

154 FERC ¶ 61,187
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midcontinent Independent System Operator, Inc.
and ITC Midwest LLC

Docket Nos. ER16-206-000
ER16-206-001
ER16-206-002

ORDER ACCEPTING AGREEMENT SUBJECT TO CONDITION

(Issued March 11, 2016)

1. On October 30, 2015, as amended on November 3, 2015 and January 12, 2016, Midcontinent Independent System Operator, Inc. (MISO),¹ on behalf of ITC Midwest LLC (ITC Midwest), filed, pursuant to section 205 of the Federal Power Act (FPA)² and Part 35 of the Commission's regulations,³ an unexecuted Facilities Services Agreement (FSA) between ITC Midwest and Wisconsin Power and Light Company (Wisconsin Power). As discussed below, we accept the FSA, subject to condition, effective November 1, 2015, as requested.

I. Background

2. ITC Midwest states that it is an independent transmission company operating primarily in Iowa, with smaller portions of its system in Minnesota, Illinois, and

¹ MISO states that it joins in the filing as the Administrator of the MISO Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff), but takes no position on the substance of the filing. MISO/ITC Midwest October 30, 2015 Filing (Filing) at 1 n.3.

² 16 U.S.C. § 824d (2012).

³ 18 C.F.R. pt. 35 (2015).

Missouri.⁴ ITC Midwest states that it is a transmission-owning member of MISO and a wholly-owned subsidiary of ITC Holdings Corp. (ITC Holdings).⁵

3. ITC Midwest states that Wisconsin Power is the developer of a 201 MW windfarm in Freeborn County, Minnesota (Bent Tree Wind Farm), which is interconnected with ITC Midwest's transmission system.⁶ ITC Midwest states that pursuant to an Amended and Restated Generator Interconnection Agreement (GIA) among ITC Midwest, Wisconsin Power, and MISO, ITC Midwest installed certain network upgrades on the ITC Midwest transmission system consisting of the Freeborn to Winnebago 161 kV Rebuild to remove a constraint caused by Wisconsin Power's Bent Tree Wind Farm.⁷

4. ITC Midwest explains that under Article 11.3 of the GIA, instead of constructing network upgrades using the Interconnection Customer's up-front capital, as provided in Attachment FF of the MISO Tariff, a Transmission Owner may elect to "self-fund" the required network upgrades and then establish a facilities charge to recover the costs from the Interconnection Customer over the term of the FSA.⁸ ITC Midwest explains that the FSA implements the Article 11.3 self-funding option and establishes a charge to recover the return of and on the costs of the network upgrades associated with the Bent Tree Wind Farm.⁹

⁴ Filing at 1.

⁵ *Id.* at 1-2.

⁶ *Id.* at 2.

⁷ *Id.* ITC Midwest explains that the GIA, which is dated May 11, 2015, conforms with MISO's *pro forma* GIA and therefore does not require Commission approval and has not been filed with the Commission.

⁸ *Id.* ITC Midwest notes that on June 18, 2015, in Docket No. EL15-68, the Commission commenced an FPA section 206 proceeding proposing to modify the manner in which interconnection customers pay for network upgrades pursuant to the MISO Tariff. *Id.* at 2 n.6 (citing *Midcontinent Indep. Sys. Operator, Inc.*, 151 FERC ¶ 61,220 (2015)). ITC Midwest states that the GIA between Wisconsin Power and ITC Midwest was effective prior to the effective date established in Docket No. EL15-68, and should not be impacted by that proceeding.

⁹ *Id.* at 2.

II. ITC Midwest's Filing

A. Description of the FSA

5. ITC Midwest states that the FSA contains a facilities charge that recovers the return of and on the capital costs of the network upgrades associated with the Bent Tree Wind Farm.¹⁰ ITC Midwest states that beginning with the month following the effective date of the FSA and continuing for a total of 300 months, Wisconsin Power is obligated to make a payment in the amount of the Monthly Revenue Requirement.¹¹ ITC Midwest states that initial payments are based on the Estimated Network Upgrade Initial Capital Cost.¹² The derivation of the Monthly Revenue Requirement is illustrated in the following table, as corrected by ITC Midwest's amended filing on November 3, 2015.¹³

Description	Amount
Estimated Network Upgrade Initial Capital Cost	\$ 38,826,851
Levelized Fixed Charge Rate	12.919519%
Annual Revenue Requirement	\$5,016,242
Monthly Revenue Requirement (Payment)	\$418,020

6. ITC Midwest states that the Monthly Revenue Requirement will be re-calculated annually by updating certain inputs to the formula rate, as reflected in Exhibit II of the FSA.¹⁴ ITC Midwest explains that the formula calculates a levelized fixed-charge rate based on the initial capital cost, the term of the FSA, the delay between the in-service date of September 1, 2015 and the effective date of the FSA, and certain data from the ITC Midwest Attachment O Formula Rate under the MISO Tariff including the following: (i) ITC Midwest combined tax rate, (ii) amounts of ITC Midwest interest on long term debt, (iii) long term debt and common equity balances, and (iv) Commission-approved return on equity for ITC Midwest.¹⁵ ITC Midwest states that beginning June 1

¹⁰ *Id.* at 3.

¹¹ *Id.*

¹² *Id.*

¹³ ITC Midwest November 3, 2015 Filing at 1. ITC Midwest explains that its November 3, 2015 Filing corrects two errors in Exhibit I of the FSA.

¹⁴ Filing at 3.

¹⁵ *Id.*

of the first calendar year following the in-service date, and each subsequent June 1 thereafter, the monthly payment will be updated based on the ITC Midwest Attachment O Formula Rate using data from the previous calendar year and the actual initial capital cost of the Network Upgrade.¹⁶ ITC Midwest states that all facilities charge revenues will be included as part of the revenue credits in the ITC Midwest Attachment O Formula Rate. ITC Midwest states that in addition, there is a one-time true-up adjustment to be calculated within one year of the in-service date after the actual capital costs for the network upgrades associated with the Bent Tree Wind Farm are known.¹⁷

7. ITC Midwest seeks waiver of the 60-day notice requirement set forth at 18 C.F.R. § 35.3 of the Commission's regulations and requests that the Commission accept the FSA for filing with an effective date of November 1, 2015.¹⁸ ITC Midwest asserts that good cause exists for waiver because the FSA is a bilateral agreement and the parties support the requested effective date.¹⁹

B. Dispute Regarding Calculation of Tax Benefit

8. ITC Midwest explains that the calculation of the facilities charge includes a computation of the present value of ITC Midwest's future stand-alone federal and state income tax depreciation deductions for the network upgrades associated with the Bent Tree Wind Farm. ITC Midwest states that it depreciates its assets for tax purposes in accordance with the general rules of Internal Revenue Code Section 168(a), commonly referred to as Modified Accelerated Cost Recovery System (MACRS) depreciation and, thus, used MACRS depreciation rates to calculate the income tax depreciation deductions. ITC Midwest states that Wisconsin Power has not disputed the inclusion of the MACRS depreciation rates in the facilities charge, but has disputed the amount of the

¹⁶ *Id.*

¹⁷ ITC Midwest explains that the true-up adjustment will be equal to the difference between payments collected to-date based on the estimated initial capital cost and what the payments would have been calculated as using the actual initial capital cost. *Id.* 3 n.8. ITC Midwest states that the true-up adjustment, as either a credit due or charges to the customer, shall be included in the next monthly bill, including interest determined in accordance with the Commission's regulations. *Id.*

¹⁸ *Id.* at 5-6.

¹⁹ *Id.* at 6 (citing *Central Hudson Gas & Electric Corp., et al.*, 60 FERC ¶ 61,106, *reh'g denied*, 61 FERC ¶ 61,089 (1992), and *Prior Notice and Filing Requirements Under Part II of the Federal Power Act*, 64 FERC ¶ 61,139, *clarified*, 65 FERC ¶ 61,081 (1993)).

income tax depreciation deductions. ITC Midwest states that specifically, Wisconsin Power has asserted that the income tax depreciation deductions should be calculated as if bonus depreciation were to be taken for eligible Network Upgrades pursuant to Internal Revenue Code section 168(k) and the associated bonus depreciation calculation were to be utilized.

9. ITC Midwest states that it disagrees with Wisconsin Power's assertion that bonus depreciation rates should be used to calculate the income tax depreciation deductions.²⁰ ITC Midwest explains that bonus depreciation expired at the end of 2014 and has not been extended,²¹ and thus, Wisconsin Power is requesting that the facilities charge be calculated on the basis of tax treatment for which the network upgrades associated with the Bent Tree Wind Farm do not currently qualify. ITC Midwest states that if bonus depreciation were to be extended for 2015, and if ITC Holdings were to take bonus depreciation for 2015, ITC Midwest would adjust the income tax depreciation deductions accordingly.

10. ITC Midwest asserts that Wisconsin Power, as the interconnection customer, is responsible for the costs of the network upgrades associated with the Bent Tree Wind Farm, and it, therefore, is only entitled to the actual tax benefit associated with the network upgrade facilities, based on the tax depreciation methodology actually being used by ITC Holdings.²² ITC Midwest asserts that the calculation of the facilities charge in the FSA reflects that methodology.

III. Deficiency Letter and Response

11. On December 29, 2015, the Commission issued a deficiency letter in this proceeding requiring ITC Midwest to submit populated MISO Attachment O formula rate and Levelized Fixed Charge Rate Calculation with Deferred Recovery templates. On January 12, 2016, MISO, on behalf of ITC Midwest, submitted a response to the deficiency letter, which included an amendment to Exhibit II of the FSA to provide populated templates.

²⁰ Filing at 5.

²¹ Subsequent to the October 30, 2015 filing of the FSA, on December 18, 2015, Congress extended bonus depreciation until 2019 under the Protecting Americans from Tax Hikes Act of 2015, Pub. Law. No. 114-113, Div. Q.

²² Filing at 5.

IV. Notice of Filings and Responsive Pleadings

12. Notice of the October 30, 2015 filing was published in the *Federal Register*, 80 Fed. Reg. 68,528-29 (2015), and notice of the November 3, 2015 filing was published in the *Federal Register*, 80 Fed. Reg. 69,212 (2015). Notice of the January 12, 2016 filing was published in the *Federal Register*, 81 Fed. Reg. 2855 (2016), with interventions and protests due on or before February 2, 2016.

13. The Iowa Utilities Board (Iowa Board) filed a notice of intervention and comments. Resale Power Group of Iowa, the Iowa Office of Consumer Advocate, and WPPI Energy filed timely motions to intervene. Wisconsin Power filed a timely motion to intervene and protest. The Iowa Consumers Coalition (Consumers Coalition), and Interstate Power and Light Company (Interstate Power) filed timely motions to intervene and comments.

14. On November 30, 2015, Wisconsin Power filed an amended protest. On December 9, 2015, ITC Midwest filed an answer to the protest and comments. On December 18, 2015, Wisconsin Power filed an answer to ITC Midwest's answer. On December 29, 2015, ITC Midwest filed an answer to Wisconsin Power's answer (ITC Midwest Second Answer).

A. Wisconsin Power Protest and Interstate Power Comments

15. Wisconsin Power and Interstate Power challenge ITC Midwest's decision to not take advantage (i.e., "opt out") of bonus depreciation via its corporate parent ITC Holdings.²³ Wisconsin Power and Interstate Power explain that, since 2008, utility taxpayers have been permitted to utilize bonus depreciation, which accelerates the depreciation of certain assets for tax purposes, thus reducing the federal income tax that would otherwise be payable in that year.²⁴ Wisconsin Power explains that for ratemaking purposes, depreciation expense is determined on a straight-line basis; the difference in timing between the accelerated depreciation of the asset for federal income tax purposes and depreciation of the asset for ratemaking purposes results in an increase in accumulated deferred income taxes (ADIT) on the books of the utility. Wisconsin Power states that for ratemaking purposes, ADIT reduces the rate base on which charges are

²³ Wisconsin Power and Interstate Power note that ITC Holdings files a consolidated federal income tax return on behalf of itself and its subsidiaries, including ITC Midwest. Wisconsin Power Protest at 7; Interstate Power Comments at 3.

²⁴ Wisconsin Power Protest at 3; Interstate Power Comments at 2-3.

determined.²⁵ Thus, Wisconsin Power explains, bonus depreciation generally results in reduced customer rates.²⁶

16. Specifically, Wisconsin Power claims that the use of bonus depreciation with respect to the network upgrades associated with the Bent Tree Wind Farm would provide a savings that may exceed \$11 million to Wisconsin Power and its customers over the 25-year life of the FSA.²⁷ Accordingly, Wisconsin Power requests that the Commission require ITC Midwest to insert the following language into the FSA:

The levelized Fixed Charge Rate and Payment shall also reflect the impacts of Bonus Tax Depreciation if the network upgrades are eligible for Bonus Depreciation.²⁸

Wisconsin Power contends that regulations adopted by the U.S. Treasury Department assume that utilities will use bonus depreciation for qualified properties to the extent they are eligible to do so.²⁹ Wisconsin Power and Interstate Power note that ITC Midwest, through its parent company, ITC Holdings, has opted out of taking bonus depreciation since 2010.³⁰ Although Wisconsin Power acknowledges that such regulations permit

²⁵ Wisconsin Power Protest at 3-4.

²⁶ *Id.* (citation omitted).

²⁷ Wisconsin Power Amended Protest at 8; Wisconsin Power Protest, Michek Aff. ¶ 13 and Att. A, Schedule 1, line 41.

²⁸ Wisconsin Power Protest at 5.

²⁹ *Id.* at 9.

³⁰ Wisconsin Power Protest at 7; Interstate Power Comments at 3. Interstate Power also explains that beginning in 2010, ITC Midwest's decision has had the effect of increasing the annual charges paid by Interstate Power for transmission service pursuant to Attachment O-ITC Midwest of the MISO Tariff. On December 18, 2015, in Docket No. ER15-1250-000, Interstate Power filed a formal challenge against ITC Midwest, raising similar arguments as it and Wisconsin Power raise in the instant proceeding. Interstate Power alleges in its formal challenge that ITC Midwest has unreasonably opted out of using bonus depreciation for calculation of its federal income tax expense, thereby understating the ADIT amounts and unduly increasing the transmission charges that Interstate Power must pay for transmission service. We address Interstate Power's formal challenge in *ITC Midwest LLC*, 154 FERC ¶ 61,188 (2016), issued contemporaneously with this order.

taxpayers to opt out of taking bonus depreciation, Wisconsin Power argues that this option is only beneficial to ratepayers when failure to do so might cause permanent loss of tax benefits to the taxpayer, such as a reduction of the permanent manufacturing production deduction or the expiration of a net operating loss.³¹ According to Wisconsin Power, ITC Midwest's FERC Form 1 shows that from 2010 through 2014, ITC Midwest did not have any such circumstances.³² Thus, Wisconsin Power states that it is unaware of any valid, customer-focused rationale for ITC Midwest not to consider the savings to be realized through use of bonus depreciation.³³

17. Wisconsin Power alleges that ITC Midwest's sole purpose in opting out of bonus depreciation is to increase revenue requirements to its customers by increasing rate base, thus generating more earnings for its corporate parent, ITC Holdings, and protecting the interest expense tax shield of ITC Holdings' significant debt leverage.³⁴ Therefore, Wisconsin Power asserts that ITC Midwest's failure and refusal to include language in the FSA reflecting the impacts of bonus depreciation is imprudent and renders the facilities charge under the FSA unjust and unreasonable.³⁵

18. Alternatively, Wisconsin Power requests that the Commission require ITC Midwest to modify the FSA by reducing the return on equity used to calculate the facilities charge to the lower end of the zone of reasonableness.³⁶ Wisconsin Power asserts that it is unjust and unreasonable for the Commission to permit ITC Midwest to use the rate of return generally used by MISO transmission owners when, unlike all other MISO transmission owners, ITC Midwest has opted out of using bonus depreciation, imposing imprudently incurred costs on Wisconsin Power.³⁷

19. The Iowa Board states that if the network upgrades associated with the Bent Tree Wind Farm qualify for bonus depreciation and if ITC Midwest does not utilize bonus depreciation, this may result in additional transmission service charges per year for each

³¹ Wisconsin Power Protest at 9-10; *id.* Janecek Aff. ¶¶ 9-10.

³² Wisconsin Power Protest at 10; *id.* Janecek Aff. ¶¶ 9-10.

³³ *Id.* at 5.

³⁴ *Id.* at 9-10.

³⁵ *Id.* at 5, 7, 10.

³⁶ *Id.* at 11-12.

³⁷ *Id.* at 12.

of the 25 years of the project's life under the FSA to Wisconsin Power and its customers.³⁸ The Iowa Board further states that ITC Midwest's choice to not utilize bonus depreciation will affect not only the Bent Tree Wind Farm network upgrades, but could affect all capital investments in the asset class, including investments elsewhere in the ITC Midwest transmission system, which could directly affect Interstate Power's costs of transmission service. The Iowa Board states that it supports the Commission's exploration of the bonus depreciation issue.³⁹

20. The Consumers Coalition asserts that the Commission should require ITC Midwest to articulate a sound rationale for not electing to take bonus depreciation and thereby ensure that rates to consumers are not higher than they need to be. The Consumers Coalition urges the Commission to ensure that ITC Midwest does not needlessly increase costs to ratepayers by unjustifiably not taking advantage of the bonus depreciation election.⁴⁰

B. ITC Midwest Answer

21. ITC Midwest states that taking bonus depreciation would increase ITC Midwest's ADIT and thus reduce its rate base and revenue requirement.⁴¹ However, ITC Midwest argues that Wisconsin Power's calculations are unrealistic because they incorrectly presume that bonus depreciation could be taken for just the network upgrades associated with the Bent Tree Wind Farm, and not for the other similarly classed facilities on the ITC Midwest system, whereas, in fact, bonus depreciation would have to be taken for all similarly classed facilities on the system. ITC Midwest also asserts that Wisconsin Power's calculations do not reflect the net operating losses that would result for the network upgrades associated with the Bent Tree Wind Farm if bonus depreciation were somehow taken for only those facilities.

22. ITC Midwest asserts that because electing bonus depreciation would reduce its revenue requirement and earnings, it would have a negative impact on ITC Midwest.⁴² ITC Midwest argues that there is no evidence to suggest that Congress intended for any taxpayer to be financially harmed by taking bonus depreciation. Further, ITC Midwest

³⁸ Iowa Board Comments at 3.

³⁹ *Id.* at 3-4.

⁴⁰ Consumers Coalition Comments at 3.

⁴¹ ITC Midwest Answer at 7-8.

⁴² *Id.*

argues that the right to opt out of bonus depreciation is unfettered and is not dependent upon any conditions, such as the permanent loss of tax benefits.⁴³ ITC Midwest asserts that Congress intended that the right to elect out of bonus depreciation be available to utilities, citing language included in the American Taxpayer Relief Act of 2012.⁴⁴

23. Further, ITC Midwest argues that bonus depreciation was not intended to provide a subsidy to utility ratepayers.⁴⁵ ITC Midwest asserts that Congress approved bonus depreciation, and all other forms of accelerated depreciation, for the purpose of stimulating new investment.⁴⁶ ITC Midwest argues that given the significant negative impact that the use of bonus depreciation would have on ITC Midwest and the fact that taking bonus depreciation would not stimulate new investment by ITC Midwest, the decision of ITC Holdings to exercise its right to elect out of bonus depreciation (and its intention to do so going forward if bonus depreciation is extended) was and is reasonable and fully consistent with the intent of Congress.⁴⁷

⁴³ *Id.* at 6-7.

⁴⁴ *Id.* at 7 (citing Pub. L. No. 112-240, § 331(d), which amended Internal Revenue Code § 168(i)(9)(A)(ii) by inserting the parenthetical “(respecting all elections made by the taxpayer under this section)”).

⁴⁵ *Id.* at 6.

⁴⁶ ITC Midwest included in its answer the direct testimony of Fred Stibor, who quoted a 2012 publication of the Congressional Joint Committee on Taxation (Joint Tax Committee):

A formulaic system of depreciation can serve to provide a tax incentive for capital investment to the extent the depreciation deductions are faster than the economic or financial statement depreciation of the property. For example, temporary rules providing for additional first-year depreciation (also known as bonus depreciation) were enacted several times in recent legislation with the purpose of providing economic stimulus during times of economic downturn.

Stibor Test. at 3 (quoting Background and Present Law Relating to Manufacturing Activities Within the United States, JCX-61-12, Prepared by the Staff of the Joint Committee on Taxation, July 17, 2012, p. 13-14 (footnote omitted)).

⁴⁷ ITC Midwest Answer at 8.

24. ITC Midwest contends that because ITC Holdings did not take bonus depreciation in 2014 and also will not take it in 2015, simulating the taking of bonus depreciation in the facilities charge to Wisconsin Power would constitute a normalization violation under applicable Internal Revenue Service (IRS) rules.⁴⁸ ITC Midwest asserts that such a violation could result in the loss of ITC Holdings' right to utilize any form of accelerated depreciation, which would result in increased rates for customers. ITC Midwest argues that for the same basic reasons, the alternative relief sought by Wisconsin Power to reduce ITC Midwest's return on equity would similarly result in a violation of the normalization rules.⁴⁹ Further, ITC Midwest argues that the return on equity to calculate the facilities charge is not properly subject to challenge in this proceeding, as this rate is simply the generally applicable, Commission-authorized return on equity used to calculate the transmission rates of MISO Transmission Owners.⁵⁰

25. ITC Midwest asserts that the scope of the instant proceeding is very narrow and cannot properly be expanded. ITC Midwest asserts that several of the intervenors have attempted to expand the scope of the proceeding to include the broader question of whether the use of bonus depreciation can or should be assumed by ITC Midwest in the calculation of its generally applicable rates. ITC Midwest argues that those efforts should be rejected.⁵¹

C. Wisconsin Power Answer to ITC Midwest Answer

26. Wisconsin Power reiterates that it is not contesting the right of ITC Midwest to opt out of bonus depreciation, but rather the prudence of the decision to do so.⁵² Wisconsin

⁴⁸ *Id.* at 9-10. Stibor explains that under the normalization rules, it is impermissible to flow the tax benefits of accelerated depreciation deductions through to ratepayers if the taxpayer has not yet realized such benefits. Stibor Test. at 6.

⁴⁹ ITC Midwest Answer at 10-11. Citing two private letter rulings, Stibor claims that simulating the taking of bonus depreciation by reducing ITC Midwest's rate of return under the FSA together with a corresponding reduction in ITC Midwest's revenue requirement would also constitute a normalization violation. *Id.*, Stibor Test. at 6-7 & n.11.

⁵⁰ ITC Midwest notes that the MISO Transmission Owners' base ROE is currently under review in two unconsolidated Commission proceedings in Docket Nos. EL14-12 and EL15-45. *Id.* at 4 n.7.

⁵¹ ITC Midwest Answer at 5.

⁵² Wisconsin Power Answer at 2-3.

Power asserts that ITC Midwest does not have the unfettered right under the FPA to recover imprudently incurred costs through a rate schedule on file at the Commission. Wisconsin Power argues that the mere fact that ITC Midwest has the statutory right to opt out of bonus depreciation does not establish that its decision to do so was prudent. Wisconsin Power asserts that ITC Midwest should not be permitted to recover costs of system upgrades from Wisconsin Power, including capital costs, that are the result of its decision to opt out of using bonus depreciation and therefore are imprudent.

27. Wisconsin Power argues that ITC Midwest has not provided any information to substantiate its claim that the use of bonus depreciation would have a negative impact on ITC Midwest.⁵³ Wisconsin Power points out that the ADIT that would result from the use of bonus depreciation would act as a source of cost-free capital to ITC Midwest. Therefore, Wisconsin Power asserts, the reduction in the revenue requirement resulting from use of bonus depreciation would simply reflect the fact that ITC Midwest's costs had been reduced, and ITC Midwest has not explained how this might legitimately be characterized as harmful to it. Wisconsin Power asserts that insofar as it is aware, there is no general Commission policy to permit utilities to recover imprudently incurred costs simply because it is lawful for the utility to incur those costs or that because removal of such costs from its cost of service would result in a reduction in a utility's revenue requirement.

28. Wisconsin Power asserts that ITC Midwest has the ability to avoid a violation of the IRS normalization rules by taking bonus depreciation.⁵⁴ Wisconsin Power explains that under normal circumstances, ITC Holdings would not be expected to file its 2015 federal income tax return until September 2016. Wisconsin Power explains that a violation of the IRS normalization rules will not occur unless and until rates have been established on the basis of presumed use of bonus depreciation for 2015 federal income tax purposes. Therefore, Wisconsin Power contends, the establishment of charges under the FSA at the present time based on the presumed use of bonus depreciation would not cause a violation of the normalization rules.⁵⁵

29. Wisconsin Power claims that the alternative relief it seeks, adjusting the return on equity, would not involve a reduction of tax expense in the cost-of-service of ITC Midwest or otherwise require adoption of any accounting treatment that directly or indirectly circumvents the normalization rules. Instead, Wisconsin Power explains, it is simply intended to provide an incentive for ITC Midwest to use bonus depreciation, and

⁵³ *Id.* at 7-8.

⁵⁴ *Id.* at 4-5.

⁵⁵ *Id.* at 4.

to provide a reduction in charges to Wisconsin Power if ITC Midwest and ITC Holdings persist in opting out of using bonus depreciation and thereby imposing excessive and imprudently incurred costs on Wisconsin Power.⁵⁶ Wisconsin Power notes that if and to the extent that the reduction of the return on equity of ITC Midwest is deemed to cause a potential violation of normalization rules, the Commission should impose a financial penalty on ITC Midwest (rather than an adjustment to rates) that is sufficiently large to provide it with an effective economic disincentive to opting out of using bonus depreciation.⁵⁷

D. ITC Midwest Second Answer

30. ITC Midwest disagrees with Wisconsin Power's stance that any costs resulting from ITC Midwest exercising its right to opt out of bonus depreciation should be deemed imprudent and should be disallowed from recovery in ITC Midwest's rates. ITC Midwest asserts that this position is the functional equivalent of extinguishing and negating the election right.⁵⁸ Additionally, ITC Midwest asserts that to its knowledge, the Commission has never found costs resulting from the exercise of a Congressionally-granted tax election right to be imprudent and has never barred their recovery. ITC Midwest claims that the Commission did the contrary in the *Koch Gateway Pipeline Company (Koch Gateway)* case.⁵⁹

31. ITC Midwest explains that in this case, Koch Gateway acquired United Gas Pipeline Company (United) and made a voluntary joint election under the Internal Revenue Code to treat the transaction as an asset sale. ITC Midwest notes that this election eliminated United's pre-existing \$60 million ADIT balance, thus increasing its rates. ITC Midwest states that Koch Gateway obtained a private letter ruling from the IRS confirming that, due to the election to treat the acquisition as an asset sale, elimination of the ADIT balance was required under the normalization rules. Shippers on the pipeline subsequently objected to the rate increase and argued that even though Koch Gateway was allowed to elect to treat the acquisition of United as an asset sale for tax purposes, the Commission was not required to recognize and authorize the resulting increase in Koch Gateway's rate base and rates. ITC Midwest states that the Commission

⁵⁶ *Id.* at 5-6.

⁵⁷ *Id.* at 7.

⁵⁸ ITC Midwest Second Answer at 2.

⁵⁹ *Id.* (citing *Koch Gateway*, 74 FERC ¶ 61,088; *reh'g denied*, 75 FERC ¶ 61,132 (1996); *reman'd on other issues sub nom. Exxon Corp. v. FERC*, 114 F.3d 1252 (D.C. Cir. 1997)).

rejected the shippers' arguments and approved the increase in rate base and rates and found that Koch Gateway was entitled to make the election it chose.⁶⁰ ITC Midwest states that the Commission further explained that treating the rate base differently would jeopardize Koch Gateway's right to accelerated depreciation in the future due to a potential normalization violation and it was reluctant to endanger favorable tax treatment.⁶¹ Therefore, ITC Midwest states, the Commission approved Koch Gateway's proposed treatment of the deferred taxes "without regard to the existence of benefits of Koch Gateway's customers."⁶²

32. ITC Midwest argues that in the instant case ITC Midwest is indisputably entitled to elect out of bonus depreciation, and that a change or adjustment to ITC Midwest's ADIT account, or an adjustment to ITC Midwest's rate base and rates, that is inconsistent or fails to recognize that election would violate the tax normalization rules and threaten ITC Midwest's ability to continue to take the considerable accelerated depreciation other than bonus depreciation that it already takes. Similarly, ITC Midwest asserts there are no grounds on which to second guess the decision to elect out of bonus depreciation, treat any portion of ITC Midwest's rate base as having been imprudently incurred, or make any other adjustment to ITC Midwest's rates in order to simulate the taking of bonus depreciation or mitigate the effects of bonus depreciation not being taken.⁶³

V. Discussion

A. Procedural Matters

33. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2015), the notice of intervention and 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, 18 C.F.R. § 385.213(a)(2) (2015), prohibits an answer to a protest or answer unless otherwise ordered by the decisional authority. We accept the answers filed by ITC Midwest and Wisconsin Power as they have provided information that assisted us in our decision-making process.

⁶⁰ *Id.* at 3 (citing *Koch Gateway*, 74 FERC ¶ 61,088 at 61,276).

⁶¹ *Id.* at 3-4 (citing *Koch Gateway*, 74 FERC ¶ 61,088 at 61,276-77).

⁶² *Id.* at 4 (citing *Koch Gateway*, 74 FERC ¶ 61,088 at 61,277).

⁶³ *Id.*

B. Substantive Matters

34. As discussed below, we accept the FSA, subject to condition, effective November 1, 2015, as requested.⁶⁴

35. The Commission has explained that in prudence challenges:

The utility does not have the burden of demonstrating that expenditures are prudent. Rather, a challenger to prudence must create a “serious doubt” as to the prudence of an expenditure; however, once that serious doubt is created, the burden shifts to the applicant to demonstrate that the expenditure in question was prudent.⁶⁵

36. We find that Wisconsin Power has provided evidence that creates a “serious doubt” as to the prudence of the additional costs incurred as a result of ITC Midwest’s decision, via its corporate parent ITC Holdings, to opt out of bonus depreciation on the facilities installed to support Wisconsin Power’s Bent Tree Wind Farm. Wisconsin Power has provided calculations illustrating that, under certain assumptions, the use of bonus depreciation would provide a savings that may exceed \$11 million to Wisconsin Power and its customers over the 25-year life of the FSA.⁶⁶ Moreover, ITC Midwest itself states that taking bonus depreciation would reduce its rate base and revenue requirement under the FSA.⁶⁷

37. We also find that ITC Midwest has not demonstrated that the decision to opt out of bonus depreciation was prudent. ITC Midwest suggests, *inter alia*, that because Congress has given it a legal right to opt of bonus depreciation, there are no grounds for

⁶⁴ The Commission can revise a proposal filed under section 205 of the FPA as long as the filing utility accepts the change. *See City of Winnfield v. FERC*, 744 F.2d 871, 875-77 (D.C. Cir. 1984). The filing utility is free to indicate that it is unwilling to accede to the Commission’s conditions by withdrawing its filing.

⁶⁵ *Entergy Services, Inc.*, Opinion No. 505, 130 FERC ¶ 61,023, at P 52 (2010), *order on reh’g*, Opinion No. 505-A, 139 FERC ¶ 61,103 (2012), *order on clarification*, 145 FERC ¶ 61,045 (2013), *review denied*, Nos. 12-1282, 13-1295 (D.C. Cir. March 13, 2015) (citation omitted).

⁶⁶ Wisconsin Power Amended Protest at 8; Wisconsin Power Protest, Michek Aff. ¶ 13 and Att. A, Schedule 1, line 41.

⁶⁷ *See* ITC Midwest Answer at 7-8.

the Commission to second guess its decision.⁶⁸ To the contrary, under appellate court and Commission precedent, the Commission is required to evaluate the prudence of a Commission-regulated entity's tax election to ensure that its rates are just and reasonable.

38. In *Midwestern*,⁶⁹ the United States Court of Appeals for the Seventh Circuit (Seventh Circuit) held that the Federal Power Commission (FPC), the Commission's predecessor agency, properly ordered natural gas companies Midwestern Gas Transmission (Midwestern) and East Tennessee Natural Gas Company (East Tennessee) to file reduced rates to reflect tax savings resulting from liberalized (or accelerated) depreciation even though the two companies had discontinued liberalized depreciation in favor of straight-line depreciation. The Seventh Circuit explained that the FPC must intervene if it determines that the elected tax policies made by management do not indicate a reasonable and prudent business expense:

Necessarily, the area of tax policies embraces managerial decisions directly reflected in the cost of natural gas supplies for the use of the ultimate customer. Here it seems to us quite reasonable and logical to recognize as inherent in the Commission the duty and requirement to exercise its expertise in evaluating the entire tax effect of managerial judgment. If such elected tax policies do not fairly indicate a reasonable and prudent business expense, which the consuming public may reasonably be required to bear, following the required hearing and review procedures, then federal regulatory intervention is required.⁷⁰

39. Here, similar to the pipelines in *Midwestern*, ITC Midwest claims that opting out of the bonus depreciation tax benefit was a Congressionally-granted right committed to the reasonable discretion of management.⁷¹ However, even if Congress intended it to have an unfettered right to opt out of bonus depreciation, this right does not negate the Commission's duty to ensure that rates and charges for Commission-jurisdictional services are just and reasonable. As *Midwestern* demonstrates, to perform this duty, the Commission must determine whether the decision to opt out of the bonus depreciation tax benefit was prudent.

⁶⁸ See, e.g., ITC Midwest Answer at 6; ITC Second Answer at 4.

⁶⁹ *Midwestern Gas Transmission Co. v. FPC*, 388 F.2d 444 (7th Cir. 1968), *cert. denied*, 392 U.S. 928 (1968) (*Midwestern*).

⁷⁰ *Midwestern*, 388 F.2d at 448.

⁷¹ ITC Midwest Answer at 6.

40. ITC Midwest's citation to *Koch Gateway* does not lead us to a contrary conclusion. Despite the ostensibly higher rates that occurred as a result of Koch Gateway's tax election for the purchase of United — which was agreed to by United — the tax election was made as part of a merger transaction and resulted in additional tax benefits (i.e., more deductions over the life of the assets) for Koch Gateway. In fact, Koch Gateway explained that the purchase would not have occurred but for the purchase method and resulting tax election. Accordingly, whether Koch Gateway and United's joint decision to take advantage of certain tax elections was a prudent business decision was not discussed in that proceeding. Koch Gateway made a beneficial tax election provided by legislation, and, as noted, a larger business transaction had required such an election. In contrast, here, similar to the circumstances in *Midwestern*, ITC Midwest has, by its own admission, opted out of a beneficial tax election that increases its income tax liability and thus, rates to consumers.⁷²

41. Further, ITC Midwest has not demonstrated that it would be financially harmed by taking bonus depreciation. In some instances, taking bonus depreciation could potentially cause a taxpayer financial harm because it could result in a permanent loss of other tax benefits. However, ITC Midwest does not make such a claim here. Wisconsin Power points out that, according to ITC Midwest's FERC Form 1, the use of bonus depreciation would not cause a permanent loss of other tax benefits to ITC Midwest, such as a reduction of the permanent Manufacturing Production Deduction or the expiration of a net operating loss.⁷³

42. ITC Midwest argues that taking bonus depreciation would cause it financial harm because it would result in a reduction in its rate base and revenue requirement, i.e., its earnings. We are not persuaded by this argument. If we were to accept ITC Midwest's rationale that a reduction in a regulated-entity's earnings equates to financial harm, then anything done to reduce a regulated-entity's company's rate base and thus to limit its revenue requirement could be subsumed by this definition. Further, we agree with Wisconsin Power that ITC Midwest has failed to demonstrate how such a reduction in its revenue requirement would be harmful to it. As Wisconsin Power has explained, the ADIT that would result from ITC Midwest's use of bonus depreciation would act as a source of cost-free capital to ITC Midwest; thus, the reduction in ITC Midwest's rate base and revenue requirement resulting from use of bonus depreciation would simply reflect the fact that ITC Midwest's costs had been reduced.

43. The record herein provides that by opting out of bonus depreciation ITC Midwest, through its corporate parent, has chosen to forgo cost-free capital solely to inflate its rate

⁷² See *Midwestern*, 388 F.2d at 448; ITC Midwest Answer at 7-8.

⁷³ See Wisconsin Power Protest at 9-10; *id.* Janecek Aff. ¶¶ 9-10.

base and revenue requirement. Under these circumstances, we find this decision to be imprudent. We also find that because imprudently incurred costs are embedded in the facilities charge under the FSA, the facilities charge is unjust and unreasonable.

44. Accordingly, as *Midwestern* dictates, Commission intervention is required. However, in fashioning a remedy in this proceeding, we are mindful not to cause ITC Midwest to run afoul of the IRS normalization rules. ITC Midwest notes that ITC Holdings did not take bonus depreciation in its consolidated tax return for 2014 and that ITC Holdings does not plan to take bonus depreciation for 2015.⁷⁴ Further, ITC Midwest explains that simulating the taking of bonus depreciation in the facilities charge, with a corresponding reduction in ITC Midwest's revenue requirement, as Wisconsin Power has requested, would constitute a normalization violation, resulting in the potential loss of accelerated tax depreciation methods currently used by ITC Midwest that would result in higher transmission rates for ITC Midwest's customers.⁷⁵

45. Therefore, although we have found that ITC Midwest's decision, via its corporate parent, to opt out of bonus depreciation was imprudent, we will not require that it reflect the impacts of bonus depreciation in the calculation of the facilities charge under the FSA for investments made in calendar year 2014.⁷⁶ Given this ruling, we will not require ITC Midwest to add into the FSA Wisconsin Power's proposed language, which would have provided that the impacts of bonus tax depreciation for all eligible network upgrades be reflected in the calculation of the facilities charge. Because ITC Holdings did not take bonus depreciation in its 2014 consolidated tax return, imputing bonus depreciation in the calculation of the facilities charge may pose the risk of a normalization violation.

46. However, we will require ITC Midwest to reflect the impacts of bonus depreciation in the calculation of the facilities charge for investments made in calendar year 2015. As Wisconsin Power explained, to the extent ITC Midwest believes that our requiring it to simulate the taking of bonus depreciation would create the possibility of a normalization violation, ITC Holdings (and therefore ITC Midwest) has the ability to avoid this violation by filing a tax return for 2015 without opting out of bonus depreciation.

⁷⁴ ITC Midwest Answer at 9.

⁷⁵ *Id.* at 9-10 (citing *Stibor Test.* at 6).

⁷⁶ As the United States Court of Appeals for the District of Columbia Circuit has recognized, the breadth of the Commission's discretion is at its zenith when fashioning remedies. *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967).

47. As noted above, ITC Midwest argues, *inter alia*, that requiring the use of bonus depreciation to be assumed in the calculation of the facilities charge would effectively negate the intent of Congress by extinguishing and negating the election right to opt out of bonus depreciation.⁷⁷ ITC Midwest also argues that such a remedy would also be attempting to force the use of bonus depreciation for the subsidization of utility rates, a purpose not intended by Congress.⁷⁸ However, these arguments are inconsistent with the holdings in *Midwestern*, which mandates that the Commission has “the duty and requirement to exercise its expertise in evaluating the entire tax effect of managerial judgment” and to intervene when the regulated-entity makes an imprudent tax election.⁷⁹

48. Accordingly, the Commission accepts the FSA, subject to condition, effective November 1, 2015, as requested. We direct ITC Midwest, and MISO as tariff administrator, to submit a compliance filing within 30 days of the date of this order, revising the FSA to reflect the impacts of taking bonus depreciation in the calculation of the facilities charge for investments made in 2015.

49. Given that we have required the simulation of bonus depreciation in the calculation of the facilities charge for investments made in 2015, we need not address Wisconsin Power’s alternative remedy of reducing ITC Midwest’s return on equity used to calculate the facilities charge to the lower end of the zone of reasonableness. Further, we agree with ITC Midwest that ITC Midwest’s return on equity is not properly within the scope of the instant proceeding. As ITC Midwest has explained, the return on equity used to calculate the facilities charge is taken directly from the ITC Midwest Attachment O Formula Rate, and is the Commission-authorized, generally applicable return on equity used to calculate the transmission rates of MISO Transmission Owners.

The Commission orders:

(A) The FSA is hereby accepted for filing, subject to condition, effective November 1, 2015, as discussed in the body of this order.

⁷⁷ *E.g.*, ITC Midwest Answer at 10; ITC Midwest Second Answer at 2.

⁷⁸ *E.g.*, ITC Midwest Answer at 10.

⁷⁹ *Midwestern*, 388 F.2d at 448.

(B) ITC Midwest, and MISO as Tariff administrator, are hereby directed to submit a compliance filing within 30 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.