. 38–41. It argues that each of the four cited orders involved entities similarly situated to Baltimore Gas, meaning it is entitled to the same treatment. Br. 38.

Baltimore Gas's argument is meritless. None of the four cited orders establishes Commission policy or precedent for one or multiple reasons. First, none of the orders includes an actual determination by the Commission on the issue disputed here: a utility's right to recover deferred tax amounts retrospectively where it failed to do so in its "next rate case." Second, the three orders that are delegated staff letter orders cannot, by their nature, bind the Commission. And third, the featured utility in the one non-delegated order is not similarly situated to Baltimore Gas because it, unlike Baltimore Gas, complied with the Commission's Tax Rule.

A. None of the Four Cited Orders Actually Resolved the Issue Disputed Here; They Therefore Do Not Establish Commission Policy or Precedent

In order to establish Commission policy or precedent on the issue disputed here, the four cited orders must have actually decided that issue. *San Diego Gas &*

Elec. Co. v. FERC, 913 F.3d 127, 142 (D.C. Cir. 2019), *panel reh'g and reh'g en banc denied*, No. 16-1433 (D.C. Cir. Apr. 19, 2019). It is not enough that the Commission previously approved a rate filing that involved recovering deferred tax amounts after the utility's "next rate case." The disputed issue must have been "squarely presented"—e.g., through protests—and "necessarily resolved." *Id*.

None of the four cited orders involved protests or even discussed a utility's eligibility to address deferred taxes where it failed to do so in its "next rate case." *See San Diego Gas*, 913 F.3d at 142; *see also* Rehearing Order P 30 (explaining that the one non-delegated order cited by Baltimore Gas "did not directly address this issue"), JA 218; *see generally* FERC Dkt. No. ER16-208 (International Transmission); FERC Dkt. No. ER16-2116 (Virginia Electric and Power Co.); FERC Dkt. No. ER13-1220 (Duquesne Light Co.); FERC Dkt. No. ER12-1397 (PPL Electric Utilities Corp.).[6] The delegated letter orders include little or no reasoning at all (as is typical),[7] and the non-delegated order makes only the broad

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[6] To be sure, the Rehearing Order also states that the record in the one case resulting in a non-delegated order did not involve deferred amounts. Rehearing Order P 30, JA 218. While the application of the subject utility, International Transmission Companies, states otherwise, on the dispositive question—whether the order actually resolved the issue—the Rehearing Order accurately found that it did not. *Id*.

[7] *See Virginia Elec. & Power Co.*, Letter Order, FERC Dkt. No. ER16-2116 (Aug. 2, 2016); *Duquesne Light Co.*, Letter Order, FERC Dkt. No. ER13-1220 (Apr. 26, 2013); *PPL Elec. Utils. Corp.*, Letter Order, FERC Dkt. No. ER12-1397 (May 23, 2012).

statement that International Transmission Companies' "revisions and related depreciation rates provide for a more accurate annual revenue requirement for the [International Transmission] Companies." *Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 61,374, at P 12 (2015); *see also* Rehearing Order P 30, JA 218. Accordingly, those orders "do[] not amount to 'policy or precedent'" on the disputed issue here and cannot bind the Commission, *San Diego*, 913 F.3d at 142 (quoting *Gas Transmission Nw. Corp. v. FERC*, 504 F.3d 1318, 1320 (D.C. Cir. 2007)), meaning Baltimore Gas's argument that the Commission has departed from a prior policy without explanation (Br. 39–40) necessarily fails.

B. The Three Cited Delegated Letter Orders Do Not Establish Commission Policy or Precedent

Baltimore Gas's argument that the Commission has departed from its past policy also fails because, as concerns the three cited delegated letter orders issued by Commission staff, those decisions "do not constitute Commission precedent binding the Commission in future cases." *Phoenix Hydro Corp.*, 26 FERC ¶ 61,389, at 61,870 (1984), *aff'd sub nom.*, *Phoenix Hydro Corp. v. FERC*, 775 F.2d 1187, 1191 (D.C. Cir. 1985). Indeed, the "exercise of … delegated authority [by staff] cannot serve to supplant the policies [the Commission] ha[s] established in [its] decisions and regulations." *Id.*; *Millennium Pipeline Co., LLC*, 145 FERC ¶ 61,088, at P 10 n.11 (2013) (same); *Westar Energy, Inc.*, 124 FERC ¶ 61,057, at P 26 (2008) (same); *Mid-Continent Area Power Pool*, 97 FERC ¶ 61,038, at 61,183

n.10 (2001) (same). That makes sense because staff determinations do not reflect the reasoned decisionmaking of the Commission, which speaks—and sets policy—through its Commissioners' orders. *See Nat'l Fuel*, 811 F.2d at 1571–72 (recognizing the "obvious difference between binding legal actions taken by the Commission … and the everyday activities of its staff"); *cf. Pub. Utils. Comm'n v. FERC*, 817 F.2d 858, 862 (D.C. Cir. 1987) ("[I]t is the Commission's decision, not a staff recommendation, which is under review.").

Baltimore Gas tries to avoid this rule with a citation to *ANR Storage Co. v. FERC* (Br. 39–40), which involved an alleged policy departure from a delegated letter order, but that case is inapposite. "In *ANR Storage*, the Commission … attempted to distinguish its conflicting market-power determinations regarding two natural gas storage providers, each with 'virtually indistinguishable' market power in the same market." *San Diego*, 913 F.3d at 142 (quoting *ANR Storage Co. v. FERC*, 904 F.3d 1020, 1025 (D.C. Cir. 2018)). "The sole underlying issue was squarely presented and necessarily resolved by the agency." *Id*. As discussed, however, here the disputed issue was not "squarely presented and necessarily resolved" in the cited orders.

Moreover, *ANR Storage* concerned the Commission's case-specific, multi-factor process for assessing an individual entity's market power—a process that necessarily involves significant agency discretion. *See ANR Storage*, 904 F.3d at 1022–23 (determination requires considering, among other things, absence of entry

barriers to markets, countervailing buyer power, availability of "good alternatives," and the ability of an entity "to exercise market power unilaterally"). Commission policy on market power therefore emerges from case-by-case application of these various factors. *See id*. at 1024–25 (comparing FERC's analysis of two entities in separate proceedings to discern Commission policy).

Here, by contrast, the Tax Rule itself establishes at least one aspect of Commission policy, irrespective of case-specific circumstances: a utility must address accrued deferred taxes in its "next rate case." Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 30,519. It is that directive, and not subsequent delegated staff letter orders that do not even consider the Tax Rule, that binds the Commission. *See, e.g.*, *CropLife Am. v. EPA*, 329 F.3d 876, 883 (D.C. Cir. 2003) (explaining that a regulation "binds private parties [and] the agency itself" (internal quotations omitted) (adjustment in original)). Indeed, because the "exercise of … delegated authority cannot serve to supplant the policies [the Commission] ha[s] established in [its] decisions and regulations," the three cited delegated letter orders cannot supersede the Tax Rule's unequivocal "next rate case" requirement. *See Phoenix*, 26 FERC ¶ 61,389, at 61,870; *see also Ala. Mun. Elec.*, 662 F.3d at 573 (recognizing deference accorded FERC's reasonable interpretation of its own orders).

C. The Commission's Treatment of Baltimore Gas Was Not Unduly Discriminatory Because International Transmission Complied With the Tax Rule, Whereas Baltimore Gas Did Not

Baltimore Gas's reliance on the one non-delegated order it cites fails for an additional reason. It argues it is similarly situated to the utility there—International Transmission—because both entities sought retrospective recoupment of deferred taxes. Br. 39. But the two utilities' circumstances differ in a crucial way: International Transmission complied with the Tax Rule's "next rate case" requirement; Baltimore Gas did not. Thus, Baltimore Gas cannot meet the standard for showing undue discrimination, which requires it to show that any differential treatment between two entities "cannot be justified," *State Corp. Comm'n of Kan. v. FERC*, 876 F.3d 332, 335 (D.C. Cir. 2017), and that there is "no reason for the difference," *Transmission Access Policy Study Grp. v. FERC*, 225 F.3d 667, 721 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

In *Midcontinent*, the Commission considered a 2015 rate filing by International Transmission, in which that utility sought to, as relevant here, change its formula rate to address accumulated deferred taxes related to a 2011 tax law change. International Transmission Rate Application at 3–6, FERC Dkt. No. ER16-208 (filed Oct. 30, 2015); *see also Midcontinent*, 153 FERC ¶ 61,374, at P 4. Baltimore Gas observes that both it and International Transmission sought

retrospective relief,[8] Br. 39, which is accurate, but International Transmission did so in a way that immediately distinguishes that matter from this case: it made rate adjustments pertaining to the tax law change "in its next rate case."[9] Thus, it complied with the Commission's 1981 Tax Rule. *See also Emera Me.*, 165 FERC ¶ 61,086, at PP 5–6, 25, 42 (2018) (approving changes to formula rates in a utility's next rate case to address effects of a 2017 tax law change); *Stingray*, 49 FERC ¶ 61,240, at 61,859 (approving changes to a utility's rate to address deferred taxes resulting from a recent tax law change); *cf. Midcontinent*, 163 FERC ¶ 61,163, at PP 38, 40, 52 (approving changes to formula rates in a utility's next rate case to address effects of tax law changes on a prospective basis).

Baltimore Gas, by contrast, seeks to address tax law changes that occurred *before* its 2005 rate case—in 1987, 1988, and 1993—as well as Flow-Through Amounts and Construction Allowance Equity, for which the 2005 filing was its "next rate case."[10] Br. 21–22; Baltimore Gas Application at 5–12, JA 52–59. And

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[8] While International Transmission also sought to adjust its formula rate to account for Construction Allowance Equity, its application does not indicate it sought retrospective recoupment of those amounts. *See* International Transmission Rate Application at 8.

[9] A search of International Transmission filings with the Commission dating back to 2011 reveals no rate cases between the 2011 tax law change and its 2015 rate case.

[10] Baltimore Gas suggests the Commission's orders deem Construction Allowance Equity deferred tax amounts to be categorically unrecoverable. Br. 53–54. That is incorrect. The Commission made plain that nothing in its denial

while it also cites deferred amounts related to a 2008 tax law change—for which the rate case on review is its "next rate case"—Baltimore Gas's Rehearing Petition to the Commission makes no argument that deferred amounts from that tax law change should be treated differently from deferred amounts related to pre-2005 tax law changes. The Commission therefore had no occasion to consider this argument. In any event, the Commission explained that, because Baltimore Gas "presented its filing as an integrated rate proposal," it evaluated the application as a whole, and would not assess discrete aspects of the application that, standing alone, might be "just and reasonable." *See* Rehearing Order P 37, JA 221.

Ultimately, Baltimore Gas fails to overcome—let alone address—the material distinctions between its application and that of International Transmission in *Midcontinent*. It therefore has not shown that "there is no reason for the difference" in treatment of the two entities, *Transmission Access*, 225 F.3d at 721, or that any differential treatment "cannot be justified," *State Corp Comm'n*, 876 F.3d at 335; *cf. ANR Storage*, 904 F.3d at 1024–25 (faulting the Commission for differential treatment between two entities that, "by FERC's own reckoning … appear virtually indistinguishable").

"prohibit[s] [Baltimore Gas] from recovering … undepreciated [Construction Allowance] Equity … on an ongoing basis if properly supported under [Federal Power Act] section 205." Rehearing Order P 38, JA 221.

D. The Commission Explained That Baltimore Gas's 12-Year Delay Far Exceeded That of the Next Nearest-In-Time Applicant

Finally, while not determinative, the Commission reasonably distinguished Baltimore Gas's application on the basis that Baltimore Gas waited almost twice as long as the next nearest-in-time applicant. Rehearing Order PP 28–29, JA 217–18. Baltimore Gas complains that the Commission did not address this distinction in its orders on review (Br. 41), but that is incorrect. In its Rehearing Petition, Baltimore Gas argued that "the seven year period in *Duquesne* is 'essentially the same time period as that between the 2009 end of the rate moratorium from [Baltimore Gas's] 20[0]6 settlement and the time that Baltimore Gas filed this Application in 2016.'" Rehearing Order P 28 (emphasis added) (quoting Rehearing Petition at 58, JA 159), JA 217–18. The Commission responded directly to this argument, explaining that the proper date from which to measure Baltimore Gas's delay was 2006, not 2009. Rehearing Order P 29, JA 218. It concluded that Baltimore Gas had failed to explain why waiting 12 years was reasonable, when the next-longest delay was Duquesne's at seven years. *See id.*

* * *

For one or multiple reasons, none of the four orders Baltimore Gas cites binds the Commission here, let alone establishes agency policy or precedent on the question of whether a utility may recoup deferred taxes not addressed in its "next rate case." Accordingly, the Commission did not err in declining Baltimore Gas's

belated application to seek $38 million from future ratepayers. To the contrary, it acted consistent with the text and intent of the Tax Rule.

CONCLUSION

For the foregoing reasons, the Commission requests that the Court deny the petition and affirm the Commission orders on review.

Respectfully submitted,

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June 11, 2019

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a) and Circuit Rules 35 and 40, I certify that this brief complies with the type-volume limitation in Fed. R. App. P. 35(b) and 40(b) because this brief contains 12,914 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

I further certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in Times LT Std 14-point font using Microsoft Word 2013.

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June 11, 2019

Baltimore Gas and Electric Co. v. FERC
D.C. Cir. No. 18-1298

CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P. 25(d), and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have, this 11th day of June 2019, served the foregoing upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system, as indicated below:

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ORAL ARGUMENT HAS NOT BEEN SCHEDULED

In the United States Court of Appeals for the District of Columbia Circuit

No. 18-1298

BALTIMORE GAS AND ELECTRIC COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

ADDENDUM TO BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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JUNE 11, 2019

ADDENDUM
Statutes, Rules & Regulations,
and
Guidance

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AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

(Pub. L. 89–554, Sept. 6, 1966, 80 Stat. 392; Pub. L. 94–574, § 1, Oct. 21, 1976, 90 Stat. 2721.)

HISTORICAL AND REVISION NOTES

Derivation	*U.S. Code*	*Revised Statutes and Statutes at Large*
....	5 U.S.C. 1009(b).	June 11, 1946, ch. 324, § 10(b), 60 Stat. 243.

Standard changes are made to conform with the definitions applicable and the style of this title as outlined in the preface to the report.

AMENDMENTS

1976—Pub. L. 94–574 provided that if no special statutory review proceeding is applicable, the action for judicial review may be brought against the United States, the agency by its official title, or the appropriate officer as defendant.

§ 704. Actions reviewable

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

(Pub. L. 89–554, Sept. 6, 1966, 80 Stat. 392.)

HISTORICAL AND REVISION NOTES

Derivation	*U.S. Code*	*Revised Statutes and Statutes at Large*
....	5 U.S.C. 1009(c).	June 11, 1946, ch. 324, § 10(c), 60 Stat. 243.

Standard changes are made to conform with the definitions applicable and the style of this title as outlined in the preface of this report.

§ 705. Relief pending review

When an agency finds that justice so requires, it may postpone the effective date of action taken by it, pending judicial review. On such conditions as may be required and to the extent necessary to prevent irreparable injury, the reviewing court, including the court to which a case may be taken on appeal from or on application for certiorari or other writ to a reviewing court, may issue all necessary and appropriate process to postpone the effective date of an agency action or to preserve status or rights pending conclusion of the review proceedings.

(Pub. L. 89–554, Sept. 6, 1966, 80 Stat. 393.)

HISTORICAL AND REVISION NOTES

Derivation	*U.S. Code*	*Revised Statutes and Statutes at Large*
....	5 U.S.C. 1009(d).	June 11, 1946, ch. 324, § 10(d), 60 Stat. 243.

Standard changes are made to conform with the definitions applicable and the style of this title as outlined in the preface of this report.

§ 706. Scope of review

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

(Pub. L. 89–554, Sept. 6, 1966, 80 Stat. 393.)

HISTORICAL AND REVISION NOTES

Derivation	*U.S. Code*	*Revised Statutes and Statutes at Large*
....	5 U.S.C. 1009(e).	June 11, 1946, ch. 324, § 10(e), 60 Stat. 243.

Standard changes are made to conform with the definitions applicable and the style of this title as outlined in the preface of this report.

ABBREVIATION OF RECORD

Pub. L. 85–791, Aug. 28, 1958, 72 Stat. 941, which authorized abbreviation of record on review or enforcement of orders of administrative agencies and review on the original papers, provided, in section 35 thereof, that: ''This Act [see Tables for classification] shall not be construed to repeal or modify any provision of the Administrative Procedure Act [see Short Title note set out preceding section 551 of this title].''

CHAPTER 8—CONGRESSIONAL REVIEW OF AGENCY RULEMAKING

Sec.
801. Congressional review.
802. Congressional disapproval procedure.
803. Special rule on statutory, regulatory, and judicial deadlines.
804. Definitions.
805. Judicial review.
806. Applicability; severability.
807. Exemption for monetary policy.
808. Effective date of certain rules.

§ 801. Congressional review

(a)(1)(A) Before a rule can take effect, the Federal agency promulgating such rule shall submit to each House of the Congress and to the Comptroller General a report containing—

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§ 824c. Issuance of securities; assumption of liabilities

(a) Authorization by Commission

No public utility shall issue any security, or assume any obligation or liability as guarantor, indorser, surety, or otherwise in respect of any security of another person, unless and until, and then only to the extent that, upon application by the public utility, the Commission by order authorizes such issue or assumption of liability. The Commission shall make such order only if it finds that such issue or assumption (a) is for some lawful object, within the corporate purposes of the applicant and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the applicant of service as a public utility and which will not impair its ability to perform that service, and (b) is reasonably necessary or appropriate for such purposes. The provisions of this section shall be effective six months after August 26, 1935.

(b) Application approval or modification; supplemental orders

The Commission, after opportunity for hearing, may grant any application under this section in whole or in part, and with such modifications and upon such terms and conditions as it may find necessary or appropriate, and may from time to time, after opportunity for hearing and for good cause shown, make such supplemental orders in the premises as it may find necessary or appropriate, and may by any such supplemental order modify the provisions of any previous order as to the particular purposes, uses, and extent to which, or the conditions under which, any security so theretofore authorized or the proceeds thereof may be applied, subject always to the requirements of subsection (a) of this section.

(c) Compliance with order of Commission

No public utility shall, without the consent of the Commission, apply any security or any proceeds thereof to any purpose not specified in the Commission's order, or supplemental order, or to any purpose in excess of the amount allowed for such purpose in such order, or otherwise in contravention of such order.

(d) Authorization of capitalization not to exceed amount paid

The Commission shall not authorize the capitalization of the right to be a corporation or of any franchise, permit, or contract for consolidation, merger, or lease in excess of the amount (exclusive of any tax or annual charge) actually paid as the consideration for such right, franchise, permit, or contract.

(e) Notes or drafts maturing less than one year after issuance

Subsection (a) shall not apply to the issue or renewal of, or assumption of liability on, a note or draft maturing not more than one year after the date of such issue, renewal, or assumption of liability, and aggregating (together with all other then outstanding notes and drafts of a maturity of one year or less on which such public utility is primarily or secondarily liable) not more than 5 per centum of the par value of the other securities of the public utility then outstanding. In the case of securities having no par value, the par value for the purpose of this subsection shall be the fair market value as of the date of issue. Within ten days after any such issue, renewal, or assumption of liability, the public utility shall file with the Commission a certificate of notification, in such form as may be prescribed by the Commission, setting forth such matters as the Commission shall by regulation require.

(f) Public utility securities regulated by State not affected

The provisions of this section shall not extend to a public utility organized and operating in a State under the laws of which its security issues are regulated by a State commission.

(g) Guarantee or obligation on part of United States

Nothing in this section shall be construed to imply any guarantee or obligation on the part of the United States in respect of any securities to which the provisions of this section relate.

(h) Filing duplicate reports with the Securities and Exchange Commission

Any public utility whose security issues are approved by the Commission under this section may file with the Securities and Exchange Commission duplicate copies of reports filed with the Federal Power Commission in lieu of the reports, information, and documents required under sections 77g, 78*l*, and 78m of title 15.

(June 10, 1920, ch. 285, pt. II, § 204, as added Aug. 26, 1935, ch. 687, title II, § 213, 49 Stat. 850.)

TRANSFER OF FUNCTIONS

Executive and administrative functions of Securities and Exchange Commission, with certain exceptions, transferred to Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by Reorg. Plan No. 10 of 1950, §§ 1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 824d. Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five-month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practices; action by Commission; "automatic adjustment clause" defined

(1) Not later than 2 years after November 9, 1978, and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public utility rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term ''automatic adjustment clause'' means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

(June 10, 1920, ch. 285, pt. II, § 205, as added Aug. 26, 1935, ch. 687, title II, § 213, 49 Stat. 851; amended Pub. L. 95–617, title II, §§ 207(a), 208, Nov. 9, 1978, 92 Stat. 3142.)

AMENDMENTS

1978—Subsec. (d). Pub. L. 95–617, § 207(a), substituted ''sixty'' for ''thirty'' in two places.

Subsec. (f). Pub. L. 95–617, § 208, added subsec. (f).

STUDY OF ELECTRIC RATE INCREASES UNDER FEDERAL POWER ACT

Section 207(b) of Pub. L. 95–617 directed chairman of Federal Energy Regulatory Commission, in consultation with Secretary, to conduct a study of legal requirements and administrative procedures involved in consideration and resolution of proposed wholesale electric rate increases under Federal Power Act, section 791a et seq. of this title, for purposes of providing for expeditious handling of hearings consistent with due process, preventing imposition of successive rate increases before they have been determined by Commission to be just and reasonable and otherwise lawful, and improving procedures designed to prohibit anticompetitive or unreasonable differences in wholesale and retail rates, or both, and that chairman report to Congress within nine months from Nov. 9, 1978, on results of study, on administrative actions taken as a result of this study, and on any recommendations for changes in existing law that will aid purposes of this section.

§ 824e. Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues

Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

(b) Refund effective date; preferential proceedings; statement of reasons for delay; burden of proof; scope of refund order; refund orders in cases of dilatory behavior; interest

Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date of the filing of such complaint nor later than 5 months after the filing of such complaint. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date of the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the publication date. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: *Provided*, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Refund considerations; shifting costs; reduction in revenues; "electric utility companies" and "registered holding company" defined

Notwithstanding subsection (b), in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company: *Provided*, That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of the Commission's order. For purposes of this subsection, the terms ''electric utility companies'' and ''registered holding company'' shall

have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended.[1]

(d) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

(e) Short-term sales

(1) In this subsection:

(A) The term ''short-term sale'' means an agreement for the sale of electric energy at wholesale in interstate commerce that is for a period of 31 days or less (excluding monthly contracts subject to automatic renewal).

(B) The term ''applicable Commission rule'' means a Commission rule applicable to sales at wholesale by public utilities that the Commission determines after notice and comment should also be applicable to entities subject to this subsection.

(2) If an entity described in section 824(f) of this title voluntarily makes a short-term sale of electric energy through an organized market in which the rates for the sale are established by Commission-approved tariff (rather than by contract) and the sale violates the terms of the tariff or applicable Commission rules in effect at the time of the sale, the entity shall be subject to the refund authority of the Commission under this section with respect to the violation.

(3) This section shall not apply to—

(A) any entity that sells in total (including affiliates of the entity) less than 8,000,000 megawatt hours of electricity per year; or

(B) an electric cooperative.

(4)(A) The Commission shall have refund authority under paragraph (2) with respect to a voluntary short term sale of electric energy by the Bonneville Power Administration only if the sale is at an unjust and unreasonable rate.

(B) The Commission may order a refund under subparagraph (A) only for short-term sales made by the Bonneville Power Administration at rates that are higher than the highest just and reasonable rate charged by any other entity for a short-term sale of electric energy in the same geographic market for the same, or most nearly comparable, period as the sale by the Bonneville Power Administration.

(C) In the case of any Federal power marketing agency or the Tennessee Valley Authority, the Commission shall not assert or exercise any regulatory authority or power under paragraph (2) other than the ordering of refunds to achieve a just and reasonable rate.

(June 10, 1920, ch. 285, pt. II, §206, as added Aug. 26, 1935, ch. 687, title II, §213, 49 Stat. 852; amended Pub. L. 100–473, §2, Oct. 6, 1988, 102 Stat. 2299; Pub. L. 109–58, title XII, §§1285, 1286, 1295(b), Aug. 8, 2005, 119 Stat. 980, 981, 985.)

[1] See References in Text note below.

REFERENCES IN TEXT

The Public Utility Holding Company Act of 1935, referred to in subsec. (c), is title I of act Aug. 26, 1935, ch. 687, 49 Stat. 803, as amended, which was classified generally to chapter 2C (§79 et seq.) of Title 15, Commerce and Trade, prior to repeal by Pub. L. 109–58, title XII, §1263, Aug. 8, 2005, 119 Stat. 974. For complete classification of this Act to the Code, see Tables.

AMENDMENTS

2005—Subsec. (a). Pub. L. 109–58, §1295(b)(1), substituted ''hearing held'' for ''hearing had'' in first sentence.

Subsec. (b). Pub. L. 109–58, §1295(b)(2), struck out ''the public utility to make'' before ''refunds of any amounts paid'' in seventh sentence.

Pub. L. 109–58, §1285, in second sentence, substituted ''the date of the filing of such complaint nor later than 5 months after the filing of such complaint'' for ''the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period'', in third sentence, substituted ''the date of the publication'' for ''the date 60 days after the publication'' and ''5 months after the publication date'' for ''5 months after the expiration of such 60-day period'', and in fifth sentence, substituted ''If no final decision is rendered by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision'' for ''If no final decision is rendered by the refund effective date or by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, whichever is earlier, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision''.

Subsec. (e). Pub. L. 109–58, §1286, added subsec. (e).

1988—Subsec. (a). Pub. L. 100–473, §2(1), inserted provisions for a statement of reasons for listed changes, hearings, and specification of issues.

Subsecs. (b) to (d). Pub. L. 100–473, §2(2), added subsecs. (b) and (c) and redesignated former subsec. (b) as (d).

EFFECTIVE DATE OF 1988 AMENDMENT

Pub. L. 100–473, §4, Oct. 6, 1988, 102 Stat. 2300, provided that: ''The amendments made by this Act [amending this section] are not applicable to complaints filed or motions initiated before the date of enactment of this Act [Oct. 6, 1988] pursuant to section 206 of the Federal Power Act [this section]: *Provided, however*, That such complaints may be withdrawn and refiled without prejudice.''

LIMITATION ON AUTHORITY PROVIDED

Pub. L. 100–473, §3, Oct. 6, 1988, 102 Stat. 2300, provided that: ''Nothing in subsection (c) of section 206 of the Federal Power Act, as amended (16 U.S.C. 824e(c)) shall be interpreted to confer upon the Federal Energy Regulatory Commission any authority not granted to it elsewhere in such Act [16 U.S.C. 791a et seq.] to issue an order that (1) requires a decrease in system production or transmission costs to be paid by one or more electric utility companies of a registered holding company; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company. For purposes of this section, the terms 'electric utility companies' and 'registered holding company' shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended [15 U.S.C. 79 et seq.].''

STUDY

Pub. L. 100–473, §5, Oct. 6, 1988, 102 Stat. 2301, directed that, no earlier than three years and no later than four

years after Oct. 6, 1988, Federal Energy Regulatory Commission perform a study of effect of amendments to this section, analyzing (1) impact, if any, of such amendments on cost of capital paid by public utilities, (2) any change in average time taken to resolve proceedings under this section, and (3) such other matters as Commission may deem appropriate in public interest, with study to be sent to Committee on Energy and Natural Resources of Senate and Committee on Energy and Commerce of House of Representatives.

§ 824f. Ordering furnishing of adequate service

Whenever the Commission, upon complaint of a State commission, after notice to each State commission and public utility affected and after opportunity for hearing, shall find that any interstate service of any public utility is inadequate or insufficient, the Commission shall determine the proper, adequate, or sufficient service to be furnished, and shall fix the same by its order, rule, or regulation: *Provided*, That the Commission shall have no authority to compel the enlargement of generating facilities for such purposes, nor to compel the public utility to sell or exchange energy when to do so would impair its ability to render adequate service to its customers.

(June 10, 1920, ch. 285, pt. II, § 207, as added Aug. 26, 1935, ch. 687, title II, § 213, 49 Stat. 853.)

§ 824g. Ascertainment of cost of property and depreciation

(a) Investigation of property costs

The Commission may investigate and ascertain the actual legitimate cost of the property of every public utility, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation, and the fair value of such property.

(b) Request for inventory and cost statements

Every public utility upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction.

(June 10, 1920, ch. 285, pt. II, § 208, as added Aug. 26, 1935, ch. 687, title II, § 213, 49 Stat. 853.)

§ 824h. References to State boards by Commission

(a) Composition of boards; force and effect of proceedings

The Commission may refer any matter arising in the administration of this subchapter to a board to be composed of a member or members, as determined by the Commission, from the State or each of the States affected or to be affected by such matter. Any such board shall be vested with the same power and be subject to the same duties and liabilities as in the case of a member of the Commission when designated by the Commission to hold any hearings. The action of such board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe. The board shall be appointed by the Commission from persons nominated by the State commission of each State affected or by the Governor of such State if there is no State commission. Each State affected shall be entitled to the same number of representatives on the board unless the nominating power of such State waives such right. The Commission shall have discretion to reject the nominee from any State, but shall thereupon invite a new nomination from that State. The members of a board shall receive such allowances for expenses as the Commission shall provide. The Commission may, when in its discretion sufficient reason exists therefor, revoke any reference to such a board.

(b) Cooperation with State commissions

The Commission may confer with any State commission regarding the relationship between rate structures, costs, accounts, charges, practices, classifications, and regulations of public utilities subject to the jurisdiction of such State commission and of the Commission; and the Commission is authorized, under such rules and regulations as it shall prescribe, to hold joint hearings with any State commission in connection with any matter with respect to which the Commission is authorized to act. The Commission is authorized in the administration of this chapter to avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission.

(c) Availability of information and reports to State commissions; Commission experts

The Commission shall make available to the several State commissions such information and reports as may be of assistance in State regulation of public utilities. Whenever the Commission can do so without prejudice to the efficient and proper conduct of its affairs, it may upon request from a State make available to such State as witnesses any of its trained rate, valuation, or other experts, subject to reimbursement to the Commission by such State of the compensation and traveling expenses of such witnesses. All sums collected hereunder shall be credited to the appropriation from which the amounts were expended in carrying out the provisions of this subsection.

(June 10, 1920, ch. 285, pt. II, § 209, as added Aug. 26, 1935, ch. 687, title II, § 213, 49 Stat. 853.)

§ 824i. Interconnection authority

(a) Powers of Commission; application by State regulatory authority

(1) Upon application of any electric utility, Federal power marketing agency, geothermal power producer (including a producer which is not an electric utility), qualifying cogenerator, or qualifying small power producer, the Commission may issue an order requiring—

(A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant,

(B) such action as may be necessary to make effective any physical connection described in subparagraph (A), which physical connection is ineffective for any reason, such as inadequate size, poor maintenance, or physical unreliability,

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to time prescribe. The entire work may be done at, or ordered through, the Government Publishing Office whenever, in the judgment of the Joint Committee on Printing, the same would be to the interest of the Government: *Provided*, That when the exigencies of the public service so require, the Joint Committee on Printing may authorize the Commission to make immediate contracts for engraving, lithographing, and photolithographing, without advertisement for proposals: *Provided further*, That nothing contained in this chapter or any other Act shall prevent the Federal Power Commission from placing orders with other departments or establishments for engraving, lithographing, and photolithographing, in accordance with the provisions of sections 1535 and 1536 of title 31, providing for interdepartmental work.

(June 10, 1920, ch. 285, pt. III, §312, as added Aug. 26, 1935, ch. 687, title II, §213, 49 Stat. 859; amended Pub. L. 113–235, div. H, title I, §1301(b), (d), Dec. 16, 2014, 128 Stat. 2537.)

CODIFICATION

''Sections 1535 and 1536 of title 31'' substituted in text for ''sections 601 and 602 of the Act of June 30, 1932 (47 Stat. 417 [31 U.S.C. 686, 686b])'' on authority of Pub. L. 97–258, §4(b), Sept. 13, 1982, 96 Stat. 1067, the first section of which enacted Title 31, Money and Finance.

CHANGE OF NAME

''Director of the Government Publishing Office'' substituted for ''Public Printer'' in text on authority of section 1301(d) of Pub. L. 113–235, set out as a note under section 301 of Title 44, Public Printing and Documents.

''Government Publishing Office'' substituted for ''Government Printing Office'' in text on authority of section 1301(b) of Pub. L. 113–235, set out as a note preceding section 301 of Title 44, Public Printing and Documents.

§ 825*l*. Review of orders

(a) Application for rehearing; time periods; modification of order

Any person, electric utility, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, electric utility, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any entity unless such entity shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b), the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

(b) Judicial review

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States court of appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

(c) Stay of Commission's order

The filing of an application for rehearing under subsection (a) shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

(June 10, 1920, ch. 285, pt. III, §313, as added Aug. 26, 1935, ch. 687, title II, §213, 49 Stat. 860; amended June 25, 1948, ch. 646, §32(a), 62 Stat. 991; May 24, 1949, ch. 139, §127, 63 Stat. 107; Pub. L. 85–791, §16, Aug. 28, 1958, 72 Stat. 947; Pub. L. 109–58, title XII, §1284(c), Aug. 8, 2005, 119 Stat. 980.)

CODIFICATION

In subsec. (b), "section 1254 of title 28" substituted for "sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347)" on authority of act June 25, 1948, ch. 646, 62 Stat. 869, the first section of which enacted Title 28, Judiciary and Judicial Procedure.

AMENDMENTS

2005—Subsec. (a). Pub. L. 109–58 inserted "electric utility," after "Any person," and "to which such person," and substituted "brought by any entity unless such entity" for "brought by any person unless such person".

1958—Subsec. (a). Pub. L. 85–791, §16(a), inserted sentence to provide that Commission may modify or set aside findings or orders until record has been filed in court of appeals.

Subsec. (b). Pub. L. 85–791, §16(b), in second sentence, substituted "transmitted by the clerk of the court to" for "served upon", substituted "file with the court" for "certify and file with the court a transcript of", and inserted "as provided in section 2112 of title 28", and in third sentence, substituted "jurisdiction, which upon the filing of the record with it shall be exclusive" for "exclusive jurisdiction".

CHANGE OF NAME

Act June 25, 1948, eff. Sept. 1, 1948, as amended by act May 24, 1949, substituted "court of appeals" for "circuit court of appeals".

§825m. Enforcement provisions

(a) Enjoining and restraining violations

Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule, regulation, or order thereunder, it may in its discretion bring an action in the proper District Court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this chapter or any rule, regulation, or order thereunder, and upon a proper showing a permanent or temporary injunction or decree or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who, in his discretion, may institute the necessary criminal proceedings under this chapter.

(b) Writs of mandamus

Upon application of the Commission the district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this chapter or any rule, regulation, or order of the Commission thereunder.

(c) Employment of attorneys

The Commission may employ such attorneys as it finds necessary for proper legal aid and service of the Commission or its members in the conduct of their work, or for proper representation of the public interests in investigations made by it or cases or proceedings pending before it, whether at the Commission's own instance or upon complaint, or to appear for or represent the Commission in any case in court; and the expenses of such employment shall be paid out of the appropriation for the Commission.

(d) Prohibitions on violators

In any proceedings under subsection (a), the court may prohibit, conditionally or unconditionally, and permanently or for such period of time as the court determines, any individual who is engaged or has engaged in practices constituting a violation of section 824u of this title (and related rules and regulations) from—

(1) acting as an officer or director of an electric utility; or

(2) engaging in the business of purchasing or selling—

(A) electric energy; or

(B) transmission services subject to the jurisdiction of the Commission.

(June 10, 1920, ch. 285, pt. III, §314, as added Aug. 26, 1935, ch. 687, title II, §213, 49 Stat. 861; amended June 25, 1936, ch. 804, 49 Stat. 1921; June 25, 1948, ch. 646, §32(b), 62 Stat. 991; May 24, 1949, ch. 139, §127, 63 Stat. 107; Pub. L. 109–58, title XII, §1288, Aug. 8, 2005, 119 Stat. 982.)

CODIFICATION

As originally enacted subsecs. (a) and (b) contained references to the Supreme Court of the District of Columbia. Act June 25, 1936, substituted "the district court of the United States for the District of Columbia" for "the Supreme Court of the District of Columbia", and act June 25, 1948, as amended by act May 24, 1949, substituted "United States District Court for the District of Columbia" for "district court of the United States for the District of Columbia". However, the words "United States District Court for the District of Columbia" have been deleted entirely as superfluous in view of section 132(a) of Title 28, Judiciary and Judicial Procedure, which states that "There shall be in each judicial district a district court which shall be a court of record known as the United States District Court for the district", and section 88 of Title 28 which states that "the District of Columbia constitutes one judicial district".

AMENDMENTS

2005—Subsec. (d). Pub. L. 109–58 added subsec. (d).

§825n. Forfeiture for violations; recovery; applicability

(a) Forfeiture

Any licensee or public utility which willfully fails, within the time prescribed by the Commission, to comply with any order of the Commission, to file any report required under this chapter or any rule or regulation of the Commission thereunder, to submit any information or document required by the Commission in the course of an investigation conducted under this chapter, or to appear by an officer or agent at any hearing or investigation in response to a subpena issued under this chapter, shall forfeit to the United States an amount not exceeding $1,000 to be fixed by the Commission after notice and opportunity for hearing. The imposition or payment of any such forfeiture shall not bar or affect any penalty prescribed in this chapter but such forfeiture shall be in addition to any such penalty.

(b) Recovery

The forfeitures provided for in this chapter shall be payable into the Treasury of the United

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costs are not recovered under any other rate component.

(e) *Exception.* A utility or system need not submit the cost support information required under paragraph (d) of this section if the limit established under paragraph (c) of this section is not more than one mill per kilowatt-hour.

(f) *Revision of rate schedules, tariffs or service agreements.* Every utility or system shall:

(1) Amend any rate schedule, tariffs or service agreements to indicate any limit established pursuant to this section, not later than 60 days after the effective date of this rule; and

(2) Hereafter conform any rate or rate change filed under this part to the requirements of this section.

(Federal Power Act, as amended, 16 U.S.C. 792–828c; Department of Energy Organization Act, 42 U.S.C. 7101–7352; E.O. 12009, 3 CFR 142 (1978))

[Order 84, 45 FR 31300, May 13, 1980. Redesignated by Order 545, 57 FR 53990, Nov. 16, 1992, as amended by Order 714, 73 FR 57533, Oct. 3, 2008]

§ 35.23 General provisions.

(a) *Applicability.* This subpart applies to any wholesale sale of electric energy in a coordination transaction by a public utility if that sale requires the use of an emissions allowance.

(b) *Implementation Procedures.* (1) If a public utility has a coordination rate schedule on file that expressly provides for the recovery of all incremental or out-of-pocket costs, such utility may make an abbreviated rate filing detailing how it will recover emissions allowance costs. Such filing must include the following: the index or combination of indices to be used; the method by which the emission allowance amounts will be calculated; timing procedures; how inconsistencies, if any, with dispatch criteria will be reconciled; and how any other rate impacts will be addressed. In addition, a utility making an abbreviated filing must:

(i) Clearly identify the filing as being limited to an amendment to a coordination rate to reflect the cost of emissions allowances, in the first paragraph of the letter of transmittal accompanying the filing;

(ii) Submit the revisions in accordance with § 35.7; and

(iii) Identify each rate schedule to which the amendment applies.

(2) The abbreviated filing must apply consistent treatment to all coordination rate schedules. If the filing does not apply consistent rate treatment, the public utility must explain why it does not do so.

(3) If a public utility wants to charge incremental costs for emissions allowances, but its rate schedule on file with the Commission does not provide for the recovery of all incremental costs, the selling public utility may submit an abbreviated filing if all customers agree to the rate change. If customers do not agree, the selling public utility must tender its emissions allowance proposal in a separate section 205 rate filing, fully justifying its proposal.

[59 FR 65938, Dec. 22, 1994, as amended by Order 714, 73 FR 57533, Oct. 3, 2008]

§ 35.24 Tax normalization for public utilities.

(a) *Applicability.* (1) Except as provided in subparagraph (2) of this paragraph, this section applies, with respect to rate schedules filed under §§ 35.12 and 35.13 of this part, to the ratemaking treatment of the tax effects of all transactions for which there are timing differences.

(2) This section does not apply to the following timing differences:

(i) Differences that result from the use of accelerated depreciation;

(ii) Differences that result from the use of Class Life Asset Depreciation Range (ADR) provisions of the Internal Revenue Code;

(iii) Differences that result from the use of accelerated amortization provisions on certified defense and pollution control facilities;

(iv) Differences that arise from recognition of extraordinary property losses as a current expense for tax purposes but as a deferred and amortized expense for book purposes;

(v) Differences that arise from recognition of research, development, and demonstration expenditures as a current expense for tax purposes but as a deferred and amortized expense for book purposes;

(vi) Differences that result from different tax and book reporting of deferred gains or losses from disposition of utility plant;

(vii) Differences that result from the use of the Asset Guideline Class ''Repair Allowance'' provision of the Internal Revenue Code;

(viii) Differences that result from recognition of purchased gas costs as a current expense for tax purposes but as a deferred expense for book purposes.

(*See* Order 13, issued October 18, 1978; Order 203, issued May 29, 1958; Order 204, issued May 29, 1958; Order 404, issued May 15, 1970; Order 408, issued August 26, 1970; Order 432, issued April 23, 1971; Order 504, issued February 11, 1974; Order 505, issued February 11, 1974; Order 566, issued June 3, 1977; Opinion 578, issued June 3, 1970; and Opinion 801, issued May 31, 1977.)

(b) *General rules*—1) *Tax normalization required*. (i) A public utility must compute the income tax component of its cost of service by using tax normalization for all transactions to which this section applies.

(ii) Except as provided in paragraph (c) of this section, application of tax normalization by a public utility under this section to compute the income tax component will not be subject to case-by-case adjudication.

(2) *Reduction of, and addition to, rate base*. (i) The rate base of a public utility using tax normalization under this section must be reduced by the balances that are properly recordable in Account 281, ''Accumulated deferred income taxes-accelerated amortization property;'' Account 282, ''Accumulated deferred income taxes—other property;'' and Account 283, ''Accumulated deferred income taxes—other.'' Balances that are properly recordable in Account 190, ''Accumulated deferred income taxes,'' must be treated as an addition to rate base.

(ii) Such rate base reductions or additions must be limited to deferred taxes related to rate base, construction or other jurisdictional activities.

(iii) If a public utility uses an approved purchased gas adjustment clause or a research, development and demonstration tracking clause, the rate base reductions or additions required under this subparagraph must apply only to the extent that the balances in Account 190 and Accounts 281 through 283 are not used, for purposes of calculating carrying charges, as an offset to balances properly recordable in Account 188, ''Research development and demonstration expenditures,'' or Account 191, ''Unrecovered purchased gas costs.''

(c) *Special rules*. (1) This paragraph applies:

(i) If the public utility has not provided deferred taxes in the same amount that would have accrued had tax normalization been applied for the tax effects of timing difference transactions originating at any time prior to the test period; or

(ii) If, as a result of changes in tax rates, the accumulated provision for deferred taxes becomes deficient in or in excess of amounts necessary to meet future tax liabilities as determined by application of the current tax rate to all timing difference transactions originating in the test period and prior to the test period.

(2) The public utility must compute the income tax component in its cost of service by making provision for any excess or deficiency in deferred taxes described in subparagraphs (1)(i) or (1)(ii) of this paragraph.

(3) The public utility must apply a Commission-approved ratemaking method made specifically applicable to the public utility for determining the cost of service provision described in subparagraph (2) of this paragraph. If no Commission-approved ratemaking method has been made specifically applicable to the public utility, then the public utility must use some ratemaking method for making such provision, and the appropriateness of this method will be subject to case-by-case determination.

(d) *Definitions*. For purposes of this section, the term:

(1) *Tax normalization* means computing the income tax component as if the amounts of timing difference transactions recognized in each period for ratemaking purposes were also recognized in the same amount in each such period for income tax purposes.

(2) *Timing differences* means differences between amounts of expenses or revenues recognized for income tax purposes and amounts of expenses or

revenues recognized for ratemaking purposes, which differences arise in one time period and reverse in one or more other time periods so that the total amounts of expenses or revenues recognized for income tax purposes and for ratemaking purposes are equal.

(3) *Commission-approved ratemaking method* means a ratemaking method approved by the Commission in a final decision including approval of a settlement agreement containing a ratemaking method only if such settlement agreement applies that method beyond the effective term of the settlement agreement.

(4) *Income tax purposes* means for the purpose of computing income tax under the provisions of the Internal Revenue Code or the income tax provisions of the laws of a State or political subdivision of a State (including franchise taxes).

(5) *Income tax component* means that part of the cost of service that covers income tax expenses allowable by the Commission.

(6) *Ratemaking purposes* means for the purpose of fixing, modifying, approving, disapproving or rejecting rates under the Federal Power Act or the Natural Gas Act.

(7) *Tax effect* means the tax reduction or addition associated with a specific expense or revenue transaction.

(8) *Transaction* means an activity or event that gives rise to an accounting entry that is used in determining revenues or expenses.

[46 FR 26636, May 14, 1981. Redesignated and amended by Order 144–A, 47 FR 8342, Feb. 26, 1982; Redesignated by Order 545, 57 FR 53990, Nov. 16, 1992]

§ 35.25 Construction work in progress.

(a) *Applicability*. This section applies to any rate schedule filed under this part by any public utility as defined in subsection 201(e) of the Federal Power Act.

(b) *Definitions*. For purposes of this section:

(1) *Constuction work in progress* or *CWIP* means any expenditure for public utility plant in process of construction that is properly included in Accounts 107 (construction work in progress) and 120.1 (nuclear fuel in process of refinement, conversion, enrichment, and fabrication) of part 101 of this chapter, the Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act (Major and Nonmajor), that would otherwise be eligible for allowance for funds used during construction (AFUDC) treatment.

(2) *Double whammy* means a situation which may arise when a wholesale electric rate customer embarks upon its own or participates in a construction program to supply itself with all or a portion of its future power needs, thereby reducing its future dependence on the CWIP of the rate applicant, but is simultaneously forced to pay to the CWIP public utility rate applicant the CWIP portion of the wholesale rates that reflects existing levels of service or a different anticipated service level.

(3) *Fuel conversion facility* means any addition to public utility plant that enables a natural gas-burning plant to convert to the use of other fuels, or that enables an oil-burning plant to convert to the use of other fuels, other than natural gas. Such facilities include those that alter internal plant workings, such as oil or coal burners, soot blowers, bottom ash removal systems and concomitant air pollution control facilities, and any facility needed for receiving and storing the fuel to which the plant is being converted, which facility would not be necessary if the plant continued to burn gas or oil.

(4) *Pollution control facility* means an identifiable structure or portions of a structure that is designed to reduce the amount of pollution produced by the power plant, but does not include any facility that reduces pollution by substituting a different method of generation or that generates the additional power necessitated by the operation of a pollution control facility.

(c) *General rule*. For purposes of any initial rate schedule or any rate schedule change filed under § 35.12 or § 35.13 of this part, a public utility may include in its rate base any costs of construction work in progress (CWIP), including allowance for funds used during construction (AFUDC), as provided in this section.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON. D C 20426

In Reply Refer To:
AI935000

April 23, 1993

TO ALL JURISDICTIONAL PUBLIC UTILITIES, LICENCES, AND NATURAL GAS COMPANIES

SUBJECT: ACCOUNTING FOR INCOME TAXES

Early Adoption
Method of Adoption
FERC Approval to Adjust the Deferred Tax Accounts
Reporting Any Net Income Effect
Discontinuance of Net-of-Tax Accounting
Equity AFUDC
Adjusting Netoftax Components of Utility Plant
Changes in Tax Lase or Rates
Flowthrough Items
NOL and Tax Credit Carryforwards
Alternative Minimum Tax Credit Carryforward
Regulatory Assets and Liabilities
Costofservice Tariffs
Investment Tax Credits
Financial Statement Disclosure
Classification of Current Portion of Deferred Income Taxes
Consolidated Income Taxes

INTRODUCTION

In February 1992, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). This Statement was the culmination of a process which the FASB began in 1982 to reexamine the accounting standards for income taxes. SFAS 109 superseded Accounting Principles Board Opinion No. 11, Accounting for Income Taxes (APB 11).

Under SFAS 109, a current or deferred tax liability or asset is recognized for the current or deferred tax consequences of all events that have been recognized in the financial statements or tax returns, measured on the basis of enacted tax law. Under APB 11, deferred tax consequences were recognized based on the differences between the periods in which transactions affect taxable income and the periods in which they enter into the determination of pretax accounting income. The change affects significantly the measurement and recognition of current and deferred income taxes reported in general purpose financial statements.

Public utilities, licensees, and natural gas companies are required to implement the provisions of SFAS 109 in general purpose financial statements issued to the public no later than the first quarter of 1993. The Statement however encouraged earlier application.

The FERC's Uniform Systems of Accounts generally provide that an entity follow comprehensive interperiod income tax

allocation except that an entity is not required to adopt comprehensive interperiod income tax allocation until the deferred income taxes are included as an expense in its rate levels by regulatory authorities.

Since the issuance of Order No. 144 in 1981, the FERC's regulations have required companies to determine the income tax allowance included in jurisdictional rate levels on a fully normalized basis. Also, Order No. 144 requires an entity to compute the income tax component in its cost of service by making provision for any excess or deficiency in deferred taxes under the following circumstances: (1) if the entity has not provided deferred taxes in the same amount that would have accrued had tax normalization been applied for tax effects of timing difference transactions originating at any time prior to the test period; or (2) if, as a result of changes in tax rates, the accumulated provision for deferred taxes becomes deficient in or in excess of amounts necessary to meet future tax liabilities as determined by application of the current tax rate to all timing difference transactions originating in the test period and prior to the test period. Therefore, the FERC's accounting and rate regulations, when read together, already require use of a liability method somewhat similar to SFAS 109 for the jurisdictional portion of an entity's business.

The primary conceptual difference between SFAS 109 and the FERC's method relates to how regulatory assets and liabilities are recognized. Under the FERC approach, regulatory assets and

liabilities are effectively netted against the deferred tax asset and liability accounts or, in some cases, not reported until related revenues are recognized. Under SFAS 109 all tax related regulatory assets and liabilities are shown broad. Certain other differences between the FERC's Uniform Systems of Accounts and SFAS 109 are discussed in the guidance that follows.

It is axiomatic that accounting statements issued by the FASB for use in general purpose financial statements of business entities should not, in itself, have an economic rate effect on a regulated entity or its customers. SFAS 109, in the main, requires costbased regulated entities to account for and report deferred tax assets and liabilities separately from related regulatory assets and liabilities. In general, such increases in the level of detail for an entity's assets and liabilities enhance disclosure, making financial information more useful to its users. The enhanced disclosure required by SFAS 109 may also prove useful for regulatory purposes. Moreover, adoption of SFAS 109 for FERC accounting and reporting purposes would result in financial information reported to the FERC and the public using the same accounting standard an objective having considerable merit in its own right.

Therefore, public utilities, licensees, and natural gas companies shall adopt SFAS 109 for financial accounting and reporting to FERC. In order to insure that the FERC continues to have the financial information it needs for regulatory purposes however, entities shall conform their accounting and reporting to the

guidance provided in this letter. Neither SFAS 109 nor the guidance contained in this letter for implementing the standard for FERC financial accounting and reporting purposes relieves entities from the requirements of Section 154.63a, Tax normalization for interstate pipelines, or Section 35.24, Tax normalization for public utilities, of the Commission's regulations.

The Commission delegated authority to the Chief Accountant under 18 C.F.R. 375.303 to issue interpretations of the Uniform System of Accounts for public utilities, licensees and natural gas companies and sign correspondence on behalf of the Commission relating to Annual Report Nos. 1, lF, 2, and 2F. The guidance provided herein constitutes final agency action pursuant to this authority. Within 30 days of the date of this letter, interested parties may file a request for rehearing by the Commission under 18 C.F.R. § 385.713.

1. EARLY ADOPTION

Question: SFAS 109 is effective for fiscal years beginning
after December 15, 1992, but the FASB encourages
earlier application. May an entity implement SFAS
109 for FERC accounting and reporting requirements
prior to January 1, 1993?

Response: An entity implementing SFAS 109 in its general purpose financial statements prior to the Statement's required effective date, may also adopt the

Statement for FERC accounting and reporting purposes. An entity however shall not implement SFAS 109 for FERC accounting and reporting purposes before it implements the Statement in its general purpose financial statements. Entities shall implement SFAS 109 for FERC accounting and reporting purposes no later than fiscal years beginning after December 15, 1992.

2. METHOD OF ADOPTION

Question: In the first year applied, SFAS 109 permits an entity to either (1) include the cumulative effect of the accounting change in the determination of current year net income, as provided for in APB Opinion No. 20, Accounting Changes; or (2) restate financial statements for prior periods to conform to the provisions of the Statement. Are both of these procedures acceptable to the FERC?

Response: No. In reporting to the FERC, the effect of initially applying this statement shall be reported as the cumulative effect of a change in accounting principle in accordance with the provisions of APB 20. An entity will not be permitted to restate prior years financial statements.

3. FERC APPROVAL TO ADJUST THE DEFERRED TAX ACCOUNTS

Question: The instructions to the Uniform Systems of Accounts presently restrict the use of the deferred tax balance sheet accounts to the purposes set forth in the text of the accounts unless prior

Commission approval is obtained. Do the adjustments to the deferred tax accounts for the implementation of SFAS 109 fall within this restriction?

Response: Yes. This letter however, will constitute the requisite authority for making adjustments to the deferred tax accounts when the application of SFAS 109 does not affect net income (i.e. the deferred tax adjustments are accompanied by the recordation of equal regulatory assets or liabilities). Entities shall request and obtain specific FERC approval for all other adjustments to the deferred tax accounts, including those related to nonjurisdictional activity. The filing shall include a complete explanation of and justification for an entity's proposed accounting.

4. REPORTING ANY NET INCOME EFFECT

Question: If the initial implementation of SFAS 109 affects net income and an entity obtains FERC approval to adjust its deferred tax accounts, where should the income effect be reported in FERC financial reports (i.e. FERC Form Nos. 1, 1-F, 2 and 2-A etc.)?

Response: The FERC report forms do not currently have a line for reporting the cumulative effect of a change in accounting principle. Therefore, the effect on net income shall be reported on the income statement on the lines designated for extraordinary income or deductions, as appropriate, in FERC financial reports. To identify that the effects on net income resulting from the initial adoption of

SFAS 109 are not an "extraordinary item" as that term is defined in the Uniform Systems of Accounts, entities shall also disclose in a footnote to the financial statements the full particulars of any amounts reports as the cumulative effect of a change in accounting principle.

5. DISCONTINUANCE OF NET-OF-TAX ACCOUNTING

Question: SFAS 109 prohibits net-of-tax accounting and reporting in general purpose financial statements. May entities continue to account and report to FERC on a net-of-tax basis?

Response: No. The present instructions to the Uniform Systems of Accounts require entities to record and report the deferred tax consequences of transactions, events, and circumstances in the appropriate deferred tax accounts. While the FERC has always preferred gross-of-tax financial accounting and reporting, it permitted an exception to this general requirement where a net-of-tax allowance for funds used during construction (AFUDC) rate was prescribed by a regulatory body in setting an entity's rate levels. The FERC granted this exception to avoid the burden of maintaining duplicate records for utility plant on a net-of-tax basis for one jurisdiction and a gross-of-tax basis for another.

Because SFAS 109 prohibits netoftax accounting and reporting in general purpose financial statements, the reasons for permitting the exception to the general requirement are no longer relevant. Therefore, entities shall

discontinue the use of netoftax AFUDC rates.

6.EQUITY AFUDC

Question: SFAS 109 considers the equity component of AFUDC a temporary difference for which deferred income taxes must be provided. How should an entity record the deferred tax liability for the equity component of AFUDC and the related regulatory asset in its accounts?

Response: An entity shall record the deferred tax liability for the equity component of AFUDC in Account 282, Accumulated Deferred Income Taxes Other Property, and any corresponding regulatory asset in Account 182.3, Other Regulatory Assets. The regulatory asset is itself a temporary difference for which deferred incomes taxes shall be recognized and recorded in Account 283, Accumulated Deferred Income Taxes Other. This accounting shall be followed for the adjustments required upon initial application of the statement and for all amounts of equity AFUDC capitalized in subsequent periods.

7. ADJUSTING NETOFTAX COMPONENTS OF UTILITY PLANT

Question: Upon initial application of SFAS 109, an entity must adjust any netoftax components of construction workinprogress and plant in service. How should an entity account for these adjustments?

Response: Entities that previously

accounted for certain components of plant cost on a netoftax basis, primarily the borrowed funds component of AFUDC, have effectively recorded the deferred income tax effects of those components directly in the plant accounts. The deferred income taxes were computed using the income tax rates in effect when the items were capitalized.

For constructionworkinprogress, an entity shall transfer the deferred income taxes actually included therein to Account 282, Accumulated Deferred Income Taxes Other Property. If the amount transferred to Account 282 is greater or less than the amount needed to meet the future tax liability related to those items based on current tax rates, additional adjustments to the deferred tax liability shall be made consistent with SFAS 109. If as a result of action by a regulator it is probable that such excess or deficiency will be returned to or recovered from customers in rates, an asset or liability shall be recognized for that probable future revenue or reduction in future revenue in Accounts 182.3, Other Regulatory Assets, or 254, Other Regulatory Liabilities, respectively. That asset or liability is also a temporary difference for which a deferred tax asset or liability shall be recognized in Account 190, Accumulated Deferred Income Taxes, or Account 283, Accumulated Deferred Income Taxes Other, as appropriate.

Similar accounting is to be followed for plantin-service items when the required information is available. However, in order to properly adjust the plantinservice account an entity will need to determine the specific amounts of borrowed funds

and equity AFUDC capitalized in prior periods, the extent to which those amounts and other netoftax components have been depreciated, the specific property units to which the amounts have been assigned and the extent to which property retirements affect the accounts in which the income tax effects now reside. In virtually all instances that information will simply not be available or will be too costly to develop. In that situation, an entity shall not adjust the plantinservice accounts based on estimates or presumed relationships. Instead, an alternate method shall be used to determine the necessary adjustments.

Under the alternate method, any difference between the reported amount and the tax basis of plant is a temporary difference for which a deferred tax liability shall be recorded in Account 282. If as a result of action by a regulator, it is probable that amounts required for settlement of that deferred tax liability will be recovered from customers through future rates, a regulatory asset equal to that probable future revenue should be recorded in Account 182.3. That asset is also a temporary difference for which a deferred tax liability shall be recognized in Account 283, Accumulated Deferred Income Taxes Other.

8. CHANGES IN TAX LAW OR RATES

Question: How should an entity record the effect of a change in tax law or rates that occurs after the year of initial implementation of SFAS 109?

Response: The entity shall adjust its deferred tax liabilities and assets for the effect of the change in tax law or rates in the period that the change is enacted. The adjustment shall be recorded in the proper deferred tax balance sheet accounts (Accounts 190, 281, 282 and 283) based on the nature of the temporary difference and the related classification requirements of the accounts. If as a result of action by a regulator, it is probable that the future increase or decrease in taxes payable due to the change in tax law or rates will be recovered from or returned to customers through future rates, an asset or liability shall be recognized in Account 182.3, Other Regulatory Assets, or Account 254, Other Regulatory Liabilities, as appropriate, for that probable future revenue or reduction in future revenue. That asset or liability is also a temporary difference for which a deferred tax asset or liability shall be recognized in Account 190, Accumulated Deferred Income Taxes or Account 283, Accumulated Deferred Income Taxes Other, as appropriate.

9. FLOWTHROUGH ITEMS

Question: An entity adopting SFAS 109 previously flowed through the tax benefits of certain temporary differences in rates when the differences originated. How should the Company recognize the deferred income taxes attributable to these temporary differences in its accounts?

Response: Deferred income taxes on all temporary differences, including differences where the related income tax

effects have been or are presently flowed through in rates, should be recorded in Accounts 190, 281, 282 and 283 based on the nature of the temporary difference and the classification requirements of those accounts. If as a result of action by a regulator, it is probable that the future increase or decrease in taxes payable due to flow through ratemaking practices will be recovered from or returned to customers through future rates, an asset or liability shall be recognized in Account 182.3, Other Regulatory Assets, or Account 254, Other Regulatory Liabilities, as appropriate, for that probable future revenue or reduction in future revenue. That asset or liability is also a temporary difference for which a deferred tax asset or liability shall be recognized in Account 190, Accumulated Deferred Income Taxes or Account 283, Accumulated Deferred Income Taxes Other, as appropriate.

10.NOL AND TAX CREDIT CARRYFORWARDS

Question: How should an entity account for the income tax effect of a net operating loss (NOL) carryforward or a tax credit carryforward?

Response: An entity shall record the income tax effects of a NOL carryforward and a tax credit carryforward in a separate subaccount of Account 190, Accumulated Deferred Income Taxes Debit. In the event that it is more likely than not (a likelihood of more than 50 percent) that some portion of its deferred tax assets will not be realized, an entity hall record a valuation allowance in a

separate subaccount of Account 190. The entity shall disclose full particulars as to the nature and amount of each type of operating loss and tax credit carryforward in the notes to the financial statements.

11. ALTERNATIVE MINIMUM TAX CREDIT CARRYFORWARD

Question: How should an entity record an alternative minimum tax credit carryforward?

Response: SFAS 109 requires a deferred tax liability or asset to be recognized for the estimated future tax effects attributable to temporary differences and carryforwards. Under SFAS 109, the AMT is viewed as a tax credit carryforward. Therefore, an entity shall record an alternative minimum tax credit carryforward in a separate subaccount of Account 190, Accumulated Deferred Income Taxes.

12. REGULATORY ASSETS AND LIABILITIES

Question: Where an entity recognizes regulatory assets or liabilities in connection with a change in its deferred tax assets and liabilities, should an entity record the change in the required deferred income tax balances in the appropriate income tax expense accounts and separately recognize the creation of regulatory assets and liabilities in a different income statement account? If so, which income statement account should be used to record the creation of regulatory assets and liabilities?

Response: The FERC recently considered the proper accounting for regulatory assets and liabilities in a rulemaking proceeding, Docket No. RM921000. Under the final rule issued in that proceeding (Commission Order No. 552 issued March 31,1993), an entity is not required to use income statement accounts to recognize regulatory assets and liabilities related to changes in deferred tax assets or liabilities when an equal and corresponding deferred tax asset or liability is recorded.

13. COSTOFSERVICE TARIFFS

Question: An entity has a costofservice tariff under which monthly billings are based on recorded amounts under FERC's Uniform Systems of Accounts. Under the tariff, only the amounts recorded in certain specified accounts affect the monthly billings. For example, the tariff may specify that Account 282 must be included in the determination of rate base but is silent with respect to Account 254. If implementing SFAS 109 for FERC accounting and reporting results in a reduction in the balance in Account 282 but a corresponding and equal increase in Account 254 (to recognize a regulatory liability) may an entity adjust its monthly billings to give proper effect to the revised accounting for income taxes?

Response: Adoption of SFAS 109 for FERC accounting and reporting purposes should not affect the measurement of cost included in an entity's billing determinations. If an entity's billing

determinations would be affected by adoption of SFAS 109, because of the provisions of its tariffs, the entity shall make a filing with the proper rate regulatory authorities prior to implementing the change for tariff billing purposes.

14. INVESTMENT TAX CREDITS

Question: Some entities accounted for investment tax credits using the deferral method. SFAS 109 views deferred investment tax credits as a temporary difference (i.e. as a reduction in the book basis of the property) for which deferred income taxes are required. How should the deferred income taxes be recorded?

Response: The deferred income taxes attributable to deferred investment tax credits shall be recorded in a separate subaccount of Account 190, Accumulated Deferred Income Taxes. If as a result of action by a regulator it is probable that the reduction in future taxes payable due to the tax deductibility of the higher tax basis of the property will be returned to customers in rates, a regulatory liability shall be recorded for the amount by which future rates will be reduced. The regulatory liability shall be recorded in Account 254, Other Regulatory Liabilities. The regulatory liability is itself a temporary difference for which deferred incomes taxes shall be recognized. Those deferred income taxes shall also be recorded in Account 190.

15. FINANCIAL STATEMENT DISCLOSURE

Question: SFAS 109 requires certain financial statement disclosures concerning income taxes. Should entities disclose the same information in financial statements filed with FERC?

Response: Yes. In addition to the disclosure requirements specified elsewhere in this letter, entities shall follow the disclosure requirements of SFAS 109 in any financial statements filed with the FERC. The required information shall be shown in the Notes To Financial Statements.

16. CLASSIFICATION OF CURRENT PORTION OF DEFERRED INCOME TAXES

Question: SFAS 109 requires entities that prepare classified statements of financial position to separate deferred tax liabilities and assets into current and noncurrent amounts. Should entities reclassify the current portion of deferred tax liabilities or assets to current accounts, such as Account 174, Miscellaneous Current and Accrued Assets, or Account 242, Miscellaneous Current and Accrued Liabilities, for FERC accounting and financial reporting purposes?

Response: No. All deferred tax liabilities and assets shallbe recorded in Accounts 190, 281, 282, or 283, asappropriate, and the current portion of thoseamounts shall not be reclassified to otheraccounts for FERC reporting purposes.

17. CONSOLIDATED INCOME TAXES

Question: Prior to SFAS 96, the FASB (or its predecessor) had not issued any specific pronouncements related to how an entity that joins in the filing of a consolidated income tax return should determine income tax expense in its separately reported financial statements.

Footnote 12 of SFAS 96 provided that the consolidated amount is the amount of current and deferred taxes reported in the consolidated financial statements for the group, or the amount that would be reported if such financial statements were prepared. Under SFAS 96, the sum of the amounts allocated to members of the group (net of consolidation eliminations) would equal the consolidated amount.

SFAS 109 modified the requirements set forth in SFAS 96. SFAS 109 does not require one particular method to allocate the consolidated income tax liability between members of a group. Instead, SFAS 109 permits a number of methods, including methods in which the sum of the amounts allocated to individual members of the group may not equal the consolidated amount. SFAS 109 specifically states that a method that allocates current and deferred taxes to members of the group as if each member were a separate taxpayer (separate return method) is consistent with the statement's criteria.

Will the FERC permit an entity to use a separate return method for FERC financial accounting and reporting?

Response: No. The FERC has issued several decisions rejecting the use of the

separate return method for determining income tax expense when an entity files as part of a consolidated group. Instead, the FERC relies on the standalone method of allocating income taxes between members of a consolidated group.

Under the standalone method the consolidated tax expense is allocated to individual members through recognition of the benefits/burdens contributed by each member of the consolidated group to the consolidated return. Under the standalone method, the sum of amounts allocated to individual members equal the consolidated amount.

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Chief Accountant

Fed. Energy Reg. Comm'n Rep. P 30254 (C.C.H.), 2015 WL 8619969

Federal Energy Regulatory Commission Reporter

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Federal Energy Regulatory Commission

Regulations Preambles

Regulations Preambles 1977 - 1981

Ruling

[¶ 30,254]
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¶ 30,254 46 F. R. 26613 (MAY 14, 1981) 18 CFR PART 2 [DOCKET NOS. RM80-42, R-424 AND R-446] REGULATIONS IMPLEMENTING TAX NORMALIZATION FOR CERTAIN ITEMS REFLECTING TIMING DIFFERENCES IN THE RECOGNITION OF EXPENSES OR REVENUES FOR RATEMAKING AND INCOME TAX PURPOSES

46 F. R. 26613 (May 14, 1981) 18 CFR Part 2 [Docket Nos. RM80-42, R-424 and R-446] Regulations Implementing Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes

[¶ 30,254]

46 F. R. 26613 (May 14, 1981)

18 CFR Part 2

[Docket Nos. RM80-42, R-424 and R-446]

Regulations Implementing Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes

Issued: May 6, 1981.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final Rule Requiring Tax Normalization and Order Removing Refund Contingencies.

SUMMARY: The Commission amends Part 2 of its regulations to require a public utility making a rate filing under the Federal Power Act or an interstate pipeline making a rate filing under the Natural Gas Act to use tax normalization for miscellaneous timing differences to compute the income tax component of its cost of service. The rule requires a rate applicant to use tax normalization for all timing difference transactions except those addressed in prior Commission orders. The rule also codifies the existing Commission practice of adjusting rate base for accumulated deferred income taxes. Finally, the rule requires a rate applicant to make provision in the income tax component of its cost of service for any excess or deficiency in the deferred tax accounts due to tax rate changes and to timing difference transactions within the scope of the rulemaking that had previously been given flow-through treatment.

In addition to this final rule, the Commission orders that refund contingencies imposed in certain cases prior to the issuance of the final rule and relating to tax normalization be removed. The removal is to be effective on the date the final rule becomes effective.

EFFECTIVE DATE: The rule is to be effective July 6, 1981. The removal of refund contingencies imposed in all cases decided subject to the Order Establishing Interim Procedures, issued June 8, 1979 under Docket Nos. R-424 and R-446 is to be effecitve July 6, 1981.

[31,518]

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C. Cost Basis for Tax Normalization

D. The "Actual Taxes Paid" Principle

E. Continual Cost and Tax Deferrals; "Permanent Tax Savings"

1. Comments and Responses on Policy Grounds

2. Comments and Responses on Legal Grounds

3. Conclusion: Tax Savings versus Tax Deferral

F. Deferred Taxes as Customer-Contributed Capital; The "Loan" Analogy

G. Rulemaking versus Case-by-Case Treatment of Tax Normalization

1. Authority for Rulemaking

2. Price Squeeze

H. Tax Normalization and the Just and Reasonable Standard of the Federal Power Act and the Natural Gas Act

I. Comments on the Impact Analyses

1. Rate Impact

a. Staff impact analysis

b. Other impact analyses

2. Cash Flow Impact

3. Rate of Return Impact

4. Cost of Capital Impact

J. Other Issues

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1. Normalization of the Tax-on-Tax Effect

2. Rate Base Levelization

3. Contributions in Aid of Construction

4. Revenue/Rate Stability

5. Efficency Incentives

6. Tax Rate Changes

7. Depreciation of Plant Financed by Deferred Taxes

III. Section-by-Section Analysis of Comments and Final Rule

A. Applicability— § 2.202(a)

B. General Rules— § 2.202(b)

C. Special Rules— § 2.202(c)

D. Definitions— § 2.202(d)

Commission Findings and Orders Final Rule

[31,519]

Appendix A—List of Commenters in Docket No. RM80-42

I. Introduction

A. Background

The Federal Energy Regulatory Commission (Commission)[1] amends Part 2 of its regulations to require tax normalization for the tax effects of certain (hereinafter "certain" or "miscellaneous") timing difference transactions (other than those specifically excluded as discussed below) in rates of electric utilities and interstate natural gas pipelines (hereinafter "utilities and pipelines" or "utilities"). The final rule also codifies the existing Commission ratemaking practice of adjusting

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rate base for accumulated deferred income taxes. Finally, the final rule requires adjustments in the deferred taxes for utilities' and pipelines' cost of service for two types of circumstances: (1) when inadequate or excessive provision for deferred taxes has been made for the tax effects of timing difference transactions within the scope of this rulemaking that had previously been given flow-through treatment; and (2) when inadequate or excessive provision for deferred taxes has been made as a result of changes in tax rates. These latter cost of service adjustments to deferred taxes are required to be made by the applicant either by following a Commission-approved ratemaking method made specifically applicable to the utility or pipeline or by developing in its next rate case a method for handling any excesses or deficiencies that might exist in the deferred tax reserves because of prior flow-through treatment of timing difference transactions or because of tax rate changes.

The final rule differs from the proposed rule in several respects. The proposed rule would have allowed utilities to elect to use tax normalization for the timing difference transactions covered by the rule; but once the election was made, all miscellaneous timing difference transactions covered would have to be normalized. This provision was intended to prevent an applicant's picking and choosing among timing difference transactions in such a way that tax normalization of a transaction would only be used if it immediately benefited the utility or pipeline. As explained in more detail below (Section III), the final rule responds to the objections of many parties to the election provision and instead requires tax normalization of all timing difference transactions covered by the rule. Companies may, however, combine the timing difference transactions for purposes of tax normalization to prevent unnecessary and costly bookkeeping for insignificant individual timing difference transactions.

The final rule also differs from the proposed rule by giving more specificity to the ratemaking treatment of the tax effects of timing difference transactions that had previously been flowed through and of the effects of tax rate changes. The proposed rule would not have permitted any adjustments to deferred taxes for deficiencies or excesses caused by reversals of past flow-through transactions or tax rate changes unless the applicant had adopted a Commission approved method for making such adjustments. The final rule requires an adjustment to be made in the applicant's next rate case following the applicability of the rule. Other minor, conforming changes were made in the final rule. These changes are discussed in detail, below, in Section III.

The rule, of course, leaves undisturbed the ability of the parties to reach a settlement on any of the issues covered by the rule.

This final rule culminates a long procedural history that was detailed in the Notice of Proposed Rulemaking[2] and **[31,520]**is summarized here. In 1975, the Commission issued Order No. 530.[3]

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another finding concerning tax normalization of the tax effects of these miscellaneous timing difference transactions. After Order No. 530-B was remanded, the Commission issued an Order Establishing Interim Procedures in Docket Nos. R-424 and R-446[8] to alleviate the procedural uncertainty among presiding law judges and litigants about the timing difference transactions covered under Order No. 530-B. In that order, the Commission declared that:

> any final decision which requires a refund of amounts otherwise in excess of the just and reasonable rate level shall not require a refund of that portion of the rate related to interperiod tax allocation [tax normalization]. That portion shall continue in effect, subject to refund, pending a final order in these dockets.

Since the Commission finds in this proceeding that tax normalization is the preferred ratemaking policy for the tax effects of the timing difference transactions covered in this proceeding, the Commission determines that tax normalization under the Order No. 530-B policy is found to produce rates that are just and reasonable. Dockets Nos. R-424 and R-446 are therefore consolidated with the instant Docket No. RM80-42. In addition to the final rule for Docket No. RM80-42, the Commission orders that for rates directed to be collected subject to refund pending the outcome of a final order in Docket Nos. R-424 and R-446 the refund contingency shall be removed as of the date that the final rule issued in this proceeding becomes effective.

B. Compliance With the Remand of Order No. 530-B

The court in *Public Systems*[9] remanded Order No. 530-B and related orders to the Commission for further action. The court found that the Commission had failed to "assess the consequences of its action for the industry," and to "indicate 'fully and carefully' the purposes behind the order."[10]

This section is intended to show how the Commission has responded to the concerns of the *Public Systems* court. The Commission believes it has fully considered and responded to the court's concerns.

[31,522]

1. Purpose and Goals of the Rule. The *Public Systems* court noted that Order No. 530-B rested on general policy considerations and stated that the Commission had failed to adequately explain the purposes and goals underlying its decision. The court stated that the only policy goals mentioned in the order would apply to a generic flow-through policy as well as to a tax normalization policy.[11]

The Commission considered a wide variety of factors in its evaluation of the tax normalization

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and flow-through policies.[12] We find that the record in this proceeding overwhelmingly supports a tax normalization policy. We find that tax normalization more appropriately comports with sound regulatory principles and with the public interest than flow-through.

As reiterated throughout this rule, tax normalization better achieves the goals of equity and fairness in rates than does flow-through. The primary rationale for tax normalization is matching: the recognition in rates of the tax effects of expenses and revenues with the expenses and revenues themselves. In terms of expenses only, this means that tax normalization matches tax benefits with cost responsibility. Tax normalization allocates the tax benefits of an expense to the same time periods that the expense itself is allocated. The Commission finds (in Section II-B) that this matching results in a more equitable interperiod allocation of tax costs to customers than does flow-through. Flowthrough, through its inequitable allocation of tax costs over time, is found to distort the Commission's pricing policies.[13]

The Commission also finds that its tax normalization policy balances its obligations to ensure reasonable rates to ratepayers and to maintain the financial integrity of the public utilities and natural gas pipelines it regulates. In Section II-C, the Commission finds tax normalization to be more properly costbased than flow-through. The Commission finds (in Section II-C and II-D) that tax normalization meets the "actual taxes paid" principle from both policy and legal standpoints. Overall, tax normalization is found to meet the just and reasonable rate standards of the Federal Power Act (FPA) and Natural Gas Act (NGA). (*See* Section II-H).

The Commission also finds that tax normalization is likely to result in rates and revenues that are more stable over time than flow-through (Section II-J.4.); and the Commission finds (Section II-J.5) that no adverse efficiency incentives are given to companies by the use of tax normalization.

Finally, the Commission finds that the issuance of this final generic rule requiring tax normalization will eliminate the ongoing controversy and attendant uncertainty regarding the appropriate treatment of miscellaneous timing difference transactions in Commission rate proceedings. The resulting administrative efficiency and clarity should benefit consumers, regulated utilities and the Commission.

2. Items Covered by the Rule. The court in *Public Systems* criticized the Commission for not specifying all of the transactions that would be covered by the tax normalization policy and for inadequately discussing the seven examples that were given.[14]

The Commission's rule requires tax normalization of the tax effects of "miscellaneous" timing difference transactions. The Notice referred to the list of examples of timing differences identified in

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with the just and reasonable standards in the Federal Power and Natural Gas Acts. This latter question is closely linked with the **[31,527]**contentions that tax normalization creates "permanent tax savings" and violates the "actual taxes paid" doctrine.

The Commission concludes, in Section II-G, that it has discretion to require tax normalization of the tax effects of miscellaneous timing differences by general rule rather than by case-by-case adjudication. The regulatory principle of matching tax effects of costs and revenues to their associated costs and revenues is an equitable principle that does not vary under an individual firm's circumstances. The Commission does not, however, believe that tax normalization must be applied in cases where the Commission has found price squeeze to be present. The tax normalization requirement may be removed to remedy undue discrimination between wholesale and retail customers.

In Section II-H, the Commission finds that tax normalization is just and reasonable under the Federal Power and Natural Gas Acts.

In the Notice, the Commission addressed the impacts its proposed tax normalization policy would have on rates, cash flow, rates of return and costs of capital as analyzed in the staff study attached to the Notice. The comments to these estimated impacts are reviewed in Section II-I; the Commission finds its staff's original analyses to be reasonable and equally applicable to the final rule.

The terms "phantom taxes" and "permanent tax savings" have often been employed to advance the argument that utilities and, more important, their stockholders are earning excess profits under tax normalization. Since deferred tax accounting does not permit utilities to transfer accumulated deferred taxes to common equity accounts for the benefit of stockholders, the Commission reiterates its earlier statement in the Notice that tax normalization does not create excess profits. This is discussed more fully in Section II-I.3.

The remaining section of this part, Section II-J, discusses other comments raised to the Notice and presents the Commission's response to these comments. Specifically, this section addresses: normalization of the tax-on-tax effect; rate base levelization; contributions in aid of construction; revenue and rate stability; efficiency incentives; tax rate changes; and depreciation of plant financed by deferred taxes.

B. Matching and Equity

The Commission stated in the Notice that the rationale underlying tax normalization is different

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from that underlying flow-through. Tax normalization is based on the matching principle. According to the matching principle, the tax reducing effect of an expense[28] is allocated to the same customers who pay the expense during the same period. When rates are set so as to permit a utility to recover an expense, the tax reducing effect of that expense is also recognized. When recovery of an expense is deferred or prepaid, so too is the tax reducing effect of that expense. In this way, normalization achieves an equitable allocation of costs between time periods.[29]

Flow-through is based primarily on the so-called "actual taxes paid" principle.[30] This principle, as **[31,528]**interpreted by flow-through proponents, states that customers should be charged, in each period, only the income taxes actually paid by the utility in that period. The matching here is between the cost of service tax allowance and the IRS-determined tax liability. The problem with this approach is that it causes the interperiod allocation of taxes in rates to be solely dependent upon tax regulations rather than upon the regulatory principle of matching costs with benefits. The result is an inequitable allocation of costs between time periods. This inequity is illustrated in the Commission's example in the Notice of how flow-through distorts prices over time:

[I]f the Commission has determined that a reasonable allocation for the recovery of a $100 expense incurred in year 1 is $50 in each of years 2 and 3, then rates in year 1 should be unchanged and rates in years 2 and 3 should be increased by $50. This is essentially what occurs under a normalization policy. A flow-through policy, however, produces a very different result. Because income received in the form of a tax allowance represents additional taxable revenues, rates under a flow-through policy actually would be reduced in year 1 by $100 and increased by $100 in each of years 2 and 3.[31]

While this example is for a single timing difference transaction, it also applies to many transactions occurring simultaneously and over successive periods since the effects of more than one transaction is simply the sum of the effects of the individual transactions.

None of the parties in this proceeding have persuaded the Commission that the above reasoning is wrong. While many comments discussed the comparative equity in the effects on rates of tax normalization and flow-through, none of the arguments raised were without flaws. These arguments and their flaws are discussed immediately below. The commenters also implicitly or explicitly argued that other factors, such as an immediate adverse impact on rates, should be given more weight. We continue to believe, however, that, from a policy perspective, substantial weight should be given to the long term equity considerations that overwhelmingly favor tax normalization over flow-through.

Three general types of equity issues were raised in the comments:

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(1) Equity between present and future ratepayers or interperiod equity;

(2) Equity between different classes of ratepayers; and

(3) Equity between ratepayers and stockholders.

The commenters raised the first type of equity issue (interperiod equity) in several ways. It was argued that since all other costs associated with a given plant are not spread evenly over its life, there is no need to spread tax costs evenly. Indeed, it was argued that flow-through would counteract the declining rates caused by the declining rate base and tend to even out the cost burden on ratepayers over a plant's life. This rate base levelization issue is addressed in Section II-J.2, below. There the Commission finds that rate levelization is not a goal of the proposed tax normalization rule and that, even if it were, flow-through of the significant items covered by the rule would not achieve this result.

A second interperiod equity criticism of tax normalization is based on the allegation that the normalization is incomplete since it does not require normalization of the tax-on-tax effect. This criticism is addressed in Section II-J.1 where it is concluded that such a proposal errs in its attempt to treat the deferred tax expense, a non-deductible expense, as a timing difference transaction.

Another interperiod equity criticism of tax normalization is based on the assumption that it requires customer-contributed capital. Commenters argued first that under conditions of growth the utility completely eludes repaying the customer loan and, second, that there is no coincidence between the customers who provide the loan and those who receive the return of the principal and interest on such loan. The Commission **[31,529]**addresses this issue in Section II-F, below, where the concept of a customer loan under tax normalization is rejected.

Several commenters recognized the interperiod inequity generated by flow-through that the Commission noted in its proposed rulemaking. Commenters pointed out that flow-through generally involves putting off the recovery of current tax costs to the future and that there is no more justification for this than there is for putting off the recovery of current depreciation costs. Another commenter argued that, because of this cost postponement, flow-through benefits (or subsidizes) current customers at the expense of future customers.

The Commission agrees with the commenters who contended that flow-through benefits wholesale customers who intend to build their own generating facilities or who otherwise intend to shift

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proposed normalization rule. Thus, there would be little savings in administrative convenience by adopting a general rule. The Commission disagrees. No issues have been raised in this proceeding that portend continued debate in rate proceedings after the institution of the final generic rule. Raising the specter of implementation or other problems without specific examples does not persuade the Commission against the generic approach.

The Commission does, however, make provision in § 2.202(c), discussed below for: (1) case-by-case determination of a proper way of handling these "miscellaneous" timing difference transactions that originated prior to this rule and were given flow-through treatment, and (2) handling the effects of tax rate changes. The case-by-case approach is used because the Commission has not yet adopted a cost of service method of uniform applicability for the utility and pipeline industries.

With respect to the rate base adjustments in § 2.202(b)(2) of the proposed rule, a number of commenters said that accumulated deferred taxes should be separated between those associated with plant in service and those associated with construction activities. It was argued that it is **[31,558]**inconsistent with the interperiod equity rationale used to support normalization to require that the deferred taxes associated with construction activities be deducted from rate base. Rather, it was argued, these taxes should be deducted from the balance that is utilized for the calculation of the Allowance for Funds Used During Construction (AFUDC).

The Commission agrees with the underlying rationale of these comments. Deferred taxes arising from construction-related taxes and pensions, for example, reduce the financing requirements to be met from other sources during the construction period of a plant. Having the use of these interest-free funds results in benefits that the Commission has traditionally passed immediately through to customers by deducting the associated accumulated deferred taxes from rate base. But since these benefits arise from costs associated with the new plant, it is more equitable to allocate them over the service life of that plant. By using the construction-related accumulated deferred taxes as an offset to the balance used in the calculation of AFUDC (rather than rate base), the net plant value going into rate base when the new plant goes on line is reduced. In this way the benefits a company receives from having the use of deferred tax funds during the plant construction period would be reflected in lower costs to be allocated over the plant's operating life.

In order to accomplish such a change in the current procedures for deducting accumulated deferred taxes from rate base, however, several existing regulations of the Commission that were not subject to the Notice in this proceeding would have to be revised— *e.g.*, the formula for calculating AFUDC, the § 35.13 filing requirements for electric utilities and the § 154.63 filing requirements for natural gas pipelines. The Commission believes that these changes in its regulations should be

a product of a separate proceeding. The final rule, in § 2.202(b)(2)(ii), requires that rate base be adjusted for all accumulated deferred taxes, including accumulated deferred taxes arising from construction-related timing differences and from other jurisdictional activities. By jurisdictional activities we mean all revenue and expense items that affect the jurisdictional cost of service (*e.g.*, regulatory commission expenses). It should be noted that accumulated deferred taxes arising from the types of timing differences excluded from this section (*e.g.*, accelerated depreciation) are also subject to § 202(b)(2) provisions. The rate adjustments in the final rule are mandatory.

The Commission notes that there may be situations in which newly created enterprises are in the process of constructing facilities for future service and do not currently have on file rates for an existing service. In such circumstances, the enterprise would have no rate base in which the deferred tax for construction-related timing differences may be reflected. Although not provided for in the final rule, the Commission believes in such circumustances that it would be appropriate to reduce the balance that is utilized for the calculation of AFUDC by the construction-related deferred taxes in order that future customers will properly receive the benefit of the time value of deferred taxes generated during the construction period.

A number of commenters responded to the Commission's request for comments on the gross-of-tax versus net-of-tax AFUDC rate methods, and substantial controversy has been engendered. The problems raised are difficult and do not lend themselves to easy, clear-cut decisions. The Commission has thus decided to sever this issue from the instant proceeding and combine any action taken on the gross-of-tax versus net-of-tax question with future revisions of the AFUDC formula.

One commenter requested that utilities be permitted the option of including accumulated deferred taxes in its capitalization at zero cost rather than using it as an offset to rate base. The **[31,559]**commenter argued that this would allow consistency with some state commission policies.

The Commission does not believe that such consistency is necessary since there are many ratemaking approaches at this Commission which differ from state ratemaking policies. Nor would inclusion of deferred taxes in the capital structure be desirable. Under the special circumstances where rate base equals total capitalization, there is no difference in the effects on revenue requirements of the two methods. However, rate base is typically less than total capitalization. Under this circumstance, the effect of including accumulated deferred taxes in the capital structure at zero cost is to set revenue requirements at a higher level than if rate base deduction were used, and thus the full benefits realized by the utility in having the use of the deferred tax funds are not passed through to its customers.

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C. *Special Rules— § 2.202(c).* The proposed § 2.202(c) set forth the "Conditions" that rate applicants must follow to conform to the proposed rule. Subparagraph (1) stated the "all or none" condition with respect to the miscellaneous timing differences. Either the rate applicant could choose to normalize all of these timing differences or it could not normalize any. Subparagraph (2) explained the ratemaking treatment to be accorded the miscellaneous timing differences that arose prior to the institution of this rulemaking. Subparagraph (3) explained the conditions applicable to future rate filings by the applicant and how an election might be changed.

In the final rule, paragraph (c) is revised and renamed "Special rules." As the final rule (in § 2.202(b)) requires tax normalization of all miscellaneous timing differences, no provision is made for electing an option or for changing that election. There are two questions that the Commission addresses in § 2.202(c) of the final rule. One question is how to treat the effects of deferred taxes when there are tax rate changes. A related question (in terms of the ratemaking solution) is how to treat timing differences that had previously been flowed through.

The tax rate change problem arises when, for example, the tax rate is cut from 48 percent to 46 percent and the amounts provided for in rates and accumulated at a 48 percent tax rate for deferred taxes is in excess of that needed to provide for future tax liabilities to be determined at the 46 percent tax rate. The question is how to return these excess deferred taxes to consumers.

Some parties to this proceeding suggest that the proper way is to require that the reversal of the tax effects of each timing difference transaction be made at the same tax rate at which it was initiated. This is one of the approaches permitted under Accounting Principles Board Opinion No. 11 or generally accepted accounting practices. The Commission believes that this is a viable approach. However, the Commission believes that other approaches could also achieve reasonable and equitable results.

The second problem addressed in this paragraph is the ratemaking treatment to be accorded the tax effects of timing difference transactions that originated prior to this final rule and had been given flow-through treatment. To the extent that certain timing difference transactions were given flow-through treatment in the past, the deferred tax reserves may be in excess of or deficient from that required to provide for the associated future tax liabilities as they arise. Several comments expressed concern that the proposed rule was unclear on the treatment to be accorded prior flow-through timing differences.

Because of the equity considerations underlying the Commission's decision to require tax normal-

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ization, the Commission finds that it is appropriate to require all companies to make some provision in their deferred taxes for the tax effects of timing difference transactions that had previously been flowed through. As long as there are any timing difference transactions for which deferred tax provisions have not been **[31,560]**made, there is some interperiod inequity in the rates to consumers. Similarly, when tax rates change and cause deferred tax reserves to become excessive or insufficient for the funding of future tax liabilities at current tax rates, there is an interperiod inequity in rates that can be lessened by some policy that would adjust the deferred tax reserves over a reasonably short period of time.

As revised, the final rule requires rate applicants to begin the process of making up deficiencies in or eliminating excesses in their deferred tax reserves so that, within a reasonable period of time to be determined on a case-by-case basis, they will be operating under a full normalization policy. The final rule in § 2.202(c)(2) requires a rate applicant to compute the income tax component in its cost of service by making provision for any excess or deficiency in its deferred tax reserves resulting both from the prior flow through treatment of timing differences and from tax rate changes.[114]

The final rule also states that this provision must be consistent with a Commission-approved ratemaking method made specifically applicable to the rate applicant. If no Commission-approved ratemaking method has been made specifically applicable to the rate applicant, the Commission requires, in § 2.202(c)(3), that the rate applicant advance some method that would accomplish the same purpose. The appropriateness of the method will be adjudicated in the next rate proceeding.

Since the appropriateness of any method to accomplish the objective of full normalization at current tax rates has not been analyzed by the Commission on a generic basis, the Commission is, at this time, requiring resolution of this problem on a case-by-case basis. As the issue is resolved in a number of cases, one or more specific methods (*e.g.*, the "South Georgia Method")[115] that would have wide applicability may be adopted.

We are reluctant to incorporate in § 2.202(c) of the rule reference to the treatment to be accorded timing difference transactions excluded from this section (by § 2.202(a)) but which were flowed through in the past since they may be considered beyond the scope of the instant rule. However, since the Commission finds tax normalization to be the proper method for handling timing differences in general, we encourage applicants to include those transactions as part of their cost of service calculations pursuant to § 2.202(c).

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(4) These findings are necessary and proper for implementing the Natural Gas Act and the Federal Power Act.

Orders

Based on the findings and the reasons set forth above, *the Commission orders that:*

(A) The refund contingencies relating to tax normalization imposed in all cases subject to the Order Establishing Interim Procedures issued June 8, 1979 under Docket Nos. R-424 and R-446 shall be removed as of the date a final rule issued in this proceeding becomes effective.

(B) The Commission further orders that Part 2 of Chapter I, Title 18, Code of Federal Regulations is amended, as set forth below, that amendment to be effective sixty days after issuance of this order.

(Federal Power Act, 16 U.S.C. 792, *et seq.;* Natural Gas Act, 15 U.S.C. 717 *et seq.;* Department of Energy Organization Act, 42 U.S.C. 1701 *et seq.;* Administrative Procedure Act, 5 U.S.C. 553 *et seq.*)

By the Commission.

Lois D. Cashell,

Acting Secretary.

Footnotes

1 The term 'Commission' refers to the Federal Power Commission (FPC) with respect to actions taken prior to October 1, 1977, and to the Federal Energy Regulatory Commission (FERC) with respect to any actions on or after that date.

2 'Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes,' Docket No. RM80-42, 45 F.R. 22053 (April 3, 1980) (hereafter cited as Notice).

3 'Order Implementing that Portion of Docket No. R-424 Relating to Interperiod Allocation of Income Taxes and Docket No. R-446, to Achieve Interperiod Allocation of Income Taxes,'

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Docket Nos. R-424 and R-446 (issued June 18, 1975).

4 Item number seven listed below was not specifically excluded in Order No. 530, but is excluded in this final rule.

5 'Order Denying application for Rehearing and Clarifying Prior Order' (issued January 19, 1976).

6 'Order Revising Prior Orders' and 'Order Denying Rehearing of Order No. 530-B' (issued July 6, 1976 and September 3, 1976).

7 *Public Systems, et al.* v. *FERC,* 606 F.2d 973 (D.C. Cir. 1979), *reh. den.* March 30, 1979.

8 Issued June 8, 1979.

9 606 F.2d at 983.

10 *Id.* at 980.

11 *Id.* at 980-981.

12 This consideration is demonstrated in the staff study attached to the Notice and in the Commission's review and evaluation of the comments contained herein. Except to the extent specifically described, the Commission adopts the staff study as part of this final rule.

13 *See* Section II-B, below, and Notice at 31, 45 F.R. at 22059.

14 606 F.2d at 981.

15 Notice at 35, 45 FR 22059.

16 Notice at Appendix C, 45 FR at 22110.

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[17] Notice at 54, 45 FR at 22063.

[18] Notice at 11-13, 45 FR at 22055

[19] *See* Section II-I, below.

[20] In addition, the study discussed the impact on rates of applying tax normalization to plant removal costs, especially with respect to nuclear generating plants and offshore pipeline facilities. The Commission believes that while these impacts are likely to be significant they are still uncertain.

[21] Notice at 36-38, 45 F.R. at 22060 (cites and footnotes omitted).

[22] Appendix A of Notice at 107-111, 45 F.R. at 22099-22103.

[23] 606 F. 2d at 981. (The court apparently equated 'tax savings' with constant or growing balances in accumulated deferred taxes.)

[24] Notice at 15-16, 41-44, 45 F.R. at 22056, 22061.

[25] Appendix A of Notice at 23-24, 47-59, 112, 45 F.R. at 22069-70, 22078-81, 22103.

[26] 606 F. 2d at 980-81.

[27] Notice at 45-48, 45 F.R. at 22062.

[28] As explained in the Notice, timing differences can arise from expense or revenue transactions that are either prepaid or deferred in rates. For discussion purposes, the differences between the two policies can be most easily understood with reference to an expense transaction that creates a tax deferral in rates.

[29] As the Commission, in the Notice, notes: '[U]nderlying the equity argument is the concept of 'used and useful' property.... If current customers are paying the expenses associated with a

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[109] Docket No. ER76-205, Opinion No. 62, issued August 22, 1979; Opinion No. 62-A, issued March 20, 1980.

[110] Reply Comments of Edison Electric Institute at 12.

[111] The revenue impacts of the life differences measured in the staff study attached to the Notice refer to the tax effects of the differences between a book life of 31 years and a tax life of 28 years (Notice at 90, 45 F.R. at 22092).

[112] The Commission disagrees with the commenter's statement that ADR benefits 'are not required to be normalized' (*Public Systems* at 24.) The Commission's position is the same as with accelerated depreciation—IRS permits the use of the faster tax write-off and shorter asset life only if normalization of the resulting tax effects is permitted by the regulatory commission. *See* Reg. § 1.167(a)-11(b)(6).

[113] In subsequent rate cases, the Commission approved the rates of utilities and pipelines, that included the normalization of timing differences associated with their use of ADR provisions for tax purposes. *See, e.g., Texas Gas Transmission* Docket No. RP74-25, Opinion Nos. 801 (May 31, 1977) and 801-A (July 29, 1977); *Transcontinental Gas Pipeline Co.,* Docket Nos. RP74-48 and RP75-3, Opinion No. 812 (July 20, 1977).

[114] One commenter was concerned that *any* previously accumulated deferred taxes could be used in this calculation. This concern is unfounded because only previously accumulated deferred taxes that would have been allocated to wholesale customers for the specific timing difference would be relevant here.

[115] *South Georgia Natural Gas Co.,* Docket No. RP77-32, order issued May 5, 1978.

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Fed. Energy Reg. Comm'n Rep. P 30340 (C.C.H.), 2015 WL 8620117

Federal Energy Regulatory Commission Reporter

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Federal Energy Regulatory Commission

Regulations Preambles

Regulations Preambles 1982 - 1985

Ruling

[¶ 30,340]
2019

¶ 30,340 ORDER DENYING REHEARING, LIFTING STAY AND CLARIFYING ORDER, ORDER NO. 144-A, FEBRUARY 22, 1982, DOCKET NOS. RM80-42, R-424, R-446, 18 CFR PARTS 2, 35, AND 154, 47 F.R. 8329, 47 F.R. 8991

Order Denying Rehearing, Lifting Stay and Clarifying Order, Order No. 144-A, February 22, 1982, Docket Nos. RM80-42, R-424, R-446, 18 CFR Parts 2, 35, and 154, 47 F.R. 8329, 47 F.R. 8991

[30,122]

[¶ 30,340]

47 F.R. 8329 (February 26, 1982); 47 F.R. 8991 (March 3, 1981).

18 CFR Parts 2, 35, and 154

[Docket Nos. RM80-42, R-424, R-446; Order No. 144-A]

Order Denying Rehearing, Lifting Stay and Clarifying Order

Issued February 22, 1982.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final rule; order on rehearing.

SUMMARY: By this order, the Commission lifts the stay imposed July 2, 1981, on its final rules requiring tax normalization and denies rehearing of those rules. The rules issued May 6, 1981 (46 FR 26613, May 14, 1981), require a public utility making a rate filing under the Federal Power Act, or an interstate pipeline making a rate filing under the Natural Gas Act, to use tax normalization for certain timing difference transactions to compute the income tax component of cost of service. The order also removes certain refund liabilities imposed during the pendency of the rulemaking and clarifies particular aspects of the final rules with respect to reductions to rate base and the recent passage of the Economic Recovery Tax Act of 1981. Finally, the order redesignates the final rules requiring tax normalization, removing them from Part 2 of the Commission's regulations and placing them in Parts 35 and 154 for public utilities and natural gas pipelines respectively.

DATE: This order, the final rules requiring tax normalizations and the removal of related refund liabilities are effective February 22, 1982.

FOR FURTHER INFORMATION CONTACT: John Conway, Deputy Assistant General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE. Room 8106, Washington, D.C. 20426, (202) 357-8033.

SUPPLEMENTARY INFORMATION:

In the matter of Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes, Docket No. RM80-42; Accounting for Premium, Discount and Expense of Issue, Gains and Losses on Refunding and Reacquisition of Long-Term Debt, and Interperiod Allocation of Income Taxes, Docket No. R-424; Amendments of the Uniform Systems of Accounts for Classes A, B and C Public Utilities and Licensees and Natural Gas Companies: Deferred Income Taxes, Docket No. R-446.

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Appendix.

On May 6, 1981, the Federal Energy Regulatory Commission (Commission)[1] issued a final order amending Part 2 of its regulations to require a public utility making a rate filing under the Federal Power Act or an interstate pipeline making a rate filing under the Natural Gas Act to use tax normalization for **[30,123]**miscellaneous timing difference transactions to compute the income tax component of its cost of service.[2] The order requires a rate applicant to use tax normalization for all timing difference transactions except those addressed in prior Commission orders. The order also codifies the existing Commission practice of adjusting rate base for accumulated deferred income taxes. In addition, the order requires a rate applicant to make provision in the income tax component of its cost of service for any excess or deficiency in the deferred tax accounts due to tax rate changes and to timing difference transactions within the scope of the rulemaking that had previously been given flow-through treatment. Finally, the order eliminates the refund contingencies in all cases subject to the interim order issued June 8, 1979, under Docket Nos. R-424 and R-446 as of the date the final rule becomes effective.

Applications for rehearing were filed by Cities Service Gas Company (Cities Service),[3] Commonwealth Edison Company (Com Ed),[4] Cities,[5] Public Systems,[6] the Public Utilities Commission of the State of California (California) and East Tennessee Group, *et al.* (East Tennessee).[7] On July 2, 1981, the Commission issued an order granting rehearing of the petition for the limited purpose of providing more time for further consideration and stayed the effective date of the order.

For the reasons set forth below, these applications for rehearing are denied. Before addressing these applications, however, the Commission believes it is important to address the effect of related provisions of the Economic Recovery Tax Act of 1981 on the final rule. This Act, which became effective after the final rule was issued in this proceeding, creates additional timing differences that fall within the scope of the rule.

I. Effect of the Economic Recovery Tax Act of 1981

On August 13, 1981, the Economic Recovery Tax Act of 1981 (ERTA) became law.[8] The Act establishes a new depreciation system, called Accelerated Cost Recovery System (ACRS), under the Internal Revenue Code (IRC).[9] Under the Act, except as provided in certain transition provisions, the utility cannot avail itself of the tax benefits under ACRS,[10] unless it normalizes method and life timing difference transactions related to property depreciated under ACRS.

ACRS completely replaces the prior system of depreciation for property placed in service after

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a single year for IRS tax return purposes; but the total available deduction over time for book and tax purposes is the same. There is only a difference in the label of the deduction (depreciation or expense) and the period that it is utilized (service life of related asset for ratemaking purposes or time of incurrence for IRS tax purposes). East Tennessee is therefore wrong in its characterization of tax normalization of base differences as imposing “phantom” taxes upon ratepayers.

A somewhat similar argument was raised by Cities Service. Cities Service believes that it was not the intention of the Commission in Order No. 144 to require tax normalization for the difference between aggregate straight-line tax depreciation and the total depreciation allowance for rate-making purposes. Cities Service believes that if such were the intention of the Commission, then this requirement is technically invalid because, according to Cities Service, it treats as an interperiod timing difference an item that is not an expense deduction for income tax purposes. The basis for its belief apparently is that the depreciation allowance for ratemaking purposes is not found as an expense deduction for income tax purposes.

Cities Service is in error. It was the intention in Order No. 144 to require the normalization of the difference between straight-line depreciation used for rate purposes (as adjusted for permanent differences such as equity AFUDC) and aggregate straight-line tax depreciation. This timing difference is clearly described in Order No. 530 and in the Notice of Proposed Rulemaking, Docket No. RM80-42, as differences between tax and book lives of property and differences that result from recognition of certain items as current expenses for tax **[30,137]**purposes and as capitalized and amortized expenses for rate purposes.

A simplified example of the nature of the various forms of timing differences related to depreciation for pre-1981 property[61] may be helpful to explain what is and what is not covered by Order No. 144, as well as to respond to Cities Service’s request for clarification. If we assume that a utility constructs an asset which will have a service life of ten years and the cost of the asset is $100 (labor and material of $90 and interest of $10), then the utility will charge to its books and recover from its ratepayers 10% of the asset cost or $10 for each of the ten years that the asset is used to provide service. Under tax normalization, this same $10 would be used as a deduction to compute the tax component of the cost of service in each year of its ten-year service life. The asset cost is deducted for tax return purposes, however, in an entirely different manner. The interest portion of the asset cost is deductible as an expense when incurred prior to the start of the service life, leaving only $90 available for tax depreciation. The guideline straight-line tax life is then determined (say 5 years—a 20% depreciation rate); then a shorter tax life permitted by the Asset Depreciation Range ADR provisions (4 years—a 25% depreciation rate which is a 20% shorter life than the guideline straight-line life) is selected. After the ADR life is selected, the ADR straight-line rate is

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Staff's Guidance on Formula Rate Updates

July 17, 2014

Disclaimer: Consistent with 18 C.F.R. § 388.104(a), this document provides informal staff guidance on preparing annual formula rate updates.

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Staff's Guidance on Formula Rate Updates

The Commission is responsible for ensuring that the rates, terms and conditions of service for wholesale sales and transmission of electric energy in interstate commerce are just, reasonable, and not unduly discriminatory or preferential. It has been the Commission's policy to permit utilities to establish rates through formulas. The Commission recognizes that the integrity and transparency of formula rates and their implementation are critically important in ensuring just and reasonable rates. Therefore, the Commission's policy is that utilities include safeguards in their transmission formula rate protocols to provide transparency in the utilities' implementation of their transmission formula rates, to ensure that the input data is the correct data and that calculations are performed consistent with the formula. Among these safeguards is a requirement for utilities to share the annual updates to their transmission rates determined pursuant to their formulas, with appropriate support, with all interested parties and to file such annual updates with the Commission on an informational basis.

In the course of reviewing transmission formula rate annual updates, Commission staff has identified certain common deficiencies that have impeded the ability to review the annual updates and verify that the resulting rates have been developed consistent with the requirements of the filed rate (i.e., the formula rate). In order to aid utilities in the development of their formula rate annual updates, Commission staff offers the following guidance for utilities in the preparation of their annual updates and annual update informational filings to avoid common deficiencies.

1. **Format**: Formula rate annual updates posted for interested parties and filed with the Commission as informational filings must include formula templates and underlying workpapers in their native format (e.g., Microsoft Excel) fully populated and with formulas intact.[1]

2. **Level of Support:** Annual updates posted for interested parties and filed with the Commission as informational filings must contain sufficient support for all inputs so that interested parties can verify that each input is consistent with the requirements of the formula.[2] Accordingly, each input that is not directly taken from a referenced line and column entry in the FERC Form No. 1 must be supported with sufficient narrative description

[1] *Midwest Indep. Transmission Sys. Operator, Inc.*, 143 FERC ¶ 61,149, at P 86 (2013).

[2] *Id.*

of the steps taken and calculations performed to derive the input. There must also be workpapers detailing the derivation of such formula input with meaningful line item descriptors, column headings, and annotation, to reconcile the formula input to FERC Form No. 1 data from which it was derived and demonstrate that the formula input was derived consistent with the requirements of the formula rate. Typical formula rate inputs not directly taken from referenced line and column entries in the FERC Form No. 1 that require such support depend on the particular formula and include, but are not limited to:

a. **Inputs that require adjustments from account balances reported in the FERC Form No. 1 consistent with Commission policies requiring that certain costs be excluded in rate determinations absent express Commission authorization, including but not limited to the following**:[3]

    i. *Unfunded Accumulated Deferred Income Tax Balances*: In its April 23, 1993 guidance,[4] the Commission clarified that the adoption of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes, for FERC accounting and reporting purposes should not affect the measurement of costs included in an entity's billing determinations. Accordingly, utilities using formula rates may need to adjust accumulated deferred income tax account balances in the FERC Form No. 1 line and column entries referenced by the formula rates to remove amounts resulting from the adoption of SFAS No. 109. Formula rate annual updates must provide sufficient support as described above for such SFAS No. 109 adjustments in order to demonstrate that the accumulated deferred income tax inputs are consistent with the requirements of the formula and the instructions in the referenced accounting guidance document.

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[3] In addition to the examples included herein, the Commission and the Chief Accountant have issued accounting guidance that restricted the inclusion of certain items from the development of rates without Commission authorization. *See, e.g.*, Commission Accounting and Reporting Guidance to Recognize the Funded Status of Defined Benefit Postretirement Plans, Docket No. AI07-1-000 (Mar. 29, 2007); Accounting and Financial Reporting for Uncertainty in Income Taxes, Docket No. AI07-2-000 (May 25, 2007).

[4] *See* Accounting for Income Taxes, Docket No. AI93-5-000 (Apr. 23, 1993).

ii. *Transaction-Related Costs*: Utilities may be subject to commitments made in FPA section 203 proceedings to exclude transaction-related costs from rates during a certain period, absent a filing under section 205 demonstrating that the transaction-related costs are exceeded by demonstrated transaction-related savings (otherwise known as a hold harmless commitment). Where the Commission has not authorized the recovery of transaction-related costs during the period associated with such a hold harmless commitment, the formula rate annual update must provide sufficient support as described above for the derivation of all inputs that require adjustment to remove amounts associated with the transaction-related costs. Where the utility has been granted specific authorization from the Commission to recover transaction-related costs through its formula rate during the period associated with such a hold harmless commitment, the formula rate annual update must identify the proceeding(s) in which the Commission authorized their recovery through rates, and provide sufficient support as described above for the derivation of all inputs included in such transaction-related costs to demonstrate that inputs have been derived consistent with such authorization.

iii. *Accounting for Asset Retirement Obligations*: In Order No. 631,[5] the Commission required public utilities to recognize asset retirement obligations for accounting purposes consistent with SFAS No. 143, Accounting for Asset Retirement Obligations. However, the Commission stated that public utilities with formula rate tariffs must not include any cost components related to asset retirement obligations in their formula rate billings without obtaining Commission approval.[6] Accordingly, where the utility has not been granted specific approval from the Commission to recover the cost of asset retirement obligations through the formula rate, the formula rate annual updates must provide sufficient support as described above for the derivation of all inputs that require adjustment to remove amounts associated with the asset retirement obligations, in order to

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[5] *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, Order No. 631, 103 FERC ¶ 61,021 (2003).

[6] *Id.* P 60.

demonstrate that the inputs are consistent with the requirements of Order No. 631. Where the utility has been granted specific approval from the Commission to recover the cost of asset retirement obligations through the formula rate, the formula rate annual update must identify the proceeding(s) in which the Commission authorized their recovery through rates, and provide sufficient support as described above for the derivation of all inputs that include such asset retirement obligations to demonstrate that inputs have been derived consistent with such authorization.

iv. *Acquisition Premiums*: Absent express Commission authorization to recover acquisition premiums, including goodwill, in rates, the Commission requires removal of the effects of acquisition premiums and goodwill from utilities' cost of service.[7] To the extent that the utility has not received Commission authorization to recover acquisition premiums in its formula rate, the annual updates must include sufficient support as described above for the derivation of all inputs that require adjustment to remove amounts associated with acquisition premiums, in order to demonstrate that the inputs are consistent with the requirements of the formula and Commission policies regarding the recovery of acquisition premiums. Where the utility has been granted specific approval from the Commission to recover acquisition premiums through the formula rate, the formula rate annual update must identify the proceeding(s) in which the Commission authorized such recovery through rates, and provide sufficient support as described above for the derivation of all inputs that include such acquisition premiums to demonstrate that the inputs have been derived consistent with such authorization.

b. Transmission incentives: Annual updates for formula rates containing inputs implementing transmission rate incentives, such as including construction work in progress in rate base, recovery of deferred costs as

[7] *See Ameren Corp.*, 140 FERC ¶ 61,034, at P 30 (2012); *ITC Holdings Corp.*, 139 FERC ¶ 61,112, at PP 47-50 (2012). *See also Arkla Energy Res. Inc.,* 61 FERC ¶ 61,004, at 61,038 (1992); *Locust Ridge Gas Company*, 29 FERC ¶ 61,052, at 61,114 (1984); *United Gas Pipe Line Co.*, 25 FPC 26, 64 (1961), *rev'd on other grounds sub nom. Willmut Gas & Oil Co. v. FPC*, 299 F.2d 111 (D.C. Cir. 1962).

regulatory assets, and recovery of the cost of abandoned plant, must indicate the portion of such formula rate inputs attributable to each project, the proceeding(s) in which the Commission granted the incentives and approved the level of deferred costs for recovery, and sufficient support as described above for the derivation of the input to demonstrate that it was derived consistent with the formula and the Commission's authorizations.

c. **Inputs that typically require adjustments from account balances reported in the FERC Form No. 1 per the requirements of the formula rates**: Such inputs include, but are not limited to: (1) administrative and general expense account balances that are often required by the formula to be adjusted for industry association membership dues, regulatory commission expenses, and advertising expenses; (2) taxes other than income taxes that are often required by the formula to be adjusted to determine those amounts that should be functionalized on the basis of labor ratios and those that should be functionalized on the basis of plant ratios; (3) accumulated deferred income tax and prepayment account balances that may, pursuant to the terms of certain formulas, require adjustments to reflect the direct assignment of amounts included in such balances, or to determine those amounts that should be functionalized on the basis of particular allocators; (4) adjustments to revenue accounts (e.g., transmission of electricity by others and rents from electric utility property) that are required by the formula rate to determine amounts appropriately credited in the annual transmission revenue requirement; (5) adjustments to load or reservation data that are required by the formula rate to determine inputs to rate divisors; and (6) adjustments to plant inputs (e.g., construction work in progress, plant-in-service, and depreciation inputs) to remove allowance for funds used during construction to prevent double recovery to the extent that construction work in progress was previously included in rate base.

Baltimore Gas and Electric Co. v. FERC
D.C. Cir. No. 18-1298

CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P. 25(d), and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have, this 11th day of June 2019, served the foregoing upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system, as indicated below:

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