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FERC Requires Public Utilities to Address Excess ADIT in Transmission Rates

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Van Smith and Ani Esenyan

On November 21, 2019, the Federal Energy Regulatory Commission ("FERC") issued Order No. 864, a final rule on *Public Utility Transmission Rate Changes to Address Accumulated Deferred Income Taxes.* The new rule requires public utilities with formula transmission rates to revise their formula rates to include a transparent methodology to address the impacts of the Tax Cuts and Jobs Act of 2017 (2017 Tax Act) and future tax law changes on customer rates by accounting for "excess" or "deficient" Accumulated Deferred Income Taxes (ADIT). FERC also required transmission providers with stated rates to account for the ADIT impacts of the 2017 Tax Act in their next rate case.

Background

The 2017 Tax Act reduced the corporate income tax rate from 35 percent to 21 percent. The tax rate change will result in a reduction in a public utility's future tax liabilities so that a portion of its ADIT balances (rate receipts collected in anticipation of future tax liability) will no longer be due to the IRS, and is thus considered excess ADIT. This transmission-related excess ADIT must be returned to customers through a public utility's transmission rates.

FERC issued a Notice of Proposed Rulemaking (NOPR) on ADIT issues on November 15, 2018. In the NOPR, FERC proposed to require public utilities with formula rates to adjust their formula rates to include (i) a mechanism to reflect any excess or deficient ADIT resulting from the 2017 Tax Act, or any future tax rate change, in rate base; (ii) a mechanism to adjust income tax allowance to reflect amortization of excess or deficient ADIT; and (iii) a new worksheet in its transmission formula rate to track on an annual basis information related to excess/deficient ADIT. FERC also proposed to require public utilities with stated rates to make a compliance filing to address excess ADIT resulting from the 2017 Tax Act.

Order No. 864 - Final Rule on ADIT Adjustments to Account for Tax Rate Changes

ADIT Adjustments in Formula Rates

In the final rule, FERC adopted each of its proposals to address ADIT adjustments for transmission providers with formula rates.

- Rate Base Adjustment Mechanism. FERC required public utilities with formula rates to include a mechanism by which excess ADIT is deducted from rate base, and deficient ADIT is added to rate base. This mechanism must be broad enough to cover any future tax changes that might give rise to excess/deficient ADIT. FERC did not require use of a specific mechanism, and instead will consider proposed changes on a case-by-case basis. FERC noted that, consistent with its previous accounting guidance, public utilities are required to record a regulatory asset (Account 182.3) associated with deficient ADIT or a regulatory liability (Account 254) associated with excess ADIT.

- Income Tax Allowance Adjustment Mechanism. FERC required public utilities with formula rates to incorporate a mechanism to adjust income tax allowances to reflect amortized excess or deficient ADIT. This mechanism must cover amortization of excess or deficient ADIT resulting from any future tax changes as well as the 2017 Tax Act. FERC will consider proposed changes on a case-by-case basis. FERC clarified that, consistent with guidance provided in the 2017 Tax Act, excess ADIT that is "protected" (i.e., plant-related) should be amortized no more rapidly than over the life of the underlying asset using the Average Rate Assumption Method (ARAM), or an alternative method if insufficient data is available to use ARAM. FERC will evaluate proposed amortization methods for the return of excess ADIT that is "unprotected" (i.e., not plant-related) on a case-by-case basis. FERC clarified that regardless of the effective date of tariff changes submitted by a public utility, the full amount of excess ADIT resulting from the 2017 Tax Act must be returned to its customers.

- New ADIT Worksheet. FERC required public utilities to add a new permanent worksheet that will annually track information related to excess or deficient ADIT in their formula rates. FERC required that the new ADIT worksheet address: (1) how any ADIT accounts were re-measured and the excess or deficient ADIT contained therein; (2) the accounting for any excess or deficient amounts in Accounts 182.3 (Other Regulatory Assets) and 254 (Other Regulatory Liabilities); (3) whether the excess or deficient ADIT is protected or unprotected; (4) the accounts to which the excess or deficient ADIT are amortized; and (5) the amortization period of the excess or deficient ADIT being returned or recovered through the rates. FERC expects public utilities to identify each specific source of excess/deficient ADIT, classify such excess/deficient ADIT as protected or unprotected, and list the proposed amortization period associated with each classification or source. FERC also expects public utilities to provide supporting documentation in their compliance filings to justify the proposed amortization periods. FERC did not require that use of a *pro forma* worksheet to convey such information, but did require that on compliance, public utilities populate the worksheets with excess/deficient ADIT resulting from the 2017 Tax Act to facilitate review by interested parties.

FERC clarified that given the formula rate changes required in the final rule, public utilities with formula rates would not be required to make subsequent FPA Section 205 filings to address rate impacts of excess/deficient ADIT associated with future tax rate changes. FERC also stated that a public utility may show that existing ADIT-related mechanisms meet the requirements of this final rule.

ADIT in Stated Rates

FERC declined to adopt its proposal to require public utilities with stated rates to determine excess ADIT resulting from the 2017 Tax Act and return such amounts to customers in a single-issue filing responding to the final rule. Instead, FERC stated it would maintain the status quo under its precedent, which requires public utilities with stated rates to address excess/deficient ADIT, including that caused by the 2017 Tax Act, in their next rate case. FERC clarified it will address the timing of proposed excess ADIT amortization on a case-by-case basis, and that public utilities may propose to delay such amortization until its next rate case.

Compliance Filings

FERC required that public utilities with formula rates submit a compliance filing by the later of 30 days after the effective date of the final rule (the effective date will be 60 days after publication of the rule in the Federal Register) or the public utility's next annual informational filing. FERC stated that proposed tariff changes to address the final rule's requirements should be made effective on the effective date of the final rule.

Several public utilities have already revised their formula rates to address excess ADIT resulting from the 2017 Tax Act. These filings sought to implement the requirements proposed by FERC in the NOPR. Under the final rule, these utilities will need to make a compliance filing, but can argue that the already-made changes satisfy the requirements of the final rule. These past filings may serve as helpful models for compliance filings by other utilities, but must be considered in light of the requirements of the final rule.

Public utilities with stated rates are not required to make a compliance filing; excess/deficient ADIT issues will be considered in the next rate proceeding.

FOR MORE INFORMATION

If you are interested in additional information regarding Order No. 864, or would like to discuss its implications, please contact Doug Smith, Gary Bachman, Van Smith, or any member of the firm's Electric Practice at (202) 298-1800 in Washington, D.C. or in Seattle at (206) 623-9372.

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