

167 FERC ¶ 61,135
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Cheryl A. LaFleur, Richard Glick,
and Bernard L. McNamee.

Michigan Electric Transmission Company, LLC
Midcontinent Independent System Operator, Inc.

Docket Nos. EL19-16-000
ER18-2323-001

ORDER ON PAPER HEARING AND REJECTING PROPOSED TARIFF REVISIONS

(Issued May 16, 2019)

1. By order issued December 20, 2018,¹ the Commission instituted, pursuant to section 206 of the Federal Power Act (FPA),² a proceeding in Docket No. EL19-16-000 to examine the methodology utilized by Michigan Electric Transmission Company, LLC (METC) for calculating the Accumulated Deferred Income Tax (ADIT) component of rate base³ in its projected test year calculations for its transmission formula rate. On January 22, 2019, Midcontinent Independent System Operator, Inc. (MISO) and METC (collectively, the Filing Parties) filed in Docket No. ER18-2323-001 proposed revisions to the transmission formula rate templates for METC included in Attachment O of the MISO Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff) to address the Commission's concerns expressed in the December 2018 Order with respect to the calculation of ADIT balances for the projected test year calculations

(Filing).⁴ In this order, we reject the Filing and direct METC to submit a compliance filing revising its transmission formula rate within 30 days of the date of this order, as discussed below.

¹ *Int'l Transmission Co.*, 165 FERC ¶ 61,236 (2018) (December 2018 Order).

² 16 U.S.C. § 824e (2012).

³ ADIT arises from timing differences between the method of computing taxable income for reporting to the Internal Revenue Service and the method of computing income for regulatory accounting and ratemaking purposes.

⁴ The Filing Parties state that MISO submitted the Filing in its role as
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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.⁵ 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 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

administrator of the Tariff, but takes no position on the substance of the Filing, and reserves the right to comment or protest.

⁵ 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).

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.”⁶ 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.⁷

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.⁸ 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.⁹

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 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

⁶ Treas. Reg. § 1.167(l)-1(h)(6)(ii) (as amended in 1974) (Normalization Rule).

⁷ *Id.*

⁸ See 26 U.S.C. § 168(i)(9)(B) (2012) (Consistency Rule).

⁹ See, e.g., *Westar Energy, Inc.*, 122 FERC ¶ 61,268, at P 98 (2008); *Delmarva Power and Light Co.*, Opinion No. 262, 38 FERC ¶ 61,098, at 61,257 (1987).

and the beginning-of-year balance or, alternatively, an average of the 13-monthly prorated balances.¹⁰ 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.¹¹

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.¹² 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.¹³ 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:

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.¹⁴

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

¹⁰ 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 See *PSCo*, 155 FERC ¶ 61,028 at PP 33-35; *Virginia Electric*, 154 FERC ¶ 61,126 at PP 19-20.

¹² I.R.S. Priv. Ltr. Rul. 201717008 (Jan. 25, 2017) (released Apr. 28, 2017) (April 2017 PLR).

¹³ *Id.* at 4, 9-10.

¹⁴ *Id.* at 10.

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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.¹⁵

8. 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.¹⁶

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 Transmission Owners (Certain MISO TOs)¹⁷ 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

¹⁵ *Id.* at 14.

¹⁶ *Id.*

¹⁷ 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.

calculations.¹⁸ 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,¹⁹ its view on this matter has changed.²⁰ 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."²¹ Accordingly, the Commission concluded that, "under these circumstances, the two-step averaging methodology is not necessary to be in compliance with the Normalization Rules."²²

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 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.

¹⁸ *Midcontinent Indep. Sys. Operator, Inc.*, 163 FERC ¶ 61,061 (2018) (April 2018 Order). The Commission noted that Certain MISO TOs currently use the two-step averaging methodology to calculate the ADIT component of rate base for formula rate projections. *Id.* P 7 (citing *Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 61,371 (2015), *order granting clarification*, 156 FERC ¶ 61,203 (2016)).

¹⁹ *See PSCo*, 155 FERC ¶ 61,028 at PP 33-35; *Virginia Electric*, 154 FERC ¶ 61,126 at PP 19-20.

²⁰ April 2018 Order, 163 FERC ¶ 61,061 at PP 23-24 (citations omitted).

²¹ *Id.* P 24.

²² *Id.*

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.²³

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.²⁴

C. METC's Previous Filing

13. On August 27, 2018, MISO, METC and two of METC's affiliates²⁵ filed in Docket No. ER18-2323-000 proposed revisions to their transmission formula rate templates included in Attachment O of the MISO Tariff to address the Commission's concerns with respect to the calculation of ADIT balances for the projected test year calculations.

II. December 2018 Order

14. In the December 2018 Order, the Commission rejected the Tariff revisions proposed by the Filing Parties in Docket No. ER18-2323-000 to remedy the concerns the Commission expressed with respect to the use of the two-step averaging methodology,

²³ *Id.* PP 29-30.

²⁴ *Id.* PP 31-34.

²⁵ International Transmission and ITC Midwest.

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because the Filing Parties did not propose a date to make the revisions effective.²⁶ As METC had not been previously been made subject to the Commission's earlier section 206 order instituting proceedings against a number of public utilities,²⁷ in the December 2018 Order, the Commission instituted a section 206 proceeding in Docket No. EL19-6-000 to examine METC's transmission formula rate. The Commission reiterated 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.²⁸ The Commission stated that it was concerned that METC's 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 METC's transmission formula rate may be unjust, unreasonable, or unduly discriminatory or preferential because its projected test year calculations use a two-step averaging methodology to determine ADIT balances. Pursuant to FPA section 206, the Commission commenced paper hearing procedures to resolve these matters.²⁹

III. Tariff Revisions Filing

15. The Filing Parties state that, consistent with the Commission's guidance in the December 2018 Order, METC proposes to revise its company-specific ADIT work papers to eliminate the use of the two-step averaging methodology to determine ADIT balances in its projected test year calculations.³⁰ Specifically, the Filing Parties propose to revise METC's formula rates in lines 29 (Account 190), 58 (Account 282), and 87 (Account 283) to ensure that they will no longer perform the two-step averaging methodology in calculating the "Average Balance" for these accounts.³¹ The Filing Parties state that the proposed revisions modify the "Average Balance" formulas in the work papers to remove the simple averaging of prorated items and to instead use only the ending balance of prorated items. However, the Filing Parties state that, per the

²⁶ December 2018 Order, 165 FERC ¶ 61,236 at P 33.

²⁷ *Ameren Illinois Co.*, 163 FERC ¶ 61,200 (2018) (June 2018 Order).

²⁸ December 2018 Order, 165 FERC ¶ 61,236 at P 35 (citing June 2018 Order, 163 FERC ¶ 61,200 at P 13).

²⁹ *Id.* P 36.

³⁰ Filing at 5, 9.

³¹ *Id.* at 5.

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requirements of the Consistency Rule,³² the formulas will require METC to continue to perform a simple averaging of non-prorated items using beginning-of-year and end-of-year balances.³³

16. In addition, the Filing Parties state that METC proposes to modify the calculation of average ADIT balances in its annual true-up calculations so as to preserve the effect of the application of the proration methodology used in its projected test year calculations.³⁴ Specifically, METC proposes to revise Note F of its company-specific Attachment Os to make clear that it will apply the IRS's proration methodology in calculating ADIT balances for both the annual projection and annual true-up. In addition, METC proposes revisions to its company-specific ADIT work papers to preserve, in its annual true-up calculations, the effect of the application of the proration methodology that it uses in its projected test year calculations.³⁵

17. The Filing Parties request an effective date of January 1, 2019 for their proposed Tariff revisions.³⁶ They assert that this requested effective date is consistent with the Commission's findings in its December 20, 2018 order³⁷ regarding the ADIT filing of Certain MISO TOs.³⁸ The Filing Parties note that the Commission explained that, although it had established a refund effective date of May 4, 2018 in the FPA section 206 proceeding addressing the Certain MISO TOs' use of the two-step averaging methodology, an effective date of January 1, 2019 was acceptable for the Tariff revisions

³² The Filing Parties state that the IRS's Consistency Rule requires that if a taxpayer uses an average balance for one component of its rate base calculation, the taxpayer must use a comparable average balance for all other rate base items. Filing at 5-6 (citing 26 U.S.C. §§ 168(i)(9)(A)(ii), 168(i)(9)(B)(ii)).

³³ *Id.*

³⁴ *Id.* at 4, 8-9.

³⁵ *Id.* at 9.

³⁶ *Id.* at 2, 10.

³⁷ *Id.* at 11 (citing *Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,235, at P 33 n.60 (2018) (December 2018 Certain MISO TOs Order)).

³⁸ Certain MISO TOs include: 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.

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given that it was “unfeasible for [Certain MISO TOs] to change their projected test year calculations for rate year 2018.”³⁹

18. The Filing Parties contend that like the Certain MISO TOs, it is unfeasible for the METC to revise its test year projections for rate year 2018.⁴⁰ Further, the Filing Parties state that, similar to the Certain MISO TOs, METC does not utilize the two-step averaging methodology in its true-up calculations, and that any over-recoveries created by METC’s use of the two-step averaging methodology in its projected test year calculations will therefore be reversed and refunded, with interest, to customers through the true-up calculations for rate year 2018.⁴¹

19. The Filing Parties note that although METC is requesting a January 1, 2019 effective date for the proposed Tariff revisions, MISO is currently billing customers using METC’s currently-effective Tariff provisions, which utilize the two-step averaging methodology for calculating projected test year balances.⁴² The Filing Parties state that, in the event the Commission accepts the proposed Tariff revisions effective January 1, 2019, MISO will re-bill customers using the proposed Tariff revisions for this interim period of time (i.e., January 1, 2019 through and including the date upon which the Commission acts on METC’s compliance filing).⁴³

IV. Notice and Responsive Pleadings

20. On December 28, 2018, notice of the initiation of section 206 proceeding in Docket No. EL19-16-000 was published in the *Federal Register*, 83 Fed. Reg. 67,273 (2018). The notice indicated that the refund effective date will be the date of publication

³⁹ Filing at 11 (quoting December 2018 Certain MISO TOs Order, 165 FERC ¶ 61,235 at P 33 n.60).

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.* We note that the Filing Parties submitted the Filing in Docket No. ER18-2323-001 through eTariff as a compliance filing (Code 80), rather than as a new FPA section 205 filing with a 60-day notice requirement. Accordingly, the Filing does not become effective in the absence of a Commission order establishing an effective date. *See Electronic Tariff Filings*, Order No. 714, 124 FERC ¶ 61,270 (2008), *clarified*, Order No. 714-A, 147 FERC ¶ 61,115 (2014); *see also Electronic Tariff Filings; Order Establishing Procedures Relating To Tariffs Filed Electronically*, 130 FERC ¶ 61,047, at P 5 & n.5 (2010).

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of the notice in the *Federal Register*. Michigan Agency for Energy and Michigan Public Power Agency filed timely motions to intervene. Michigan Public Service Commission (Michigan Commission) filed an out-of-time motion to intervene.

21. On January 28, 2019, METC filed an initial brief in Docket No. EL19-16-000 in response to the December 2018 Order. No other briefs were filed. In its brief, METC states that the Commission should terminate the section 206 proceeding in Docket No. EL19-16-000 as moot because, consistent with the Commission's guidance in the December 2018 Order, METC has submitted a proposal to revise METC's company-specific Attachment O transmission formula rate template and ADIT work paper so as to eliminate the use of the two-step averaging methodology.⁴⁴

22. Notice of the Filing was published in the *Federal Register*, 84 Fed. Reg. 708 (2019), with interventions and protests due on or before February 12, 2019. Michigan Commission filed a notice of intervention. Michigan Agency for Energy and Michigan Public Power Agency filed timely motions to intervene.

V. 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 notice of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to the proceedings in which they were filed. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d), we grant Michigan Commission's late-filed motion to intervene in Docket No. EL19-16-000 given its interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

B. Substantive Matters

24. As an initial matter, consistent with the preliminary findings in the December 2018 Order,⁴⁵ we find that the transmission formula rate of METC 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 December 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 December 2018 Order, we find the continued use of a two-step averaging methodology understates ADIT balances relative to

⁴⁴ METC Initial Brief at 5.

⁴⁵ December 2018 Order, 165 FERC ¶ 61,236 at P 35.

the value of other rate base items, thus increasing rate base, and results in unreasonably higher rates.

25. In the Filing, METC proposes, *inter alia*, to remove the two-step averaging methodology from the calculation of ADIT balances for the projected test year. We find that these proposed revisions would address the concerns outlined by the Commission in the April 2018 Order and the December 2018 Order. However, we find that aspects of the Filing that are not part of METC's two-step averaging remedy, i.e., METC's proposed revisions to apply the IRS's proration methodology to its true-up calculations, are barred by the filed-rate doctrine and the rule against retroactive ratemaking, and therefore we reject the Filing.

26. METC proposes an effective date of January 1, 2019, for its proposed Tariff revisions, including its proposal to apply the proration methodology to its true-up calculations. Such a proposal could result in a retroactive rate increase, as it would apply to a period—the 2019 rate year—that is partly historical, given that the Filing was made on January 22, 2019, after part of 2019 had elapsed.⁴⁶ Accordingly, METC's proposal to apply the proration methodology starting with the true-up for the entire 2019 rate year is impermissible and therefore we reject the Filing. Although we are rejecting METC's Filing, we note that it may refile its proposal to apply the IRS's proration methodology to its true-up calculations, provided that its proposed revisions apply prospectively, in a separate 205 filing. The Commission will evaluate the proposal at that time.

27. As we have found that METC's use of the two-step averaging methodology in its projected test year calculations is unjust and unreasonable and unduly discriminatory or preferential, pursuant to FPA section 206, we direct METC to make a compliance filing revising METC's transmission formula rate to remove the two-step averaging methodology within 30 days of the date of this order.

The Commission orders:

(A) The Filing Parties' Filing is hereby rejected, as discussed in the body of this order.

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

(C) METC 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.

⁴⁶ See *Midcontinent Indep. Sys. Operator, Inc.*, 157 FERC ¶ 61,250 at P 27 (2016).

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.