

154 FERC ¶ 61,188  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

ITC Midwest LLC

Docket No. ER15-1250-000

ORDER ON FORMAL CHALLENGE

(Issued March 11, 2016)

1. On March 13, 2015, as amended on March 27, 2015, ITC Midwest LLC (ITC Midwest) filed its annual informational formula rate update, as required by the formula rate protocols set forth in Attachment O of Midcontinent Independent System Operator, Inc.'s (MISO) Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff). On December 18, 2015, Interstate Power and Light Company (Interstate Power) submitted a formal challenge pursuant to Rule 206 of the Commission's Rules of Practice and Procedure<sup>1</sup> and section IV.C of Attachment O-ITC Midwest to the MISO Tariff, challenging certain inputs of ITC Midwest's formula rates. Specifically, Interstate Power challenges the amounts of accumulated deferred income taxes (ADIT) in ITC Midwest's Accounts 281-283<sup>2</sup> that are used to calculate charges for transmission services over facilities of ITC Midwest. Interstate Power alleges that ITC Midwest unreasonably and imprudently 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, adversely affecting consumers served by Interstate Power. As discussed below, we grant in part and deny in part the formal challenge, and we require ITC Midwest to recalculate its Attachment O transmission revenue requirements, effective January 1, 2015, to simulate the taking of bonus depreciation for eligible facilities in calendar year 2015.

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<sup>1</sup> 18 C.F.R. § 385.206 (2015).

<sup>2</sup> See Uniform System of Accounts, 18 C.F.R. pt. 101.

## **I. The Formula Rate and Protocols**

2. Attachment O of the MISO Tariff sets forth the formula rate templates and protocols under which ITC Midwest and other MISO Transmission Owners recover their respective annual transmission revenue requirements and through which they establish charges for transmission service for facilities that they own that are under MISO's functional control.
3. ITC Midwest's protocols detail how ITC Midwest's formula rate is to be updated annually and how it can be challenged. Section II of the formula rate protocols requires ITC Midwest to update its transmission rates annually by June 1 and provide its annual formula rate true-up, actual net revenue requirement, and true-up adjustment to MISO and cause such information to be posted on the MISO website and open access same-time information system (OASIS). Section IV of the protocols states that interested parties shall have until the following January 31 to review the inputs, supporting explanations, allocations and calculations and to notify ITC Midwest of any specific informal challenges to the formula rate annual true-up. After submitting an informal challenge, section IV specifies that a party shall have until April 15 to submit a formal challenge with the Commission.
4. Informal and formal challenges are limited to seven avenues of inquiry listed in section IV.D of the protocols: (1) the extent or effect of an accounting change; (2) whether the annual true-up or projected net revenue requirement fails to include data properly recorded in accordance with these protocols; (3) the proper application of the formula rate and procedures in these protocols; (4) the accuracy of data and consistency with the formula rate of the calculations shown in the annual true-up and projected net revenue requirement; (5) the prudence of actual costs and expenditures; (6) the effect of any change to the underlying Uniform System of Accounts or FERC Form No. 1; or (7) any other information that may reasonably have substantive effect on the calculation of the charge pursuant to the formula.
5. In a 2013 order on investigation of MISO's formula rate protocols, the Commission required annual updates to be made through informational filings, which, once formally challenged, the Commission may rule on.<sup>3</sup> Further, the Commission stated that in the formal challenge procedure, the transmission owner would bear the burden of demonstrating the correctness of its update or true-up, and transmission owners are obliged to demonstrate the rate resulting from the application of the formula rate complies with the directives of section 205 of the Federal Power Act

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<sup>3</sup> *Midwest Indep. Transmission Sys. Operator, Inc.*, 143 FERC ¶ 61,149, at P 92 (2013).

(FPA); however, complaining parties will still bear the burden of proof in challenging both the reasonableness of the filed formula rate itself and the prudence of particular expenses that are input to the formula rate.<sup>4</sup>

## II. Background

6. Interstate Power states that it is a load-serving public utility that sells electric power and energy to approximately 490,000 retail customers in Iowa.<sup>5</sup> Interstate Power states that it is a transmission-dependent utility and acquires transmission service pursuant to the MISO Tariff.

7. Interstate Power states that ITC Midwest is a wholly owned subsidiary of ITC Holdings Corp. (ITC Holdings) that owns and operates transmission facilities in Iowa, Minnesota, Illinois, and Missouri.<sup>6</sup> Interstate Power states that charges for transmission service within the ITC Midwest zone of MISO are determined pursuant to a cost-of-service formula rate set forth in Attachment O-ITC Midwest of the MISO Tariff. Interstate Power states that ITC Midwest is a single-member limited liability company of ITC Holdings, which is taxed as a corporation for federal income tax purposes; ITC Midwest records federal and state income taxes and makes payments to ITC Holdings based on its stand-alone company tax position in accordance with an intercompany tax sharing agreement with ITC Holdings.

8. Interstate Power explains that in general, assets used in providing public utility service are depreciated for ratemaking purposes through use of straight-line depreciation over the estimated service lives of such facilities.<sup>7</sup> Interstate Power states that in contrast, the Internal Revenue Code allows taxpayers to accelerate the depreciation of certain assets for tax purposes using the Modified Accelerated Cost Recovery System (MACRS). Interstate Power explains that systems for accelerated depreciation share a common Congressional purpose – to subsidize the cost of investing in depreciable assets, and this purpose is accomplished by having the government extend interest-free “loans” to taxpayers who acquire these assets. Interstate Power states that the difference in the amount of tax determined due to accelerated depreciation of an asset for federal income tax purposes and straight-line depreciation of the asset for ratemaking purposes results in

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<sup>4</sup> *Id.* P 18.

<sup>5</sup> Interstate Power Formal Challenge at 2.

<sup>6</sup> *Id.* at 3.

<sup>7</sup> *Id.* at 4.

an increase in ADIT as recorded on the books of the utility, and therefore results in lower rate base and lower revenue requirement.

9. Interstate Power states that since the Economic Stimulus Act of 2008, and its subsequent extensions through multiple legislative actions, taxpayers have been permitted to take bonus depreciation, an add-on to accelerated depreciation that allows taxpayers to accelerate further the depreciation of certain assets for tax purposes by taking additional first year depreciation on qualified property.<sup>8</sup> Interstate Power states that because bonus depreciation would yield a greater depreciation deduction for certain qualified assets in the first year for tax purposes than under MACRS, bonus depreciation generally results in an even greater increase in ADIT, thus further lowering a utility's rate base and revenue requirement.<sup>9</sup>

### **III. Interstate Power's Formal Challenge**

10. Interstate Power alleges that ITC Midwest has unreasonably and imprudently opted out of using bonus depreciation in the calculation of its federal income tax expense, thereby understating its ADIT and unduly increasing the transmission charges that Interstate Power must pay for transmission service and adversely affecting consumers served by Interstate Power.<sup>10</sup>

11. Interstate Power requests that the Commission order ITC Midwest to take such actions as may be necessary or appropriate for ITC Midwest to reverse its decision to opt out of using bonus depreciation and to refund to its transmission service customers, including Interstate Power, the excess amounts collected by ITC Midwest for transmission service beginning in 2012<sup>11</sup> over amounts that would have been collected if ITC Midwest had not opted out of using bonus depreciation, with interest.<sup>12</sup> In addition,

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 1-2.

<sup>11</sup> Although ITC Holdings has affirmatively opted out of taking bonus depreciation since tax year 2010, Interstate Power states that it limits this request to beginning with tax year 2012 because the federal income tax returns for ITC Midwest and ITC Holdings for tax years 2010 and 2011 are now final. *See, e.g.,* Interstate Power Challenge at 6-7, 17.

<sup>12</sup> *Id.* at 9, 27.

ITC Midwest requests that, to the extent the Commission has the authority to do so, the Commission should do the following:

- (1) Require ITC Midwest to request a private letter ruling from the Internal Revenue Service (IRS) to revoke the decisions to opt out of bonus depreciation and to file amended federal income tax returns for the tax years 2012 through 2014 based on use of bonus depreciation;
- (2) Require ITC Midwest to adjust its Attachment O cost-of-service formula rate prospectively for billing purposes, beginning on January 1, 2016, to reflect the increase in ADIT that would result from a successful private letter ruling; and
- (3) Preclude ITC Midwest from opting out of use of bonus depreciation for future years in the absence of a filing with the Commission which establishes a clear justification and documentation of benefits to customers from its doing so, including *pro forma* rate calculations that quantify the benefits to customers of its doing so, as posted on its OASIS.<sup>13</sup>

12. Interstate Power explains that bonus depreciation allows taxpayers to depreciate 50 percent of the cost of eligible property. Interstate Power further explains that when a taxpayer claims bonus depreciation on its tax returns, its tax liability is reduced in the early years of an asset's life, leaving it with incremental cash – an interest-free governmental “loan.”<sup>14</sup> Interstate Power asserts that the later in the life of the asset, when the tax liability is higher than it would have been using straight-line depreciation, the “loan” is repaid through tax liability payments. Interstate Power explains that because the “loan” is extended and repaid through filing of federal income tax returns, there is no interest imposed on the taxpayer for the incremental cash available to the taxpayer early in the asset's life.<sup>15</sup> Interstate Power contends that the default practice in the electric industry is to take bonus depreciation, and this practice is consistent with Commission policies because it provides a cost-free source of financing that benefits customers.<sup>16</sup>

13. Interstate Power asserts that the almost universal practice in the electrical utility industry is for utilities to use bonus depreciation when it is available in order to reduce

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<sup>13</sup> *Id.* at 9, 28.

<sup>14</sup> *Id.* at 4.

<sup>15</sup> *Id.* at 5.

<sup>16</sup> *Id.* at 10.

charges to ratepayers unless, by doing so, the utility would realize a permanent loss of a tax benefit such as a reduction of the permanent Manufacturing Production Deduction or the expiration of a net operating loss.<sup>17</sup>

14. Interstate Power explains that ITC Holdings has affirmatively opted out of taking bonus depreciation for years 2010 through 2014 pursuant to section 168(k)(2)(D)(iii) of the Internal Revenue Code, which allows a corporate tax filer to opt out of bonus depreciation on an originally filed federal income tax return.<sup>18</sup> According to Interstate Power and its review of ITC Holdings' 2014 Form 10-K, there does not appear to be any tax-based reason for ITC Midwest's decision.<sup>19</sup> As such, Interstate Power muses that it would be hard to fathom why any rational enterprise would ever make the tax election that ITC Midwest made – unless the enterprise's rates are set on the basis of its costs, including a return on its invested capital. Interstate Power explains that for a regulated utility with captive customers, the interest-free nature of all accelerated depreciation (including bonus depreciation) “loans” is recognized and passed on to ratepayers by reducing the rate base by the utility's ADIT balance. Interstate Power states that ratepayers do not provide a return on rate base that is funded by these interest-free “loans,” and the utility retains none of the benefits of having procured an interest-free “loan.” Interstate Power asserts that as a result, the Congressional incentive for entities to invest in depreciable assets provided by access to bonus depreciation is not nearly as strong for a regulated utility, such as ITC Midwest, as it is for an entity providing service at competitively set rates.<sup>20</sup>

15. Interstate Power alleges ITC Midwest's position appears to be that because ITC Midwest has access to sources of capital other than interest-free governmental “loans,” and because it can recover the cost of that capital from its customers, bonus depreciation is of no benefit to it.<sup>21</sup> Interstate Power argues that it was imprudent for ITC Midwest to

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<sup>17</sup> *Id.* at 11-12 (citing *id.*, Exhibit 6, Janacek Aff. ¶ 13). Interstate Power witness Janacek states that at a recent Edison Electric Institute taxation committee, representatives of 40-50 utility companies were asked whether they elected out of bonus depreciation, and no one raised their hands. *Id.*, Ex. 6, Janacek Aff. ¶ 13.

<sup>18</sup> Interstate Power Formal Challenge at 6. In contrast, Interstate Power notes, ITC Midwest elected to use bonus depreciation in 2008 and 2009. *Id.*, Ex. 3 at 5.

<sup>19</sup> Interstate Power Formal Challenge at 13.

<sup>20</sup> *Id.* at 14.

<sup>21</sup> *Id.*

forgo this zero-cost capital and to use much more expensive sources of capital instead.<sup>22</sup> Additionally, Interstate Power asserts that ITC Midwest has not explained how it is affirmatively harmed by availing itself of the incremental interest-free “loans” the government offered it.<sup>23</sup> On the other hand, Interstate Power claims that ITC Midwest’s decision to opt out of bonus depreciation from 2010 to 2014 resulted in an increase in ITC Midwest’s revenue requirement for 2015 of approximately \$18 million, the largest share of which has been passed through to Interstate Power and its customers.<sup>24</sup>

16. Besides increasing the rate base and revenue requirement of ITC Midwest, Interstate Power contends that ITC Holdings’ decision, as the corporate tax filer, to opt out of bonus depreciation creates a tangible and significant benefit to the parent and related subsidiaries of ITC Holdings that is paid for by the additional tax payments made by ITC Midwest.<sup>25</sup> To the extent there is taxable income at its major regulated subsidiaries, ITC Holdings is able to offset taxable losses at the parent company and related subsidiaries such that they can immediately generate the cash tax benefits without deferring these benefits into future periods. Interstate Power notes that if ITC Midwest had not opted out of bonus depreciation from 2010 through 2014, ITC Midwest would not have had any federal income tax liability for any of those years, and it would have paid \$127 million less in Federal cash tax payments during that time.<sup>26</sup> According to Interstate Power, any decision by ITC Midwest to take certain actions which benefit its corporate parent at the expense of its ratepayers must be considered imprudent.<sup>27</sup>

17. Interstate Power explains that the Commission has allowed challenges to the inputs to or implementation of the formula rates based on errors, imprudence, or otherwise inappropriate costs until well after the challenge period.<sup>28</sup> Interstate Power asserts that the Commission has previously used its authority to order refunds of imprudently incurred costs through a formula rate in the *Yankee Atomic Electric*

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<sup>22</sup> *Id.* at 14-15.

<sup>23</sup> *Id.* at 15.

<sup>24</sup> *Id.* at 6-7; *see also id.* Ex. 5, Michek Aff. ¶ 10 and Att. A, line 12.

<sup>25</sup> Interstate Power Formal Challenge at 15.

<sup>26</sup> *Id.* at 6.

<sup>27</sup> *Id.* at 15.

<sup>28</sup> *Id.* at 17 (citing *Ameren Corp.*, 147 FERC ¶ 61,225, at P 27 (2014)).

*Company* case.<sup>29</sup> Interstate Power states that because its formal challenge relates to the prudence of ADIT amounts to be deducted from ITC Midwest's rate base in accordance with its cost-of-service formula rate, it is clearly within the scope of matters that may be challenged under section IV.D of Attachment O-ITC Midwest of the MISO Tariff. As such, Interstate Power asserts that the Commission should use its authority to order ITC Midwest to refund to its transmission customers all charges based on costs that were imprudently incurred due to its decision to opt out of using bonus depreciation.<sup>30</sup>

18. Interstate Power asserts that the formal challenge does not involve efforts at impermissible retroactive ratemaking because the decisions made by ITC Holdings' to opt out of bonus depreciation affect the transmission service charges being collected by ITC Midwest currently and prospectively.<sup>31</sup> Additionally, Interstate Power explains that it is not asking ITC Midwest to refund to its customers the rate reductions that would result from a fictional taking of bonus depreciation, rather Interstate Power explains that it is simply asking ITC Midwest to file a request to the IRS for a private letter ruling that will permit ITC Midwest to amend its prior federal income tax returns and reduce its actual federal income tax expense for such prior years based on use of bonus depreciation, and to use the reduced rate base in calculating transmission service charges for 2012 and subsequent years.<sup>32</sup> Interstate Power contends that with the IRS's authorization through a private letter ruling that allows ITC Midwest to amend its prior federal income tax returns, it would avoid an IRS normalization rule violation.

#### **IV. Notice of Filing and Responsive Pleadings**

19. Notice of Interstate Power's formal challenge was published in the *Federal Register*, 81 Fed. Reg. 3127 (2016), with interventions and protests due on or before February 3, 2016. The Iowa Utilities Board, the Minnesota Public Utilities Commission, Midcontinent MCN LLC, Resale Power Group of Iowa, Inc., DTE Electric Company, the Iowa Office of Consumer Advocate, Michigan Public Power Agency, and Missouri River Energy Services filed motions to intervene. WPPI Energy (WPPI), Jo-Carroll Energy, Inc. (Jo-Carroll), Iowa Consumers Coalition (Iowa Consumers), and Southern Minnesota Energy Cooperative (Southern Minnesota) filed motions to intervene and comments in

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<sup>29</sup> *Id.* at 18 (citing *Yankee Atomic Electric Co.*, 60 FERC ¶ 61,316, at 62,096-097 (1992)).

<sup>30</sup> Interstate Power Formal Challenge at 18.

<sup>31</sup> *Id.* at 19.

<sup>32</sup> *Id.* at 21.

support of the formal challenge. ITC Midwest filed an answer to the formal challenge (ITC Midwest February 3 Answer).

20. On February 12, 2016, Interstate Power filed an answer to ITC Midwest's answer. On February 19, 2016, ITC Midwest filed an answer to Interstate Power's answer (ITC Midwest February 19 Answer).

21. WPPI, Jo-Carroll, and Southern Minnesota state that ITC Midwest's enlargement of its nominal rate base by failing to avail itself of available tax related savings is not a just, reasonable, and prudent course of conduct that should be recognized in Commission-jurisdictional rates.<sup>33</sup> Further, Iowa Consumers 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.<sup>34</sup>

**A. ITC Midwest February 3 Answer**

22. ITC Midwest argues that Interstate Power's claims and requests for relief should be denied for both procedural and substantive reasons. Procedurally, ITC Midwest claims that Interstate Power's assertions are beyond the scope of a formal challenge under ITC Midwest's formula rate protocols.<sup>35</sup> ITC Midwest argues that the formal challenge does not raise issues related to the implementation of ITC Midwest's formula rate.

23. ITC Midwest asserts that the target of Interstate Power's formal challenge is not the ADIT balance itself or the validity of the calculations associated with the ADIT input, but rather, the underlying decision to opt out of bonus depreciation.<sup>36</sup> ITC Midwest argues that the decision to opt out of bonus depreciation, however, is neither a "cost" nor an "expenditure," and thus not within the scope of the limited prudence review permitted under the formal challenge process established in the protocols.<sup>37</sup> ITC Midwest asserts

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<sup>33</sup> WPPI Energy Comments at 3-4; Jo-Carroll Energy Comments at 3; Southern Minnesota Energy Cooperative Comments at 3.

<sup>34</sup> Iowa Consumers Coalition Comments at 3.

<sup>35</sup> ITC Midwest February 3 Answer at 7.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 2, 9.

that its protocols are designed to address the implementation of its formula rate for a given rate year, not substantive policy issues like the exercise of tax election rights under the Internal Revenue Code.<sup>38</sup>

24. Further, ITC Midwest argues that a formal challenge may not be used to seek relief for periods prior to 2014 or future rate years.<sup>39</sup> ITC Midwest argues that these aspects of Interstate Power's formal challenge are outside the scope of ITC Midwest's protocols because the protocols did not become effective until 2014 and formal challenges are limited under the protocols to the annual true-up and projected net revenue requirement for a single year. ITC Midwest asserts that Interstate Power's formal challenge should be limited to the true-up posted by ITC Midwest in May 2015 for rate year 2014 and the Projected Net Revenue Requirement posted in August 2015 for rate year 2016.

25. ITC Midwest notes that in interpreting the challenge procedures in section IV.A of the protocols, the Commission explained that, "challenge procedures are available to interested parties only for a given rate year."<sup>40</sup> ITC Midwest argues that Interstate Power has attempted to conflate a formal challenge with a FPA section 206 complaint.<sup>41</sup> ITC Midwest asserts that Interstate Power has premised its request for relief regarding ITC Midwest's 2012 and 2013 charges on precedents regarding the Commission's authority under section 206 of the FPA to order refunds of imprudently incurred costs. ITC Midwest argues that, because Interstate Power has not filed a complaint under section 206 of the FPA and has instead filed a formal challenge under the ITC Midwest Attachment O protocols, Interstate Power is limited to matters that properly are subject to challenge under the protocols.

26. ITC Midwest asserts that should the Commission choose to address the substance of Interstate Power's formal challenge, ITC Holdings' decision not to take bonus was consistent with Congressional intent.<sup>42</sup> ITC Midwest contends that bonus depreciation was not intended to provide a subsidy to utility ratepayers, but instead,

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<sup>38</sup> *Id.* at 2.

<sup>39</sup> *Id.* at 9.

<sup>40</sup> *Id.* at 10 (citing *Midcontinent Indep. Sys. Operator, Inc.* 150 FERC ¶ 61,025, at P 50 (2015)).

<sup>41</sup> *Id.* at 3, 11.

<sup>42</sup> ITC Midwest February 3 Answer at 2.

bonus depreciation, and all other forms of accelerated depreciation, was approved by Congress for the purpose of stimulating new investment. Additionally, ITC Midwest argues that Interstate Power provided no support for its implication that taxpayers can only opt out of taking bonus depreciation if the failure to do so would result in the loss of permanent tax benefits.<sup>43</sup> ITC Midwest contends that because the right to opt out of bonus depreciation is unconditional, the only conclusion that can reasonably be drawn is that Congress intended all taxpayers to have the unfettered right to opt out of bonus depreciation whenever they determined that, in their own specific circumstances, taking bonus depreciation would not be advantageous, citing language in the American Taxpayer Relief Act of 2012.<sup>44</sup>

27. ITC Midwest asserts that Interstate Power's estimate of the impact of not taking bonus depreciation on ITC Midwest's 2014 revenue requirement is overstated because it does not reflect the increased net operating losses that would have resulted for ITC Midwest if it had actually taken bonus depreciation for each of the years.<sup>45</sup> ITC Midwest contends that these net operating losses would have resulted in deferred tax assets that would partially offset ITC Midwest's ADIT liability balance and would thereby have reduced the impacts claimed by Interstate Power. However, ITC Midwest agrees that, if bonus depreciation had been taken from 2010-2014, ITC Midwest's 2014 ADIT balance would be somewhat higher than is shown in the 2014 true-up, and ITC Midwest's rate base, its rates and earnings would be reduced.<sup>46</sup> ITC Midwest argues that such a reduction in earnings would financially harm ITC Midwest. ITC Midwest asserts that there is no evidence to support, or even suggest, that Congress intended any taxpayer to be financially harmed by taking bonus depreciation.<sup>47</sup>

28. ITC Midwest asserts that the informal poll at the recent Edison Electric Institute tax committee, cited by Interstate Power, is of little or no value. ITC Midwest argues that it is the only independent, publicly traded transmission-only company, with rates, terms, and conditions of service of its transmission company operating subsidiaries solely

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<sup>43</sup> *Id.* at 13.

<sup>44</sup> *Id.* (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).").

<sup>45</sup> ITC Midwest February 3 Answer at 14 (citing Stibor Test. at 7).

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

regulated by this Commission, and it is, therefore, not similarly situated with conventional, predominantly state-regulated, vertically integrated investor-owned utilities. Additionally, ITC Midwest states that the identity of the companies polled, their rate structures, investment plans and other relevant circumstances are not known, and the specific effects that taking bonus depreciation has had on them and will have on them in the future are also not known.<sup>48</sup>

29. Further, ITC Midwest asserts that with respect to utilities, Congress has mandated the use of tax normalization procedures that are specifically designed to ensure that regulators cannot flow the tax benefits of accelerated depreciation deductions through to ratepayers if the taxpayer has not yet realized such benefits.<sup>49</sup> Thus, ITC Midwest asserts that Interstate Power's request that the Commission adjust and reduce ITC Midwest's transmission rates and revenue requirement for 2012 and subsequent years to reflect bonus depreciation for all eligible facilities would cause a violation of the IRS normalization rules.<sup>50</sup> ITC Midwest asserts that it would have to take bonus depreciation for tax purposes in order to avoid such a normalization violation, effectively negating its right to opt out of bonus depreciation.

30. 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*.<sup>51</sup>

31. ITC Midwest explains that Koch Gateway Pipeline Company (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. ITC

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<sup>48</sup> *Id.* at 16.

<sup>49</sup> *Id.* at 12 (citing *Stibor Test.* at 2-3).

<sup>50</sup> ITC Midwest February 3 Answer at 16 (citing *Stibor Test.* at 6; Internal Revenue Code Section 168(k)(2)(D)(iii)).

<sup>51</sup> *Id.* at 18 (citing *Koch Gateway Pipeline Company*, 74 FERC ¶ 61,088 (1996) (*Koch Gateway*); *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)).

Midwest explains that 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 asserts that the Commission 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.<sup>52</sup> 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.<sup>53</sup> Therefore, ITC Midwest contends, the Commission approved Koch Gateway's proposed treatment of the deferred taxes "without regard to the existence of benefits of Koch Gateway's customers."<sup>54</sup>

32. ITC Midwest argues that the facts in the instant case are closely analogous to those in *Koch Gateway*.<sup>55</sup> ITC Midwest asserts that its decision through its corporate parent to opt out of bonus depreciation was reasonable, and that a change or adjustment to ITC Midwest's ADIT accounts, 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.<sup>56</sup>

33. Similarly, ITC Midwest asserts that in *Enbridge Pipelines*, a case which, like *Koch Gateway*, involved the elimination of a pre-existing ADIT balance as a result of a pipeline acquisition, the Commission held and confirmed on rehearing that it was reluctant to take an action that would endanger a pipeline's right to favorable tax treatment through the use of normalization (i.e., deferring taxes) in the future.<sup>57</sup> ITC Midwest argues that in *Enbridge Pipelines*, "[T]he Commission [found], as it did in

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<sup>52</sup> *Id.* at 19 (citing *Koch Gateway*, 74 FERC ¶ 61,088 at 61,276).

<sup>53</sup> *Id.* at 3-4 (citing *Koch Gateway*, 74 FERC ¶ 61,088 at 61,276-277).

<sup>54</sup> *Id.* at 4 (citing *Koch Gateway*, 74 FERC ¶ 61,088 at 61,277).

<sup>55</sup> *Id.* at 19.

<sup>56</sup> *Id.* at 4.

<sup>57</sup> *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 (2002), *order on rehearing*, 102 FERC ¶ 61,310 (2003).

[*Koch Gateway*], that it will approve the reduction in ADIT *without regard to the existence of benefits to the pipeline's customers.*"<sup>58</sup>

34. ITC Midwest asserts that it and ITC Holdings were and continue to be entitled to opt out of bonus depreciation. Further, ITC Midwest claims that the election to opt out of bonus depreciation has caused ITC Midwest's ADIT balance to be somewhat lower, and its rate base and rates to be somewhat higher, than they would have been had the election not been made, but it does not permit ITC Midwest to earn a return on cost free capital and does not result in any sort of windfall.<sup>59</sup> Therefore, ITC Midwest asserts that there are no grounds on which to second guess the decision to opt 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.<sup>60</sup>

### **B. Interstate Power Answer**

35. Interstate Power argues the formal challenge is not procedurally deficient and that the Commission has the ability to modify charges affected by ITC Midwest's decision to opt out of bonus depreciation in 2010 and thereafter.<sup>61</sup> Interstate Power notes that the formal challenge was filed pursuant to both Rule 206 of the Commission's Rules of Practice and Procedure, and section IV.C of Attachment O-ITC Midwest to MISO's Tariff. Interstate Power contends that both avenues permit scrutiny of incurred costs in a formula rate that are imprudent.<sup>62</sup> Additionally, Interstate Power asserts that because decisions made by ITC Midwest prior to 2014 have a direct effect on charges for the 2014 year, they are necessarily within the scope of matters to be considered by the Commission in the formal challenge.<sup>63</sup> Further, Interstate Power asserts that it would be inefficient and contrary to the orderly administration of the FPA for the Commission to

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<sup>58</sup> ITC Midwest February 3 Answer at 20-21 (quoting *Enbridge Pipelines*, 100 FERC ¶ 61,260 at P 170 (internal citations omitted) (emphasis supplied by ITC Midwest)).

<sup>59</sup> *Id.* at 22.

<sup>60</sup> *Id.*

<sup>61</sup> Interstate Power Answer at 3.

<sup>62</sup> *Id.* at 3-4.

<sup>63</sup> *Id.* at 7.

consider allegations of imprudence with respect to the recovery of costs for the 2014 rate year and thereafter in this proceeding, but require Interstate Power to file a separate complaint to raise the very same allegations insofar as they affect charges for prior years.<sup>64</sup>

36. Interstate Power states that ITC Midwest claims that the formal challenge does not assert that ITC Midwest has incorrectly implemented its filed formula rate, but instead involves consideration of the underlying decision by ITC Midwest to opt out of bonus depreciation which, in ITC Midwest's view, goes beyond whether the rate formula, when implemented properly, correctly calculates the resulting rate.<sup>65</sup> Interstate Power argues that by imprudently opting out of bonus depreciation and thereby increasing the rate base used to calculate charges under its cost-of-service formula rate, ITC Midwest failed to implement its formula rate properly.<sup>66</sup> Further, Interstate Power claims that even if the costs used by ITC Midwest to calculate charges under its formula rate accurately reflect the costs on its books, the formula rate protocols clearly contemplate that a formal challenge may address the prudence of such costs and expenditures that the transmission owner is seeking to recover.<sup>67</sup>

37. Interstate Power alleges that ITC Midwest has not disputed evidence showing that its decision to opt out of bonus depreciation was imprudent. Specifically, Interstate Power states that it pointed out in the formal challenge that by opting out of bonus depreciation, ITC Midwest is forgoing zero-cost capital to help finance its investments in new transmission facilities, while simultaneously obtaining new capital from private investors at relatively significant rates. Interstate Power asserts that ITC Midwest failed to explain in its answer how its decision to forgo use of zero-cost capital might be considered prudent, and thus, ITC Midwest had not carried its burden under section 205 of the FPA to demonstrate the prudence of its decision.<sup>68</sup>

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<sup>64</sup> *Id.* at 8.

<sup>65</sup> *Id.* at 4-5.

<sup>66</sup> *Id.* at 5.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* at 10; *see also id.* at 8-9 (citing *Minnesota Power & Light Co.*, Opinion No. 86, 11 FERC ¶ 61,311 at 61,645 (1980) (“where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the [rate applicant] has the burden of dispelling these doubts and proving the questioned expenditures to have been prudent.”)).

38. Interstate Power states that although the Internal Revenue Code permits taxpayers to opt out of using bonus depreciation, it is not relevant to whether ITC Midwest's decision to do so was prudent.<sup>69</sup> Interstate Power asserts that the intent of Congress as set forth in sections 205 and 206 of the FPA is for all rates and charges for transmission service to be just and reasonable, and ITC Midwest may only recover costs that have been prudently incurred.<sup>70</sup> Thus, the issue addressed by the Commission is whether a reasonable utility management would have opted out of bonus depreciation under circumstances such as those facing ITC Midwest and at the relevant point in time.<sup>71</sup>

39. Interstate Power notes that ITC Midwest attempted to discount the value of Interstate Power's survey of participants in a recent meeting of the Edison Electric Institute taxation committee. Interstate Power states that it reviewed a large sample of the participating utilities' Forms 10-K, and at a minimum, can confirm that American Transmission Company, a stand-alone transmission company which is similarly situated to ITC Midwest, does not opt out of bonus depreciation. Similarly, Interstate Power notes that ITC Midwest has attempted to demonstrate that its circumstances are different from those of other investor-owned electric utilities on the basis that it is "the only independent, publicly traded transmission-only company, with rates, terms and conditions of service of its transmission company operating subsidiaries solely regulated by the Commission."<sup>72</sup> However, Interstate Power states that insofar as it is aware, the only relevant considerations are that (1) ITC Midwest is a transmission owner, which makes it eligible for bonus depreciation; (2) rates and charges for transmission service over the ITC Midwest transmission system are regulated by the Commission pursuant to sections 205 and 206 of the FPA; and (3) the common stock of ITC Midwest is owned by a corporate parent whose common stock is traded publicly.<sup>73</sup> According to Interstate Power, ITC Midwest is no different from any of the other investor-owned utilities engaged in providing Commission-jurisdictional transmission service whose decisions not to opt out of bonus depreciation were discussed in the Janecek Affidavit. Interstate Power asserts that for that reason, if the Commission permits ITC Midwest to enrich

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<sup>69</sup> *Id.* at 11.

<sup>70</sup> *Id.* (citing *New England Power Co.*, *Opinion No. 231*, 31 FERC ¶ 61,047, at 61,081-084 (1985)).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 13 (quoting ITC Midwest February 3 Answer at 15-16).

<sup>73</sup> *Id.*

itself by opting out of using bonus depreciation, it is likely that other investor-owned utilizers engaged in providing transmission service may seek to follow suit.<sup>74</sup>

40. In regard to *Koch Gateway* and *Enbridge Pipelines*, Interstate Power asserts that the circumstances were dissimilar to the instant case as the ratepayers in *Koch Gateway* received a benefit, whereas ITC Midwest's customers do not, and there was no suggestion in either of the cases that the decision of the pipelines to treat the transactions at issue as asset transfers were imprudent.<sup>75</sup> Further, Interstate Power contends that while the Commission discussed in both *Koch Gateway* and *Enbridge Pipelines* the potential for a violation of the normalization rules of the IRS, neither of those decisions indicated whether either pipeline had the ability to reverse the decision causing its ADIT to be extinguished, whereas ITC Midwest has the ability to seek permission to revoke its decisions to opt out of bonus depreciation beginning in 2012.<sup>76</sup>

### C. ITC Midwest February 19 Answer

41. ITC Midwest asserts that Interstate Power has not filed a complaint in this proceeding, but rather, filed a formal challenge under ITC Midwest's Attachment O formula rate protocols. ITC Midwest contends that Interstate Power's attempt to conflate the two processes is improper, because in a complaint proceeding, the burden of proof rests with the complainant whereas in this case, Interstate Power claims that the burden is on ITC Midwest. Thus, even if Interstate Power's arguments and its various requests for relief actually would be properly encompassed within a complaint filed pursuant to Rule 206, that circumstance would have no relevance here for the simple and dispositive reason that Interstate Power has not filed a complaint.<sup>77</sup>

42. Further, ITC Midwest claims it has shown that the decisions to opt out of taking bonus depreciation in 2010-2014 were both reasonable and consistent with Congressional intent.<sup>78</sup> In addition, ITC Midwest states that while Interstate Power has repeatedly claimed that taking bonus depreciation whenever it is available is almost universal

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<sup>74</sup> *Id.*

<sup>75</sup> *Id.* at 15-16.

<sup>76</sup> *Id.* at 16.

<sup>77</sup> ITC Midwest February 19 Answer at 1-2.

<sup>78</sup> *Id.* at 2. ITC Midwest witness Stibor states that ITC Holdings also does not anticipate taking bonus depreciation in 2015. Interstate Power Answer, Stibor Test. at 3.

practice in the electric utility industry unless it would cause such a permanent loss, there is no evidence that Congress intended a permanent tax loss to be a necessary prerequisite for opting out of bonus depreciation.<sup>79</sup>

43. ITC Midwest claims that Interstate Power's attempt to distinguish the *Koch Gateway* and *Enbridge Pipelines* decisions cited in ITC Midwest's answer missed the mark because it is irrelevant that the tax elections in those cases were agreed to by both the acquiring and the acquired entities, neither of which were ratepayers.<sup>80</sup> In addition, ITC Midwest states that the Commission confirmed in *Koch Gateway* and *Enbridge Pipelines* that ADIT reductions resulting from lawful tax elections must be reflected in utility rates without regard to the existence of benefits to customers.<sup>81</sup> According to ITC Midwest, whether or not *Koch Gateway* or *Enbridge Pipelines* could have reversed their tax elections is also irrelevant because the Commission did not claim any right to question those elections, and thus, it had no reason to consider whether the elections could be reversed, and it should not play a role in this case either.<sup>82</sup>

## V. Discussion

### A. Procedural Matters

44. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2015), the notices 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 Interstate Power as they have provided information that assisted us in our decision-making process.

### B. Substantive Matters

45. As discussed below, we grant in part and deny in part the formal challenge, and require ITC Midwest to recalculate its Attachment O transmission revenue requirements,

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<sup>79</sup> ITC Midwest February 19 Answer at 3.

<sup>80</sup> *Id.* at 3-4.

<sup>81</sup> *Id.* at 4.

<sup>82</sup> *Id.*

effective January 1, 2015, to simulate the taking of bonus depreciation for eligible facilities in calendar year 2015.

46. As a threshold matter, we reject ITC Midwest's procedural argument that Interstate Power's formal challenge does not raise issues related to the implementation of ITC Midwest's formula rate. The formal challenge contests inputs to the formula rate, specifically the ADIT values in Accounts 281-283.<sup>83</sup> Further, the formal challenge alleges that because ITC Midwest, through its corporate parent ITC Holdings, opted out of bonus depreciation and thereby inflated its rate base, imprudently incurred costs were passed through ITC Midwest's formula and charged to customers.<sup>84</sup> Thus, we disagree with ITC Midwest that the formal challenge does not raise "the prudence of actual costs and expenditures," and we find that the subject matter of Interstate Power's formal challenge properly falls within the scope of the ITC Midwest protocols.<sup>85</sup>

47. 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.<sup>86</sup>

48. We find that Interstate Power 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. Interstate Power provided calculations, illustrating that, under certain assumptions, the decision to opt out of bonus depreciation from 2010 to 2014 resulted in an increase in ITC Midwest's

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<sup>83</sup> *E.g.*, Interstate Power Formal Challenge at 1, 8.

<sup>84</sup> *E.g.*, *id.* at 6-7.

<sup>85</sup> Because, as discussed below, we are limiting relief to being effective beginning January 1, 2015, we need not address ITC Midwest's procedural argument that Interstate Power's formal challenge may not be used to seek relief for periods prior to 2014 or future rate years.

<sup>86</sup> *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).

revenue requirement for 2015 of approximately \$18 million.<sup>87</sup> Moreover, ITC Midwest itself acknowledges that taking bonus depreciation would have reduced its rate base and revenue requirement under the FSA.<sup>88</sup>

49. 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 a legal right to opt of bonus depreciation, there are no grounds for the Commission to second guess the decision.<sup>89</sup> 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. In *Midwestern*,<sup>90</sup> 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.<sup>91</sup>

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<sup>87</sup> Interstate Power Answer at 6-7; *see also id.* Ex. 5, Michek Aff. ¶ 10 and Att. A, line 12.

<sup>88</sup> *See* ITC Midwest February 3 Answer at 14.

<sup>89</sup> *See, e.g., id.* at 19.

<sup>90</sup> *Midwestern Gas Transmission Co. v. FPC*, 388 F.2d 444 (7th Cir. 1968), *cert. denied*, 392 U.S. 928 (1968) (*Midwestern*).

<sup>91</sup> *Midwestern*, 388 F.2d at 448.

50. Here, similar to *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.<sup>92</sup> 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.

51. ITC Midwest's citations to *Koch Gateway* and *Enbridge Pipelines* do 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.<sup>93</sup>

52. *Enbridge Pipelines* is likewise distinguishable from the instant proceeding. In the *Enbridge Pipelines* proceeding, Enbridge Pipelines (KPC) was acquired by two subsidiaries of Midcoast Energy Resources. Similar to *Koch Gateway*, the parties made a joint tax election at the time of the transaction to treat the acquisition as a sale of assets, rather than a sale of partnership interest. As in *Koch Gateway*, the tax election resulted in an immediate taxable gain to sellers, a reduction of ADIT, and thus an increase in the rate base; the Commission found in both cases that a taxable event had occurred, that income taxes were due and payable, and as a result, the ADIT balances prior to the sale were appropriately reduced.<sup>94</sup> Also as in *Koch Gateway*, the tax election the pipeline made was part of a larger transaction involving a merger, and the prudence of the tax election was not at issue. The parties' arguments and the Commission's findings were focused on the conflict between the accounting for ADIT, mechanics of the formula rate, and the IRS normalization requirements.

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<sup>92</sup> E.g., ITC Midwest February 3 Answer at 4.

<sup>93</sup> See *Midwestern*, 388 F.2d at 448; ITC Midwest February 3 Answer at 14.

<sup>94</sup> *Enbridge Pipelines*, 102 FERC ¶ 61,310 at P 43.

53. As discussed further below, we agree that imputing bonus depreciation on ITC Midwest's formula rates in prior periods in which bonus depreciation was not actually taken by ITC Midwest for tax purposes poses a risk that ITC Midwest may violate the IRS normalization requirements. However, as noted in *Enbridge Pipelines*, the Commission is not bound to follow an IRS ruling for ratemaking purposes.<sup>95</sup> Here, we are making a determination that ITC Midwest's decision, through its corporate parent, to make a tax election to forgo zero-cost capital to increase its rate base and revenue requirement has been shown to be imprudent and results in unjust and unreasonable transmission rates. Accordingly, we find that the contrast between the facts and circumstances in which the Commission made its determinations in *Koch Gateway* and *Enbridge Pipelines* and those in this proceeding calls for a different determination.

54. 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. Interstate Power points out that, according to ITC Midwest's FERC Form 1 and ITC Holdings' 2014 Form 10-K, 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.<sup>96</sup>

55. 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 rate base and thus to limit its revenue requirement could be subsumed by this definition. Further, we agree with Interstate Power that ITC Midwest has failed to demonstrate how such a reduction in its revenue requirement would be harmful to it. As Interstate 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.

56. 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

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<sup>95</sup> *Enbridge Pipelines*, 100 FERC ¶ 61,260 at P 152.

<sup>96</sup> *See* Interstate Power Formal Challenge at 13; *id.* Ex. 6, Janecek Aff. ¶ 14.

base and revenue requirements. Under these circumstances, we find this decision to be imprudent. We also find that because imprudently incurred costs have been passed through ITC Midwest's Attachment O transmission revenue requirement, this revenue requirement is unjust and unreasonable.

57. 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 witness Stibor notes that ITC Holdings did not take bonus depreciation in its consolidated tax return for 2010-2014 and that ITC Holdings does not plan to take bonus depreciation for 2015.<sup>97</sup> Further, ITC Midwest explains that adjusting ITC Midwest's rates and reducing its revenue requirement to simulate the taking of bonus depreciation, as Interstate 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.<sup>98</sup>

58. 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 for eligible facilities in the calculation of its Attachment O transmission revenue requirement for years prior to calendar year 2015.<sup>99</sup> Because ITC Holdings did not take bonus depreciation in its consolidated tax returns for 2010-2014, imputing bonus depreciation in the calculation of ITC Midwest's Attachment O transmission revenue requirement for those years may pose a risk of a normalization violation.

59. We acknowledge that Interstate Power has sought to ameliorate concerns regarding a potential normalization violation; Interstate Power requested in the formal challenge that we direct ITC Midwest to request, through its corporate parent, a private letter ruling from the IRS to revoke its decisions to opt out of using bonus depreciation for 2014 and all available prior years.<sup>100</sup> We decline to provide such a remedy, as we are mindful not to encroach on the province of the IRS. Further, imposing such a remedy

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<sup>97</sup> ITC Midwest February 3 Answer, Stibor Test. at 2-3.

<sup>98</sup> *E.g.*, ITC Midwest February 3 Answer at 4, 16.

<sup>99</sup> 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).

<sup>100</sup> *E.g.*, Interstate Power Formal Challenge at 9, 22.

would not entirely eliminate the risk of a normalization violation, given the possibility that the IRS could reject ITC Midwest's request to revoke its decision to opt out of bonus depreciation.

60. Accordingly, effective beginning on January 1, 2015, we will require ITC Midwest to recalculate its Attachment O transmission revenue requirements to simulate the taking of bonus depreciation for eligible facilities in calendar year 2015. This recalculation should be reflected in the 2015 Attachment O True Up Adjustment, to be posted on ITC Midwest's OASIS in 2016 and included in its 2017 annual informational Attachment O filing. To the extent that 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.

61. As noted above, ITC Midwest argues, *inter alia*, that requiring the use of bonus depreciation to be assumed in the calculation of the Attachment O transmission revenue requirement would contravene the intent of Congress by effectively negating the election right to opt of bonus depreciation.<sup>101</sup> 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.<sup>102</sup> However, these arguments are unpersuasive. ITC Midwest's decision to opt out of bonus depreciation to increase its customers' rate base is neither reasonable nor prudent. Even if Congress did not initially intend for bonus depreciation to be used to reduce or subsidize utility rates, this alone does not negate the Commission's duty in exercising its expertise when "evaluating the entire tax effect of managerial judgment" and to intervene when the regulated-entity makes an imprudent tax election.<sup>103</sup> Therefore, under Commission precedent, reducing or subsidizing utility rates may be a proper remedy when the increase in rates results from an imprudent decision.<sup>104</sup>

62. We decline however, as Interstate Power requests, to preclude ITC Midwest from opting out of use of bonus depreciation in future years in the absence of a filing with the Commission establishing a clear justification and documentation of the benefits to

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<sup>101</sup> *E.g.*, ITC Midwest February 3 Answer at 16-17.

<sup>102</sup> *E.g.*, *id.* at 17.

<sup>103</sup> *Midwestern*, 388 F.2d at 448.

<sup>104</sup> *See id.*

customers for doing so.<sup>105</sup> Such a filing requirement would be improper because it would prematurely presume the imprudence of ITC Midwest's actions and would place the initial burden on ITC Midwest to establish prudence, rather than on its customers to raise a "serious doubt" of prudence.<sup>106</sup> Although based on the record in this proceeding we have found ITC Midwest's decision, via its corporate parent, to opt out of bonus depreciation to have been imprudent, we cannot presume that such a decision would necessarily be imprudent in future years. For example, opting out of bonus depreciation in future years could potentially enable ITC Midwest to avoid suffering a permanent loss of a tax benefit. If, in the future, ITC Midwest indicates in its annual informational Attachment O filing or in its OASIS postings its intention to opt of bonus depreciation, and if its customers believe that such a decision may be imprudent, customers are free to raise this issue in subsequent informal and formal challenge proceedings.

The Commission orders:

Interstate Power's formal challenge is hereby granted in part and denied in part, as discussed in the body in this order.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.

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<sup>105</sup> See, e.g., Interstate Power Formal Challenge at 9.

<sup>106</sup> See, e.g., *Entergy Services, Inc.*, Opinion No. 505, 130 FERC ¶ 61,023 at P 52.