154 FERC ¶ 61,126
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, Tony Clark,
and Colette D. Honorable.

PJM Interconnection, L.L.C.
Virginia Electric and Power Company

Docket No. ER14-1831-001

ORDER ON REVISED ADIT TREATMENT

(Issued February 23, 2016)

1. On October 30, 2015, Virginia Electric and Power Company, doing business as Dominion Virginia Power (Dominion), submitted a compliance filing in the above referenced proceeding, following its receipt of an Internal Revenue Service (IRS) Private Letter Ruling (PLR).[1] As discussed below, we accept these company-specific revisions to Attachment H-16 of PJM Interconnection, L.L.C.'s (PJM) Open Access Transmission Tariff (Tariff), with an effective date of May 1, 2014, as requested.[2]

I. Background

2. Under Commission ratemaking policies, income taxes included in rates are determined based on the return on net rate base calculated using straight-line depreciation. However, in calculating the actual amount of taxes due to the IRS, companies generally are able to take advantage of accelerated depreciation. Accelerated depreciation will generally lower taxes payable during the early years of an asset's life followed by corresponding increases in taxes payable during the later years of an asset's life. This means that a company's income taxes payable in a period will differ from its income tax expense in the same period for ratemaking purposes. The difference between the income taxes based on straight-line-depreciation and the actual taxes paid by the company are reflected in an account called Accumulated Deferred Income Taxes (ADIT)

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[1] I.R.S. Priv. Ltr. Rul. 143241-14 (July 6, 2015) (PLR).

[2] PJM Interconnection, L.L.C., Intra-PJM Tariffs, OATT ATT H-16A, OATT Attachment H-16A - Virginia Electric, 6.0.0.

or Accumulated Deferred Federal Income Taxes (ADFIT). Because the customers are, in effect, pre-paying taxes and providing the company with cost-free capital, the Commission subtracts the ADFIT from the company's rate base thereby reducing customer charges. This method of passing the 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 (Normalization Rules) mandate the use of a very specific proration procedure in measuring the amount of future test period ADFIT that can reduce rate base. The IRS requires, for a utility that solely utilizes a future period (projected test year) to determine depreciation, that "the amount of the reserve [for deferred taxes] 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."[3] The pro rata amount of any increase or decrease during the future portion of the period is determined by multiplying the increase or decrease 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] The purpose of the Proration Requirement is to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers, allowing funds provided by accelerated depreciation to be used for investments.

4. The IRS requires utilities to follow its regulations in order to take advantage of accelerated depreciation. Dominion and other electric utilities have requested revenue rulings from the IRS regarding the calculation of ADFIT for formula rates which 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, for example, for the differences from investments that did not occur when projected.

5. On April 30, 2014, Dominion filed in Docket No. ER14-1831-000, pursuant to section 205 of the Federal Power Act,[5] to change the methodology it uses to calculate the ADFIT component of its rate base to bring it into compliance with the Normalization Rules and thereby continue the availability of accelerated tax depreciation to the benefit of its customers. Specifically, Dominion stated that the IRS's proration formula must be applied to its ADFIT balance (Proration Requirement). Additionally, Dominion asserted that once the proration formula is applied, the ADFIT balance used to reduce rate base

[3] Treas. Reg. § 1.167(1)-1(h)(6)(ii).

[4] *Id.*

[5] 16 U.S.C. § 824d (2012).

must be calculated using the same 13-month average that is used in calculating the net plant component of rate base (Consistency Requirement). In a June 2014 Order,[6] the Commission ruled that Dominion's particular tax question was "a case of first impression before this Commission … on the specific matters of tax law raised," and ruled "that it is necessary to obtain the IRS's interpretation of how its Normalization Rules apply in the context of Dominion's Formula Rates."[7] Accordingly, the June 2014 Order formally established a hearing, but held all proceedings at the Commission in abeyance until Dominion received guidance directly from the IRS. On July 6, 2015, the IRS released that guidance in the form of a PLR, which is its primary mode of ruling on fact-specific questions of interpreting the tax code.

6. On August 14, 2015, Dominion filed the PLR in this docket and announced that it had taken effect under IRS rules of procedure. Dominion had asked the IRS:

> to determine whether the Proration and Consistency Requirements of the Normalization Rules are required in the case of a rate recovery mechanism, whereby: (1) the cost of service test period includes projected periods, i.e., periods subsequent to the effective date of the rates, and (2) the differences between such projected costs and the utility's actual incurred costs are included as an adjustment to cost-of-service in the next resetting of the rates for the recovery mechanism.[8]

According to Dominion, the PLR announced seven conclusions, five of which conformed with Dominion's expectations as reflected in its original filing, and two of which differed from Dominion's expectations.[9] In particular, Dominion characterizes the IRS as ruling:

> while the Proration Requirement applies to all future test periods and the estimated projection components of the Formula Rate, the Proration Requirement is not applicable to the increase of actual ADIT activity above the original projections when computing the true-up portion of the Formula Rate. It also ruled that the Consistency Requirement

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[6] *PJM Interconnection, L.L.C.*, 147 FERC ¶ 61,254 (2014) (June 2014 Order).

[7] *Id.* P 18.

[8] Dominion August 14, 2015 Supplemental Filing at 2.

[9] *Id.* at 2.

> was not violated by using the two different averaging methodologies for plant components of rate base and related ADIT that has been historically used in Dominion's Formula Rate.

Dominion sought, and was granted, additional time to revise its tariff proposal to be in line with the IRS's determinations.

7. On October 30, 2015, Dominion submitted the instant compliance filing. Dominion addressed the calculation of ADFIT for use in both the projected test period and the true-up adjustment. Regarding the projected test period, Dominion states that its proposal on April 30, 2014, in which Dominion proposed to use proration in calculating ADFIT, is generally consistent with the PLR. However, Dominion asserts that it is unnecessary to use the same 13-month average that it uses to calculate net plant for ADFIT, and Dominion instead proposes to use an average based on the beginning-of-year and end-of -year prorated values. Dominion cites the PLR's finding that "[w]hile there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and ADFIT on the other… it is sufficient that both are determined by averaging and both are determined over the same period of time."[10]

8. Regarding the true-up adjustment, Dominion proposes to retain the IRS's proration methodology for the originally projected ADFIT amount, but not to apply proration to any actual ADFIT activity in excess of that amount. In support of its proposed changes to the true-up calculation, Dominion refers to the PLR's finding that "In calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[11] Dominion contends that although this ruling "might at first appear counterintuitive, it preserves both the economic effect of the IRC-required proration and the definitions of 'future' and 'historical' test periods provided in the PLR."[12] Dominion advises that it has confirmed with the IRS that this was the intent of the PLR.[13]

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[10] PLR at 10, *cited in* Dominion October 30, 2015 filing at 6.

[11] PLR at 7, *cited in* Dominion October 30, 2015 filing at 7.

[12] Dominion October 30, 2015 filing at 7.

[13] *Id.*

II. Notice and Responsive Pleadings

9. Notice of Dominion's filing was published in the Federal Register, 80 Fed. Reg. 68,528 (2015), with interventions and protests due on or before November 20, 2015. Virginia Municipal Electric Association No. 1, Old Dominion Electric Cooperative, and the North Carolina Electric Membership Corporation intervened and jointly (collectively, Indicated Customers) filed a timely protest. On December 8, 2015, Dominion filed a motion for leave to answer and answer to the protest of Indicated Customers. On December 22, 2015, Indicated Customers filed an answer to Dominion's answer.

10. Indicated Customers allege that Dominion misinterprets certain aspects of the IRS's regulations and the PLR's guidance. First, Indicated Customers complain that after Dominion performs its proration calculation, it takes the extra step of averaging the beginning and ending balance.[14] Indicated Customers contend that this extra step is duplicative, because the proration process itself has the effect of averaging ADFIT balance over the December-to-December period. Second, Protestors contend that Dominion has incorrectly interpreted the IRS's response in the PLR to mean that only the difference between the forecast of the ADFIT during the year and the amount of ADFIT that was actually booked is exempt from the proration requirement.[15] Indicated Customers contend that it is "the actual amount added to the ADFIT over the test year" – that is, all of the ADFIT accrued during the test year – that is exempt from proration, not merely the difference between the projection and the actual amount.[16] Finally, Indicated Customers object to Dominion's proposed effective date. Indicated Customers assert that there is no need to restate the 2014 and 2015 projected amounts for ADFIT to reflect proration, since the projected rates have already been paid by transmission customers.

11. In answering the Indicated Customers' Protest, Dominion argues that the IRS's regulations require proration of the test period data and averaging of the prorated data over that period.[17] According to Dominion, under the Consistency Requirement, it must apply the same convention (e.g., an averaging convention) to the prorated ADFIT amounts that it applies to the other elements of rate base. However, Dominion notes that the Consistency Requirement accommodates the use of variations in averaging conventions. In other words, the averaging methodology used for ADIT and other components of rate base can be based upon different conventions provided all related

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[14] Indicated Customers Protest at 4.

[15] *Id.* at 5.

[16] *Id*.

[17] Dominion Answer at 5-7.

components (plant, accumulated depreciation, ADIT) are averaged.[18] Thus, Dominion explains that, since it averages balances in calculating other elements of its rate base, it must apply an averaging convention to the prorated ADFIT balances as well.[19]

12. With respect to the true-up, Dominion argues that the PLR requires it to preserve the proration of the ADFIT that was used for projected rates. Dominion explains that the PLR describes the true-up component as a reconciliation mechanism wherein actual amounts that are in excess of projections are collected from customers in a subsequent rate year.[20] Dominion quotes the PLR as stating, "the true up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations."[21] Dominion suggests that, under IRS regulations, a true-up is not the same as a historical test period. Dominion further notes that the PLR holds, "[i]n calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[22] Dominion explains that the true-up amount to be billed to customers represents only the difference between a revenue requirement determined in that recalculation and the revenue requirement determined in the original projected component of the formula rate. Dominion advises that recognition of this distinction is critical to understanding the PLR guidance provided by the IRS.

13. According to Dominion, the true-up adjustment included within the Annual Transmission Revenue Requirement (ATRR), as reflected in Dominion's formula rate templates, is limited to the ADFIT included in the projected component of the formula rate but not to the incremental changes in ADFIT (the "actual amount added") attributable to the differences between the projected amounts already included in the rate period and the total actual ADFIT balances. Dominion explains that it is only such differences in ADFIT activity, rather than the entirety of the ADFIT activity reflected in the recalculation, that would occur before the effective date of attendant rates or be considered *historical* as that term is used by the IRS in its interpretation of the proration

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[18] *Id.*

[19] Dominion Answer at 7 (citing I.R.S. Priv. Ltr. Rul. 9202029 (October 15, 1991); I.R.S. Priv. Ltr. Rul. 9313008 (December 17, 1992); I.R.S. Priv. Ltr. Rul. 9224040 (March 16, 1992)).

[20] Dominion Answer at 9.

[21] PLR at 8, *cited in* Dominion Answer at 12.

[22] PLR at 8, *cited in* Dominion Answer at 8.

formula provisions of its regulations. On the other hand, projected ADFIT activity, to the extent realized, has already impacted the revenue requirement underlying customer rates that became effective prior to the projected periods. Accordingly, only the differences are not subject to the proration requirements, Dominion argues.

14. Regarding its requested effective date, Dominion states that its goal is to limit the period of non-compliance with the Normalization Rules. Dominion states that its proposal would apply the PLR-compliant true-up computation beginning with the May 1, 2014 effective date established by the Commission (subject to refund) in this proceeding. Dominion states that this does not involve applying the Normalization Rules to the projections for 2014 through 2016.

15. Dominion states that if the Commission's decision in this proceeding varies from Dominion's understanding of the PLR, Dominion may determine that a subsequent PLR request is required to provide confirmation that the resulting tariff conforms to the IRS's requirements.

16. In their December 22, 2015 answer, Indicated Customers reiterate the objections summarized above. Indicated Customers assert that Dominion's proposal will needlessly increase rates for customers.

III. Discussion

17. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[23] the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure prohibits an answer to a protest unless otherwise ordered by the decisional authority.[24] We will accept Dominion's December 8, 2015 answer and Indicated Customers' December 22, 2015 answer.

18. In this filing, Dominion seeks to have the Commission accept revisions to its formula rate to reflect the IRS's regulations for calculating deferred income taxes for purposes of determining Dominions Transmission Formula Rate. Dominion asserts that these revisions are necessary in order to preserve Dominion's ability to use accelerated depreciation for federal income tax purposes. We agree with Dominion that its proposal is a reasonable interpretation of the PLR.

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[23] 18 C.F.R. § 385.214 (2015).

[24] 18 C.F.R. § 385.213(a)(2) (2015).

19. In recent orders, the Commission has clarified that, when a section 205 filing is strictly limited to tax matters, the Commission will base its evaluation on whether "the proposed revisions are reasonable to comply with IRS regulations,"[25] and expressly rejected the "objection that Private Letter Rulings issued by the IRS cannot be a basis for [] proposed rate revisions."[26] The Indicated Customers, following this guidance, have limited its protest to arguing "that Dominion has misinterpreted certain aspects of the IRS's guidance."[27] Accordingly, Indicated Customers argue that, "Dominion has improperly calculated the net prorated amount for use in the projected formula rates,"[28] and "also misunderstood the guidance provided by the PLR regarding the true-up component of the formula rate;"[29] the Indicated Customers' requested revisions to Dominion's rates all flow from this argument.

20. Indicated Customers maintain that Dominion has added an unrequired separate step of averaging the beginning and ending ADFIT balances not required by the PLR. They maintain that prorationing is an average and that Dominion therefore should use the end of year pro rated ADFIT balance, as opposed to the simple average. We find, however, that Dominion's methodology is reasonable. Dominion's proposal determines the average rate base by taking the average net plant and subtracting an average of ADFIT values.[30] As the PLR states: "[w]hile there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and ADFIT on the other… it is sufficient that both are determined by averaging and both are determined over the same period of time."[31] This interpretation

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[25] *Midcontinent Independent System Operator, Inc.*, 153 FERC ¶ 61,371, at P 36 (2015).

[26] *Id.* P 40.

[27] Indicated Customers' Protest at 3.

[28] *Id.* at 4.

[29] *Id*.

[30] Prorating an investment over time is not the equivalent of an average. Prorating weights the ADFIT from projected investments by the month in which they are incurred; an average uses the prorated monthly ADFIT values and determines the central or typical value from those data.

[31] PLR at 10, *cited in* Dominion October 30, 2015 filing at 6.

also is consistent with the interpretation of other utilities applying the IRS regulations regarding proration.[32]

21. Indicated Customers also object to Dominion's proposal to retain the IRS's proration methodology for the originally projected ADFIT amount. This treatment is consistent with the PLR, which states "in calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[33] Indicated Customers' contention that unweighted values should be used for the true-up would effectively undo the proration calculation of rates required by the IRS.

22. Finally, Indicated Customers object to Dominion's proposed May 1, 2014 effective date. However, the PLR states that "[a]ny rates that have been calculated using procedures inconsistent with this ruling ('nonconforming rates') which are or which have been in effect and which, under the applicable state or federal regulatory law, can be adjusted or corrected to conform to the requirements of this ruling, must be so adjusted or corrected."[34] Dominion's filing is consistent with the PLR.

The Commission orders:

Dominion's filing is accepted, effective May 1, 2014, as requested.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[32] *See, e.g.*, *Midcontinent Independent Transmission Operator, Inc.*, 153 FERC ¶ 61,374 (2015).

[33] PLR at 7, *cited in* Dominion October 30, 2015 filing at 7.

[34] PLR at 10, *cited in* Dominion December 8, 2015 Answer at 15.