ORDER ON PAPER HEARING

(Issued December 20, 2018)

1. By order issued June 21, 2018, the Commission instituted, pursuant to section 206 of the Federal Power Act (FPA), a proceeding in Docket No. EL18-158-000 to examine the methodology utilized by GridLiance West Transco LLC (GridLiance) for calculating Accumulated Deferred Income Tax (ADIT) balances in its projected test year and/or annual true-up calculations for its transmission formula rate. In this order, we direct GridLiance to submit a compliance filing revising its transmission formula rate within 30 days of the date of this order, as discussed below.

I. Background

2. Under Commission ratemaking policies, income taxes included in rates are determined based on the return on net rate base that is calculated using straight-line depreciation. However, in calculating the actual amount of income taxes due to the Internal Revenue Service (IRS), companies generally are able to take advantage of accelerated depreciation. Accelerated depreciation will usually lower income taxes payable by companies during the early years of an asset’s life followed by corresponding increases in income taxes payable during the later years of an asset’s life when the depreciation is lower. This means that a company’s income taxes owed to the IRS during a period will differ from its income tax expenses used for Commission ratemaking purposes during the same period. The difference between the income tax expense

---


3 See, e.g., Pub. Serv. Co. of Col., 155 FERC ¶ 61,028, at P 2 (2016) (PSCo); PJM Interconnection, L.L.C., 154 FERC ¶ 61,126, at P 2 (Virginia Electric), order denying reh’g, 156 FERC ¶ 61,200 (2016).
included in a company’s rate based on straight-line depreciation and the actual income taxes owed to the IRS by the company are reflected in an ADIT account. Because the resulting balance in an ADIT account effectively provides the company with cost-free capital, the Commission generally requires a company to subtract the ADIT from rate base, thereby reducing customer charges. The reduction to rate base is diminished as the ADIT reverses due to actual taxes owed to the IRS subsequently exceeding the income taxes calculated based on straight-line depreciation. This method of passing the time value of benefits from accelerated depreciation on to ratepayers throughout the asset’s life is referred to as tax normalization.

3. The depreciation normalization rules of the Internal Revenue Code and the IRS regulations (Normalization Rules) mandate the use of a very specific proration procedure in measuring the amount of future test period ADIT that can reduce rate base. Section 1.167(l)-1(h)(6)(ii) of the IRS regulations requires that, if a utility uses solely a future period (projected test year) to determine depreciation, “the amount of the reserve account for the period is the amount of the reserve at the beginning of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during such period.” The pro rata amount of any increase during the future portion of the period is determined by multiplying the increase by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.

4. In addition, under the Normalization Rules, taxpayers are required to use the same methodology to estimate or to project tax expenses, depreciation expenses, reserves for deferred taxes, and rate base, which is called the Consistency Rule. This Consistency Rule is substantially similar to the Commission’s requirement that all rate base components and expenses in rates be calculated on a synchronized basis over the same test period.

5. The IRS requires utilities to follow its regulations in order to take advantage of accelerated depreciation. Certain public utilities have requested private letter rulings (PLR) from the IRS regarding the calculation of ADIT for formula rates that include a projection of expected investments for the coming year. These formula rates also include

---


5 Id.


a true-up mechanism through which the utility calculates adjustments to its formula rate inputs, for example, for the differences between projected investments and investments that were actually incurred.

6. In the past, the Commission has approved companies’ requests to use the IRS’s proration requirement to calculate the ADIT component of rate base for formula rate projection requirements and/or formula rate true-ups. In addition, some companies have proposed to apply an averaging step in addition to the initial proration whereby a company either performs a simple average of the resulting prorated value for the year and the beginning-of-year balance or, alternatively, an average of the 13-monthly prorated balances. In past orders, the Commission has approved the use of this two-step averaging methodology given concerns raised by utilities that failure to do so would violate the IRS’s proration requirement or the Consistency Rule, and thus would prohibit companies from using accelerated depreciation for tax purposes.

**A. April 2017 PLR**

7. On April 28, 2017, the IRS released a PLR providing guidance to a public utility taxpayer on the application of the Normalization Rules to the taxpayer’s transmission formula rate. The taxpayer asked whether, given that it employs a future test period in its projected test year calculation and the proration methodology applies, the Consistency Rule does not require that any averaging convention applied to other elements of rate base (i.e., a simple average of the beginning-of-year and end-of-year balances or a 13-month average balance) also apply to the taxpayer’s prorated ADIT balance used in its projected test year calculations. The taxpayer distinguished the factual situation where the test period is part historical and part forward-looking from the factual situation where the test period is entirely forward-looking, which is used in Commission formula rates, to support its request that the IRS find that its regulations do not require the second step of the two-step averaging methodology. The IRS concurred:

---

8 The application of the IRS’s proration methodology together with the additional averaging step is referred to in this order as the two-step averaging methodology.


11 Id. at 4, 9-10.
In regard to Taxpayer’s requested ruling two, we agree with Taxpayer that averaging conventions, when applied to entirely future test periods, should presumptively be treated as having the same purpose as the Proration Requirement, thereby negating the necessity to apply both conventions serially to changes in [ADIT] balances.  

In Requested Ruling No. 2, the IRS summarized its ruling on the issue:

If Taxpayer employs a future test period in its Transmission Projected Rate . . . and the Proration Requirement applies, in computing Taxpayer’s Transmission Projected Rate . . . , the Consistency Rule does not require that any averaging convention applied to other elements of rate base also apply to Taxpayer’s prorated [ADIT] balance.

Further, in Requested Ruling No. 4 of the April 2017 PLR, the IRS clarified that the proration methodology applied by utilities to their originally projected ADIT amounts should be maintained in the annual true-up:

[I]n computing its Transmission True-Up . . . , the Proration Requirement does not apply only to the differences between Taxpayer’s originally projected changes in its [ADIT] balances and its experienced changes in those balances. The Proration Requirement continues to apply to the originally projected changes.

B. April 2018 Order

9. On April 27, 2018, the Commission issued an order rejecting a proposal by Midcontinent Independent System Operator, Inc. (MISO) and Certain MISO

12 Id. at 10.

13 Id. at 14.

14 Id.
Transmission Owners (Certain MISO TOs)\textsuperscript{15} to revise Certain MISO TOs’ transmission formula rate templates, included in Attachment O of the MISO Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff), to apply the two-step averaging methodology to their annual transmission formula rate true-up calculations.\textsuperscript{16} The Commission explained that, although it had previously permitted transmission owners to use the two-step averaging methodology to calculate ADIT balances based on the understanding that this methodology was necessary to comply with the Normalization Rules,\textsuperscript{17} its view on this matter has changed.\textsuperscript{18} The Commission found that, in light of the IRS’s guidance in the April 2017 PLR, “if the IRS’s proration methodology is applied to calculate ADIT balances in forward-looking formula rates—such as the Attachment O formula rates of Certain MISO TOs—then the additional averaging step need not also be applied in order to comply with the Consistency Rule.”\textsuperscript{19} Accordingly, the Commission concluded that, “under these circumstances, the two-step averaging methodology is not necessary to be in compliance with the Normalization Rules.”\textsuperscript{20}

10. The Commission disagreed with the argument made by Certain MISO TOs that the April 2017 PLR relaxes the Consistency Rule only for the projected test year calculation and that this relaxation cannot be extended to the annual true-up calculation, which uses a historical period. The Commission explained that, although during the annual true-up, ADIT will be composed of both the originally projected amounts (which are prorated), and the difference between the originally projected amounts and the actual

\textsuperscript{15} Certain MISO TOs included: ALLETE, Inc. for its operating division Minnesota Power (and its subsidiary Superior Water, L&P), Montana-Dakota Utilities Co., Northern Indiana Public Service Company, Otter Tail Power Company, and Southern Indiana Gas & Electric Company.


\textsuperscript{17} See PSCo, 155 FERC ¶ 61,028 at PP 33-35; Virginia Electric, 154 FERC ¶ 61,126 at PP 19-20.

\textsuperscript{18} April 2018 Order, 163 FERC ¶ 61,061 at PP 23-24 (citations omitted).

\textsuperscript{19} \textit{Id.} P 24.

\textsuperscript{20} \textit{Id.}
amounts (which is not prorated), this does not negate Requested Ruling No. 2 of the April 2017 PLR. The Commission explained that because the proration methodology is applied to the originally-projected amounts for the entire test period in the annual true-up, the Commission believed that, consistent with the IRS’s clarification in discussing Requested Ruling No. 2, it is not necessary to perform further averaging of the originally projected amounts in the true-up to satisfy the Consistency Rule.

11. After determining that the two-step averaging methodology was no longer required to comply with IRS regulations, the Commission found that the continued use of the two-step averaging methodology for calculating ADIT may result in unjust and unreasonable rates. Specifically, the Commission found that, since the first step of the two-step averaging methodology generates a prorated ADIT value for the year, reflecting a weighted average ADIT balance based on the number of days remaining in the year, taking the second step of averaging the prorated value for the year with the beginning-of-year balance produces a result that is disproportionately skewed towards the beginning-of-year balance. The Commission further found that this skew may understate the ADIT reduction to rate base, which, in turn, would lead to an overstated rate base and thus may result in unreasonably higher rates. Therefore, the Commission concluded that the use of the two-step averaging methodology had not been shown to be just and reasonable for the purpose of Commission ratemaking and thus rejected Certain MISO TOs’ request to apply this methodology to their annual transmission formula rate true-up calculation.21

12. Finally, the Commission stated that it appeared that Certain MISO TOs’ transmission formula rate templates under Attachment O of the Tariff may be unjust, unreasonable, or unduly discriminatory or preferential because their projected test year calculations use a two-step averaging methodology to determine ADIT balances. The Commission instituted a proceeding, pursuant to section 206 of the FPA, to examine the methodology utilized by Certain MISO TOs in calculating ADIT balances in their projected test year calculations for their Attachment O formula rate templates.22

II. June 2018 Order

13. In the June 2018 Order, the Commission explained that, in light of the April 2017 PLR and the April 2018 Order, the Commission undertook a review of Commission-jurisdictional transmission formula rates and identified GridLiance and other transmission owners as entities who—in addition to Certain MISO TOs—currently use the two-step averaging methodology to calculate the ADIT component of rate base in their projected test year calculations and/or annual true-up calculations for their

21 Id. PP 29-30.

22 Id. PP 31-34.
transmission formula rates. The Commission concluded that if the IRS’s proration methodology is applied to calculate ADIT balances in forward-looking formula rates, then the additional averaging step need not also be applied in order to comply with the Consistency Rule, and thus, the two-step averaging methodology is not necessary to be in compliance with the Normalization Rules. The Commission stated that it is concerned that the continued use of a two-step averaging methodology may understate ADIT balances relative to the value of other rate base items, thus increasing rate base, and may result in unreasonably higher rates. The Commission stated that, therefore, it appeared that the transmission formula rates of entities that utilize this two-step averaging methodology in their projected test year calculations and/or annual true-up calculations may be unjust, unreasonable, or unduly discriminatory or preferential. Pursuant to FPA section 206, the Commission commenced paper hearing procedures to resolve these matters.

III. Notice and Responsive Pleadings

14. Notice of the initiation of the section 206 proceeding in this docket was published in the Federal Register, 83 Fed. Reg. 30,163-164 (2018). The notice indicated that the refund effective date will be the date of publication of the notice in the Federal Register. Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, Six Cities), and Transmission Agency of Northern California filed timely motions to intervene.

15. On July 23, 2018 and August 23, 2018, respectively, GridLiance and Joint Consumer Advocates filed initial briefs in response to the June 2018 Order. On

---

23 June 2018 Order, 163 FERC ¶ 61,200 at P 13. Orders addressing the other transmission owners identified in the June 2018 Order will be issued separately.

24 Id. (citing April 2018 Order, 163 FERC ¶ 61,061 at P 24).

25 Id. P 14.

26 On July 20, 2018, the Commission extended the due date to file initial briefs to August 27, 2018, and reply briefs to September 17, 2018.

27 Joint Consumer Advocates are the Customer Utilities Rate Advocacy Division of the Arkansas Attorney General’s Office, the Iowa Office of Consumer Advocate, the Michigan Citizens Against Rate Excess, the Minnesota Attorney General, the Minnesota Department of Commerce, and the Citizens Utility Board of Wisconsin.
August 27, 2018, GridLiance filed an errata to its initial brief. On September 17, 2018, Six Cities filed a reply brief.

A. Initial Briefs

16. GridLiance states that it agrees to eliminate the two-step averaging methodology from its transmission formula rate for the purpose of calculating its ADIT balances for the projected test year and to apply only the IRS’s proration methodology, as recommended by the Commission in the June 2018 Order. \(^{28}\) Specifically, GridLiance proposes, \textit{inter alia}, to revise Attachment 6a-ADIT Projection of its transmission formula rate to remove the averaging step from the calculation of the total balance of ADIT Accounts 282, 283, and 190. \(^{29}\)

17. In addition, GridLiance proposes to revise its approach to calculating ADIT balances for its annual true-up. \(^{30}\) In place of its current approach of taking the simple average of beginning-of-year and end-of-year ADIT balances, GridLiance proposes to calculate ADIT balances for its annual true-up by using the IRS’s proration methodology. \(^{31}\) GridLiance proposes to add a new Attachment 6f-ADIT True-up Proration, which GridLiance states is a worksheet it will utilize to calculate its annual true-up of the balances for ADIT Accounts 282, 283, and 190. GridLiance also proposes to revise Attachment 6e-ADIT True-up to: (1) insert a new line 11 that will account for the prorated end-of-year balance for ADIT Account 282; (2) remove the averaging step from the calculation of the total balance of ADIT Account 282; (3) insert a new line 15 that will account for the prorated end-of-year balance for ADIT Account 283; (4) remove the averaging step from the calculation of the total balance of ADIT Account 283; (5) insert a new line 19 that will account for the prorated end-of-year balance for ADIT Account 190; and (6) remove the averaging step from the calculation of the total balance of ADIT Account 190.

\(^{28}\) GridLiance Amended Initial Brief at 5.

\(^{29}\) \textit{Id.} at 6.

\(^{30}\) \textit{Id.} at 5-6.

\(^{31}\) Under GridLiance’s proposed revised transmission formula rate, the proration of the annual true-up shall apply beginning with the annual true-up for the 2019 rate year. See proposed revision to Note A in Appendix III of GridLiance’s transmission formula rate.
18. GridLiance requests that the Commission accept the proposed revisions and additions to its transmission formula rate, direct it to file its proposed revisions as tariff records through the Commission’s eTariff platform, and to terminate this proceeding.\textsuperscript{32}

19. Joint Consumer Advocates assert that the April 2017 PLR is clear that forward-looking formula rates do not require the two-step averaging methodology for calculating ADIT balances.\textsuperscript{33} Specifically, Joint Consumer Advocates note that the April 2017 PLR states that the IRS Consistency Rule does not require that any averaging convention applied to other elements of rate base must also apply to the prorated ADIT balance. Joint Consumer Advocates argue that applying another form of averaging—i.e., a simple average of the beginning-of-year and end-of-year balances or a 13-month average—on top of proration is unjust and unreasonable because it significantly reduces the ADIT credit, which results in overstated rate base and rates.\textsuperscript{34} Therefore, Joint Consumer Advocates recommend that the Commission require the elimination of the two-step average methodology to determine ADIT balances.\textsuperscript{35}

20. Joint Consumer Advocates also propose additional alternative recommendations.\textsuperscript{36} First, Joint Consumer Advocates note that use of a historical rather than forecasted test year would eliminate the need to prorate the ADIT balance.\textsuperscript{37} Joint Consumer Advocates explain that such an approach could use estimated rather than actual data since, for the IRS, the key factor determining when ADIT proration is necessary is the date on which the rate is effective. Joint Consumer Advocates thus recommend that the Commission consider use of a historical period, consistent with the requirement established by the Minnesota Public Utilities Commission.\textsuperscript{38}

\textsuperscript{32} GridLiance Amended Initial Brief at 6.

\textsuperscript{33} Joint Consumer Advocates Initial Brief at 5.

\textsuperscript{34} Id.

\textsuperscript{35} Id. at 5-6, 8-9.

\textsuperscript{36} Id. at 6-8.

\textsuperscript{37} Id. at 7.

\textsuperscript{38} Id. at 7-8.
21. Second, Joint Consumer Advocates argue that the overall concept of proration is not appropriate. Joint Consumer Advocates explain that because the IRS changed its proration requirements despite long-standing prior interpretations, Joint Consumer Advocates filed comments on August 23, 2016 in Docket No. ER16-197-000, et al., and Docket No. ER14-1831-000, et al., that addressed their concerns with the IRS’s more recent interpretations regarding proration of ADIT balances and their recommendation not to allow any ADIT proration. In addition, Joint Consumer Advocates note that they requested that the Commission hold a technical conference.

B. Reply Brief

22. Six Cities state that they do not oppose GridLiance’s proposal to use the proration methodology to calculate ADIT. However, Six Cities state that they have identified apparent errors in the implementation of this methodology. Specifically, Six Cities note that in Attachment 6f-ADIT True-up Proration, the formulas under the column labelled “partially prorated actual balance,” do not properly perform calculations under certain scenarios. Six Cities request that the Commission conduct, or direct GridLiance to conduct, a comprehensive review of the changes reflected in GridLiance’s transmission formula to ensure that it is performing all calculations properly and, if necessary, direct GridLiance to submit a compliance filing to address any identified errors.

IV. Discussion

A. Procedural Matters

23. Pursuant to Rule 214 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2018), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

39 Id. at 8.

40 Id.

41 Six Cities Reply Brief at 2.

42 Id. at 2-3.

43 Id. at 4.
B. **Substantive Matters**

24. As an initial matter, consistent with the preliminary findings in the June 2018 Order, we find that GridLiance’s transmission formula rate is unjust and unreasonable and unduly discriminatory or preferential to the extent that it provides for the use of the two-step averaging methodology to calculate the ADIT component of rate base. As the Commission stated in the June 2018 Order, if the IRS’s proration methodology is applied to calculate ADIT balances in forward-looking formula rates, the two-step averaging methodology is not necessary to be in compliance with the Normalization Rules. Consistent with the preliminary findings in the June 2018 Order, we find the continued use of a two-step averaging methodology understates ADIT balances relative to the value of other rate base items, thus increasing rate base, and results in unreasonably higher rates.

25. We find that GridLiance’s proposal to revise its transmission formula rate to eliminate the use of the two-step averaging methodology in its projected test year calculations would adequately address these concerns. Accordingly, we direct GridLiance to submit a compliance filing revising its transmission formula rate as to its projected test year calculations within 30 days of the date of this order, with such changes to be effective June 27, 2018, the refund effective date established by the June 2018 Order.

26. However, we find that GridLiance’s proposal to revise its transmission formula rate to apply the IRS’s proration methodology to its true-up calculations—including, but not limited to, GridLiance’s proposed new Attachment 6f-ADIT True-up Proration and its proposed revisions to Attachment 6e-ADIT True-up—is beyond the scope of this proceeding. As GridLiance does not use the two-step averaging methodology in its true-up calculations, GridLiance’s proposal to prorate its annual true-up is not necessary to comply with the June 2018 Order and is thus outside the scope of this proceeding. To the extent GridLiance believes it needs to revise its true-up calculations to meet the IRS’s proration requirement, GridLiance may make a separate filing with the Commission pursuant to section 205 of the FPA to do so.

27. We find that Joint Consumer Advocates’ alternative recommendations regarding the use of a historical test year and the elimination of the use of the proration methodology are outside the scope of what the Commission required when instituting the

---

44 June 2018 Order, 163 FERC ¶ 61,200 at P 13.

45 See supra P 16.

46 If GridLiance makes such a filing, it should also address the errors in Attachment 6f-ADIT True-up Proration that Six Cities identified in their reply brief.
section 206 proceeding to remove the two-step averaging methodology, and we therefore do not consider them here.

The Commission orders:

(A) The Commission finds that GridLiance’s transmission formula rate is unjust and unreasonable and unduly discriminatory or preferential, as discussed in the body of this order.

(B) GridLiance is hereby directed to make a compliance filing within 30 days of the date of this order, as discussed in the body of this order.

By the Commission. Commissioner McIntyre is not voting on this order. Commissioner McNamee is voting present.

( SEAL )

Nathaniel J. Davis, Sr.,
Deputy Secretary.