

145 FERC ¶ 61,045
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony Clark.

Entergy Services, Inc.

Docket No. ER07-956-004

ORDER GRANTING CLARIFICATION IN PART AND DENYING
CLARIFICATION IN PART

(Issued October 16, 2013)

1. On May 7, 2012, the Commission issued Opinion No. 505-A,¹ which, *inter alia*, clarified the manner in which accumulated deferred income taxes (ADIT)² associated with net operating losses are to be functionalized in the bandwidth calculation. Entergy Services, Inc. (Entergy),³ on behalf of five Entergy Operating Companies,⁴ requests clarification of the derivation of the Commission's ratio for net operating loss ADIT or, in the alternative, rehearing if clarification is not granted. For the reasons discussed below, Entergy's request for clarification is granted in part and denied in part.

¹ *Entergy Services, Inc.*, Opinion No. 505-A, 139 FERC ¶ 61,103 (2012).

² ADIT is an accounting device required under Generally Accepted Accounting Principles (GAAP) and the Commission's Uniform System of Accounts (USofA) that is used to reflect the tax effect of the differences in timing between when an expense is reflected as a tax deduction based on the provisions of the Internal Revenue Code and when the expense is reflected in the income statement under GAAP and the USofA.

³ Entergy is a wholly-owned subsidiary of Entergy Corporation that provides operating services to six Entergy Operating Companies.

⁴ The five Entergy Operating Companies involved in this proceeding are, at the relevant times for filing pursuant to the first bandwidth calculation: Entergy Arkansas, Inc., Entergy Gulf States, Inc., Entergy Louisiana LLC, Entergy Mississippi, Inc., and Entergy New Orleans, Inc. In 2007, Entergy Gulf States, Inc. was split into Entergy Texas, Inc. and Entergy Gulf States Louisiana, LLC, which subsequently serve load in their respective states, but that reorganization is not relevant to this proceeding, which pertains to the 2006 bandwidth payment.

I. Background

2. In Opinion No. 505,⁵ the Commission implemented for the first time the Commission's bandwidth remedy⁶ as provided for in Opinion Nos. 480 and 480-A.⁷ In that order, the Commission ruled, *inter alia*, that Entergy properly excluded from the bandwidth calculation the ADIT amounts that are not includable for cost-of-service purposes, finding that such exclusion is consistent with the bandwidth formula contained in Entergy's Service Schedule MSS-3.⁸ However, the Commission also ruled that ADIT amounts related to net operating loss carry-forwards must be included in the bandwidth calculation. The Commission ruled that the net operating loss carry-forwards are related to storm damage losses from Hurricanes Katrina and Rita, and the storm damage losses are properly accounted for in Account 182.3 and must be amortized to the appropriate functional operation and maintenance accounts as the costs are recovered in rates.

3. In Opinion No. 505-A, in response to requests for clarification from Entergy and the Louisiana Public Service Commission (Louisiana Commission), the Commission clarified that ADIT associated with the net operating loss must be functionalized in the bandwidth calculation and not directly assigned to production.⁹ The Commission also provided guidance on how the ADIT should be functionalized. The Commission

⁵ *Entergy Services, Inc.*, Opinion No. 505, 130 FERC ¶ 61,023 (2010), *order on reh'g*, Opinion No. 505-A, 139 FERC ¶ 61,103, *order on compliance*, 139 FERC ¶ 61,104 (2012).

⁶ The purpose of the bandwidth remedy is to roughly equalize production costs among the Entergy Operating Companies. The remedy provides that each calendar year the production costs of each Operating Company are calculated, with payments made by the low cost Operating Company(ies) to the high cost Operating Company(ies) such that, after reflecting the payments and receipts, no Operating Company would have production costs more than 11 percent above the Entergy System average or more than 11 percent below the Entergy System average.

⁷ *Louisiana Pub. Serv. Comm'n v. Entergy Servs., Inc.*, Opinion No. 480, 111 FERC ¶ 61,311, *order on reh'g*, Opinion No. 480-A, 113 FERC ¶ 61,282 (2005), *order on compliance*, 117 FERC ¶ 61,203 (2006), *order on reh'g and compliance*, 119 FERC ¶ 61,095 (2007), *aff'd in part and remanded in part*, *Louisiana Pub. Serv. Comm'n v. FERC*, 522 F.3d 378 (D.C. Cir. 2008), *order on remand*, 137 FERC ¶ 61,047, *order dismissing reh'g*, 137 FERC ¶ 61,048 (2011).

⁸ Opinion No. 505, 130 FERC ¶ 61,023 at P 233.

⁹ Opinion No. 505-A, 139 FERC ¶ 61,103 at P 58.

explained that the net operating loss¹⁰ carry-forwards are the result of a calculation that combines all the revenues and expenses of Entergy. The Commission further explained that the net operating loss is made up of many expenses, none of which, in isolation, can be considered the singular cause of the net operating loss. The Commission stated that, therefore, attributing ADIT related to the net operating loss to a particular expense or function in isolation is arbitrary because the net operating loss is not created by any single category of expenses.¹¹ Consequently, the Commission developed a ratio for establishing the amount of the total net operating loss ADIT that should be functionalized in the bandwidth calculation:

Accordingly, to properly include [net operating loss] ADIT amounts in bandwidth calculations, Entergy must multiply its [net operating loss] carry-forward balance by the ratio of incurred expenses includable for Commission cost-of-service purposes to total expenses incurred during the period the [net operating loss] was recognized.¹²

4. The Commission concluded that ADIT related to the calculated net operating loss carry-forward balance to be included in the bandwidth calculations must then be allocated to the production function in the bandwidth formula using the plant ratios as prescribed by Service Schedule MSS-3.¹³

5. Entergy filed a request for clarification and/or rehearing of Opinion No. 505-A with regard to net operating loss ADIT. The Louisiana Commission filed an answer.

II. Request for Clarification and Rehearing

6. Entergy argues that the Commission should clarify the derivation of its ratio for net operating loss ADIT. It notes that in Opinion No. 505-A, the Commission eschewed a “but for” analysis of what caused a particular net operating loss. Entergy explains that instead, the Commission determined that all revenues and all expenses in combination produced the net operating loss and therefore it is not reasonable to conclude that but for

¹⁰ A net operating loss is an income tax benefit that may be carried forward to future years and treated as an offset to future years’ taxable income. For Commission accounting purposes, the tax effect of this income tax benefit is recorded as a deferred tax asset in Account 190, Accumulated Deferred Income Taxes.

¹¹ Opinion No. 505-A, 139 FERC ¶ 61,103 at P 59.

¹² *Id.* P 60.

¹³ *Id.*

a particular event there would have been no net operating loss. Entergy states that while it agrees that it is difficult to assign net operating loss to any specific expense, it requests clarification as to how to calculate the ratio of “incurred expenses includable for Commission cost-of-service purposes to total expenses incurred during the period the net operating loss was recognized.”¹⁴ Entergy contends further detail is required in order for Entergy to ensure that it calculates the ratio correctly as the Commission intended.

7. Entergy states that it initially interpreted Opinion No. 505-A as requiring the ratio to be calculated where the numerator is “above the line expenses” and the denominator is the sum of “above the line expenses plus below the line expenses.”¹⁵ Entergy notes that, consequently, the 2012 bandwidth filing was calculated in this fashion. Entergy explains that it has since realized, however, that such a ratio will always be near 100 percent because the below-the-line expenses are and historically have been *de minimis* when compared to above-the-line expenses. Entergy contends that this would not be an issue if it were the case that net operating losses were created solely due to below-the-line expenses not recoverable in rates.¹⁶ Entergy explains, however, that what gives rise to a net operating loss is a function of taxable revenues and tax deductible expenses, which can be significantly different from the above-the-line and below-the-line expenses, and which may not reflect the true cause of net operating loss ADIT. Entergy argues that the use of an “above the line/below the line costs” approach will result in an arbitrary and irrational ratio that does not reflect how the net operating Loss carry-forwards are incurred.

8. Entergy argues that the ratio should be calculated using the operating expenses for Commission cost-of-service purposes per the financial books for a year as the numerator – defined as the Total Utility Operating Expenses as shown on the FERC Form No. 1, Annual Report, at page 115 (excluding income taxes), which represents the operating expenses that were properly includable in rates in that year. Entergy explains that the denominator then would be calculated as the total expenses deducted on the tax return in the same tax year. It contends that the simplest way to determine this amount is to define

¹⁴ Entergy Request for Clarification at 7 (quoting Opinion No. 505-A, 139 FERC ¶ 61,103 at P 60).

¹⁵ Above-the-line expenses are operating expenses that are related to a utility’s operations and direct costs. Below-the-line expenses are those expenses not related to a utility’s operating activities.

¹⁶ Entergy Request for Clarification at 7.

it as the sum of the numerator and the amount shown in the FERC Form No. 1, page 261, on the line entitled “Deductions on Return Not Charged Against Book Income.”¹⁷

9. Entergy states that it recognizes that the Commission may view its pleading as a request for rehearing rather than a request for clarification. Entergy states that in such event, it requests rehearing of Opinion No. 505-A to provide for the suggested modifications described above. It contends that an above-the-line/below-the-line approach would result in an arbitrary and irrational ratio that does not reflect how the net operating loss carry-forwards are incurred.¹⁸

III. Discussion

A. Procedural Matters

10. Rule 713(d)(1) of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.713(d)(1) (2012), prohibits answers to a request for rehearing. Therefore, we reject the Louisiana Commission’s answer.

B. Commission Determination

11. We agree with Entergy that further clarification of the derivation of the ratio for net operating loss ADIT is needed, but reject Entergy’s specific proposal. In Opinion No. 505-A, the Commission broadly stated that the net operating loss carry-forward is the result of a calculation that combines all the revenues and expenses of Entergy, and that attributing ADIT related to the net operating loss to a particular expense or function would be arbitrary because the net operating loss is not created by any single category of expenses.¹⁹ In light of the inability to attribute the cause of the net operating loss to any particular expense, the Commission developed a ratio for net operating loss ADIT. The ratio provides for the determination of the proportional amount of net operating loss ADIT that is associated with expenses incurred during the period the net operating loss was recognized that can be reasonably attributed to utility operations and are generally and properly includable in Commission cost-of-service rates.

12. Entergy disputes the Commission’s ruling, arguing that it is not all revenues and expenses that give rise to a net operating loss; Entergy contends that it is instead all *taxable* revenues and *tax deductible* expenses.²⁰ Entergy contends that a significantly

¹⁷ *Id.* at 9.

¹⁸ *Id.* at 10.

¹⁹ Opinion No. 505-A, 139 FERC ¶ 61,103 at P 59.

²⁰ Entergy Request for Clarification at 7 and 8.

different net operating loss can result from using all revenues and expenses incurred during a period in the calculation of a net operating loss. Entergy seeks clarification that the Commission intended for the ratio to include expenses that reflect the “true cause” of the amount of the net operating loss ADIT.²¹ To this end, Entergy proposes that the ratio be comprised of total utility operating expenses reported in the FERC Form No. 1 as the numerator, and the sum of amounts in the numerator and expenses deducted in the determination of taxable income in the tax return that were not included in the determination of book income in the FERC Form No. 1 as the denominator amount.

13. We agree with Entergy that the ratio should include expenses that reflect the true cause of the amount of the net operating loss ADIT. Under the Internal Revenue Code, a net operating loss occurs when certain tax deductible expenses exceed taxable revenues for a taxable year.²² Thus, we also agree with Entergy that its net operating loss resulted from a calculation that combined its taxable revenue and tax deductible expenses during the period that the net operating loss was recognized.

14. A net operating loss recognized in a particular year may be used to offset the profits of other years. In accordance with the Commission’s accounting regulations, the tax effect of net operating losses that will be carried forward to offset profits of future years must be accounted for as an ADIT asset and recorded in Account 190.²³ Because net operating losses are established based on tax deductible expenses rather than all expenses, we agree that the ratio used to determine a just and reasonable allocation of ADIT amounts to include in the bandwidth calculations should also be based on tax deductible expenses. Accordingly, we clarify that to properly include net operating loss ADIT amounts in bandwidth calculations, Entergy must multiply its net operating loss carry-forward balance by the ratio of incurred *tax deductible* utility expenses includable for Commission cost-of-service purposes to total *tax deductible* expenses incurred during the period the net operating loss was recognized. This net operating loss ADIT ratio results in a pro rata allocation of net operating loss ADIT amounts to the bandwidth formula. In accordance with the provisions of the bandwidth formula,²⁴ Entergy must

²¹ *Id.* at 8.

²² I.R.C. § 172 (2006).

²³ Entergy recorded ADIT associated with net operating losses in Account 190 and reported the amounts in its 2006 FERC Form No. 1, Annual Report. *See* Entergy Operating Companies’ respective 2006 FERC Form No. 1 Pages 234 – 234b, Accumulated Deferred Income Taxes (Account 190).

²⁴ *See* Service Schedule MSS-3, § 30.12.

apply the resulting ADIT amounts to plant ratios to determine the amount of the ADIT to include in bandwidth calculations.

15. However, in regards to Entergy's proposal for derivation of the inputs to the numerator and denominator of the ratio, Entergy's proposed inputs do not result in the appropriate amount of net operating loss ADIT being included in the bandwidth calculation, nor do the inputs reflect the true cause of the amount of the net operating loss. Consequently, we deny Entergy's request for rehearing.

16. Entergy's proposed ratio excludes certain expenses deducted for tax purposes that should be included in the numerator of the ratio, and thus inappropriately reduces the amount of net operating loss ADIT that should be included in bandwidth calculations. Entergy's proposal is based on a mistaken assumption that the ratio does not factor the differences between the timing of when expenses are included in income tax and rate determinations.²⁵ Pursuant to this assumption, Entergy reasons that the numerator should include utility operating expenses reported in the FERC Form No. 1, which are incurred expenses included in taxable income determinations that were includable in rates in the year the net operating loss was created, and should exclude other incurred utility operating expenses included in taxable income determinations that will be includable in future rates. However, contrary to Entergy's assumption, the difference between the timing of when expenses are included in income tax and rate determinations is factored into the results of using the ratio in the bandwidth calculation.

17. In accordance with the Commission's accounting regulations, the effect of the difference between the timing of when an expense is included in the determination of taxable income and book income must be accounted for as a deferred tax asset or liability.²⁶ Further, the Commission's tax normalization rule requires that deferred tax assets and liabilities be included in cost-based rate determinations.²⁷ Entergy recognized deferred tax liabilities associated with incurred utility operating expenses that were included in taxable income determinations and excluded from book income and ratemaking determinations during the period the net operating loss was recognized. These deferred tax liabilities are included in the bandwidth calculation. Pursuant to the

²⁵ Entergy Request for Clarification at 9.

²⁶ See General Instruction No. 18, Comprehensive Interperiod Income Tax Allocation, 18 C.F.R. Part 101 (2012); see also, the text of Accounts 190, Accumulated Deferred Income Taxes, 281, Accumulated Deferred Income Taxes – Accelerated Amortization Property, 282, Accumulated Deferred Income Taxes – Other Property, and 283, Accumulated Deferred Income Taxes – Other, 18 C.F.R. pt. 101 (2012).

²⁷ 18 C.F.R. § 35.24, Tax Normalization for Public Utilities.

provisions of the bandwidth formula, and consistent with the Commission's tax normalization rule, these deferred tax liabilities reduce the total amount of ADIT included in the bandwidth calculation when netted with the net operating loss ADIT.²⁸ Thus, the difference between the timing of when expenses are included in income tax and rate determinations is an inherent factor in the ratio that is effectuated through operation of the bandwidth formula.

18. Entergy has not justified its proposal to exclude from the numerator of the ratio certain incurred tax deductible utility operating expenses that are generally and properly includable in future rates. Moreover, Entergy has not justified the exclusion from the bandwidth calculation of ADIT associated with those expenses. Service Schedule MSS-3 indicates that deferred taxes should be included in bandwidth calculations if properly included for FERC cost-of-service purposes. The deferred taxes at issue here meet this standard, and thus are includable in the bandwidth calculation. Consequently, Entergy must include in the numerator of the ratio the sum of total utility operating expenses as shown on the FERC Form No. 1 at page 115 (excluding income taxes) and incurred utility operating expenses includable in future rates that were deductions on the tax return not charged against book income during the period the net operating loss was recognized.²⁹ In other words, the numerator should include all utility operating expenses incurred and included in taxable income determinations during the period the net operating loss was recognized.

19. Furthermore, Entergy's proposal for the derivation of amounts to include in the denominator of the ratio is also incorrect as it excludes certain expenses that should be included. Entergy proposed to include the sum of total utility operating expenses reported in the FERC Form No. 1 and expenses included in income tax determinations that were not reported in the FERC Form No. 1 in the denominator of the ratio. However, Entergy failed to include below-the-line expenses reported in the FERC Form No. 1 that were included in taxable income determinations. Accordingly, Entergy must include in the denominator of the ratio the sum of utility operating expenses and below-the-line expenses (excluding income taxes) charged against book income as reported in

²⁸ Net ADIT included in the bandwidth calculation is comprised of the sum of deferred tax assets recorded in Account 190 and deferred tax liabilities recorded in Accounts 281 and 282, as reduced by deferred tax assets and liabilities not generally and properly includable for FERC cost-of-service purposes plus 3 percent of investment tax credits recorded in Account 255, Accumulated Deferred Investment Tax Credits. *See* Service Schedule MSS-3, § 30.12.

²⁹ The latter expenses are included in the total expenses reported in the FERC Form No. 1 at page 261 for items under "Deduction on Return Not Charged Against Book Income."

the FERC Form No. 1 at pages 115 and 117, respectively, that were included in taxable income determinations during the period the net operating loss was recognized, and deductions on the tax return not charged against book income as reported in the FERC Form No. 1 at page 261.

The Commission orders:

Clarification is granted in part and denied in part as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.